



Llywodraeth Cymru
Welsh Government

A Report by Internal Audit Services

**An Investigation into Allegations Received by the
Welsh Government
in Respect of Cylch**

July 2013

Background

1. In August 2012 a number of allegations relating to Cylch were received by the Welsh Government and considered by the Welsh Government's Whistleblowing Panel. The allegations primarily related to individuals associated with Cylch, companies related to Cylch and another organisation, Plastics Sorting Limited (PSL), which had recently gone into administration.
2. In September 2012, following consideration by the Welsh Government's Whistleblowing Panel, Welsh Government officials met with the Whistleblower and another individual who had made allegations in respect of Cylch. Based on the issues raised by the two individuals and the evidence provided it appeared that there were reasonable grounds to warrant a more detailed investigation of financial controls and governance issues within Cylch by the Welsh Government's Internal Audit Services (IAS).
3. This investigation was undertaken between October 2012 and January 2013. At the time of our review Mal Williams was the CEO and Mike Croxford the Chair of Cylch. It should be noted that Mal Williams was also a trustee of Cylch. We are aware that since our fieldwork finished there is now a new CEO, Richard Thomas, in place and the Chair will stand down at the next AGM. However within the report where the post of CEO is referred to it means Mal Williams and the Chair refers to Mike Croxford.
4. Within this report we refer to the CEO's other business interests. It should be noted that during this investigation we found no evidence of any pecuniary gain by the CEO through these interests.
5. Cylch is the Wales Community Recycling Network in Wales. It is the umbrella organisation for the community re-use, recycling and composting sectors in Wales. Cylch has a membership of approximately 80 groups across Wales and is involved with a wide range of stakeholders and initiatives in this capacity.
6. Cylch was established in 1997 and incorporated on 21st February 2000 and is a private company limited by guarantee. It registered as a charity on 23rd August 2001.
7. Cylch's Memorandum of Association states that the Trustees are responsible for managing the business of the Charity. It interprets "Trustees" to mean the Directors of the Charity. Cylch has a Board of Trustees, which includes Cylch's Chief Executive, (which is authorised by the charity's governing documents).
8. Since the completion of our audit fieldwork and issue of the draft report Cylch has filed its audited accounts for the year ending 31st March 2012. In their report the Auditors raise an "Emphasis of Matter" in respect of the going concern concept and Cylch's position on restricted funds. The Auditors report that due to the levels of loans and investments written off in the year (in excess of £2m) coupled with the use of restricted funds for unrestricted purposes it puts in doubt Cylch's ability to continue as a going concern. We will ensure that these issues are brought to the attention of Welsh Government policy officials in their consideration of any future funding to Cylch.

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9. Cylch supports the Welsh Government's sustainability agenda and acts as an advocate for "Towards Zero Waste" the overarching waste strategy for Wales.
10. Cylch has received core funds from the Welsh Government since 2001. The amounts received are shown below:

2001/02 (final quarter)	£37,467
2002/03	£108,000
2003/04	£108,000
2004/05	£183,000
2005/06	£280,000
2006/07	£280,000
2007/08	£287,000
2008/09	£471,000
2009/10	£480,000
2010/11	£490,000
2011/12	£450,000
2012/13	£300,000

11. Cylch has also received other Welsh Government funding to support a number of projects and initiatives. In 2003-04 Cylch supported an application to the Welsh European Funding Office (WEFO) for the funding to support the creation of the Strategic Recycling Scheme (SRS). The Welsh Government provided £6.8m of match funding to support this initiative, which was administered by the Wales Council for Voluntary Action (WCVA) and provided £15.2m of funding to support implementation of the Wales waste strategy.
12. During this time Cylch identified a shortage of experience and capacity in the community sector. To support the enhanced capacity within the community recycling sector, the Welsh Government provided funding to help the establishment of a national community sector contractor – Cleanstream Group Community Interest Company (CGCIC). The amount of funding provided to CGCIC was:

2007-08	£50,000
2008-09	£50,000
2009-10	£50,000

13. This funding helped Cylch establish CGCIC and through it Torfaen Cleanstream Recycling Ltd (TCRL), a community recycling enterprise providing recycling services to Torfaen CBC. The Welsh Government provided TCRL with additional support of £800,000 but despite this TCRL was replaced by an in-house local authority recycling service.
14. CGCIC spawned initiatives in carpet recycling through Cleanstream Developments and plastics recycling through Plastic Sorting Limited (in which CGCIC had a 30% stake and voting control). CGCIC received the following funding to help establish PSL's plastics recycling facility:

2007-08	£34,238
2008-09	£98,215

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15. Reflecting on these different uncoordinated funding initiatives it became clear that the Welsh Government needed to move away from the ad hoc grant funding of the community recycling sector via Cylch. Funding was provided for an analysis of how the community recycling sector might be more effectively funded. The table below shows the funding received by Cylch. As a result of this work a report entitled “Funding the Future” was produced by Cylch.

2007-08	£70,000
2008-09	£20,000
2009-10	£10,000

16. The recommendations made in the “Funding the Future” report revolved around the need to move to a more strategic and sustainable approach to funding. This was predicated on the principles that community and social enterprises should have independent finance and the finance should reflect the stages of development of different organisations. As such the Welsh Government made available to Cylch funding for the creation of an independent financial mechanism to support the development of the community/social enterprise recycling sector. This was in the form of an investment fund which included elements of both grant and loan funding. The fund was originally known as the Cylch Capacity Building Fund which then became Cylch Investment Programme (CIP). CIP funding provided to Cylch was as follows:

2008-09	£1,000,000
2009-10	£1,000,000
2010-11	£1,000,000
2011-12	£345,000

17. In 2009-10 an additional £1,000,000 was provided to Cylch’s CIP fund specifically for capital expenditure.
18. Cylch was required to tender for the administration of these funds, including the additional capital sum, and following an open and competitive tendering process, Charity Bank was appointed.
19. To support the expansion of the independent financial mechanism the Welsh Government provided the following funding to Cylch to support a funding officer within Charity Bank.

2010-11	£100,000
2011-12	£100,000
2012-13	£100,000

20. The funding provided to Charity Bank for the funding officer appears high and we have raised concerns on this and other value for money issues in the main body of the report

Wales Socials Enterprise Coalition (WSEC)

21. During July 2012, allegations were also received by the Welsh Government in respect of the Wales Social Enterprise Coalition (WSEC). Cylch’s CEO, Mal

Williams was also Chair of WSEC (at the time). The issues raised in relation to WSEC have been investigated and reported on separately and did not form part of the scope of this investigation.

Charity Commission

22. In August 2012 the Charity Commission wrote to Cylch detailing concerns that had been raised which were linked to the 2010/11 financial accounts of Cylch. [REDACTED]
[REDACTED]. IAS has liaised with the Charity Commission over this matter and has kept them updated on the investigation work that we have performed. The Charity Commission will be provided with a copy of this report.
23. During the course of our investigation we have not specifically examined whether Cylch are operating in accordance with its charitable objects, however we are concerned that the way Cylch transacted with the CEO's other business interests may be contrary to the organisation's charitable objects, particularly as Cylch were liable for the financial risks associated with these transactions. This risk did crystallise, resulting in a financial liability to Cylch. This is further explored in paragraph 39.

Previous Internal Audit Work

24. In December 2011 IAS issued an audit report on the management of Cylch's core funding by the Welsh Government. At the time IAS were only able to provide limited assurance on the controls in place. We have not re-examined any of the controls within the Welsh Government in respect of the funding arrangements with Cylch as part of this investigation, although we have received assurance from management that all of the recommendations made in the 2011 audit report have been fully implemented. As part of this investigation we have interviewed several Welsh Government officials who are involved in the funding of Cylch and the results of these interviews are incorporated into our findings in this report.

Overall Conclusion

25. This investigation has identified significant and fundamental weaknesses in the control and governance framework within Cylch. The Board within Cylch has not provided the necessary strategic direction and leadership for the organisation and they have allowed the Chief Executive Officer (CEO) to operate autonomously. The CEO has made decisions and undertaken business activities which have not always had the desired business outcome. If these decisions had been properly considered and ratified by an effective Board there may have been a different and more favourable result.
26. We are aware that Cylch is currently undergoing considerable changes to its structure and operations. The organisation has previously identified deficiencies in the existing arrangements and is in the process of introducing improvements this area. The proposed changes should go some way to addressing the issues identified during our review and provide a more robust control framework within which to operate.

27. It should be noted that whilst we have identified some serious failings in the current control framework and governance processes within Cylch there is no evidence to suggest there has been any improper use of funds, instead the key weaknesses have related to:

- Poor record keeping and a lack of audit trails, particularly in respect of the administration of the CIP fund;
- The lack of transparency in the relationship between Cylch and the companies that the CEO had a business interest in;
- The lack of clarity over recharging arrangements between Cylch and the CEO's other companies;
- The lack of financial expertise within Cylch, particularly at Board level;
- The membership of the Board, including the close relationship between the Chair and Cylch's CEO; and
- The poor value for money in some business decisions.

Recommendations

28. We are aware that the Welsh Government is currently considering an application for Cylch's future core funding. Whilst it is not within the scope of the review to determine whether the Welsh Government should fund Cylch or not, if the Welsh Government are to continue funding Cylch significant improvements need to be made to Cylch's control framework and governance processes. Outlined in Annex A are recommendations which Cylch should ensure that they take forward and implement with immediate effect to enhance and improve the existing control and governance framework. We have also made two recommendations which need to be taken forward and implemented by the Welsh Government.

29. If further Welsh Government funding is provided to Cylch, IAS will revisit Cylch at a later date to ensure that all of the recommendations outlined in Annex A have been appropriately implemented.

Detailed Findings

Cylch Investment Programme (CIP)

30. In 2008/09 Cylch were given funding for the CIP fund from the Welsh Government. This fund was £3m over three years and was to be administered by Charity Bank. There was a contract between Cylch and Charity Bank that lays out the relationship and reporting requirements between the Charity Bank and Cylch and the grant memorandum lays out the minimum reporting requirements between Cylch and the Welsh Government. We are aware that representatives of the Charity Bank attend some Board meetings to provide reports and update Cylch, however there was a significant lack of documentation evidencing the relationship between the Charity Bank and Cylch. For example, as part of the due diligence process the CEO of Cylch had final approval of the loans that were to be awarded. However our investigation showed that there was no documentation or records to evidence the decisions made by the CEO, as this process was conducted via email. We are aware that much of the relationship between the Charity Bank and Cylch was between the CEO and the CEO of Charity Bank and appears to have been conducted via email; however there are no records of any discussions or decisions. Further there is no record of any of the meetings that were held between the CEO of Cylch and Charity Bank.
31. At the start of the contract Charity Bank were not due to receive any fees to cover the administration of the fund, instead any interest generated by the loans would be kept by Charity Bank. However due to the banking crisis and the economic downturn, it was subsequently agreed by Cylch that Charity Bank would receive £50k per year to administer and manage the CIP fund. Charity Bank were also provided with a further £100,000 per year, over three years to support a funding officer who was responsible for identifying other funding sources to add to the CIP fund. Charity Bank appears to have received a significant amount of funding from the Welsh Government in respect of the CIP; before any interest they received. This is not in line with best practice, appears excessive and potentially does not represent good value for money.
32. In May 2011 the Charity Bank contract ended; however Cylch had not put any processes in place to manage the end of this contract. At the time of writing this report, Cylch had only just received the final settlement statement from the Charity Bank outlining the position regarding the outstanding loans. It is understood that the four remaining loans outstanding will continue to be administered by Charity Bank but it is of concern to note that there is no formal agreement to manage this ongoing relationship.
33. We are also aware that during the life of the contract with Charity Bank there was some difficulties in obtaining financial information from Charity Bank, particularly at the year end when the information was required for the production of the statutory accounts. These issues should have been highlighted to the Board and taken up formally with Charity Bank, although we have no evidence that this ever took place, instead the on going relationship with Charity Bank was a largely informal one between the CEO of Cylch and the CEO of Charity Bank.

Governance

34. Cylch's Memorandum and Articles of Association restrict the selection of Trustees to Cylch's members. Cylch have recognised that this does not promote or support good governance arrangements and will be recommending changes to the constitution to enable independent Trustees to be appointed for their skills and giving a new role to Trustees from the membership in an Advisory Body.
35. Further a review of the membership of Cylch's Board revealed that none of the Members have adequate financial skills. It is vital that the Board of Cylch have the appropriate skills to enable them to provide sufficient leadership, direction and challenge, particularly in respect of financial matters.
36. At the time of our investigation we examined the performance management arrangements for the CEO. We were informed that the CEO was not subject to any form of formal performance monitoring. Good practice would suggest that the performance of any CEO is subject to formal review by the Chair of the Board to ensure that the organisation is provided with appropriate leadership and management.
37. We are aware that there is a close relationship between the Chair and the CEO; they have known each other for many years and as such the communication between them is often informal for example, they do not set up formal meetings to regularly discuss Cylch issues. This does not represent good practice and further, it exposes both individuals to the risk of criticism of cronyism.

Recharging Arrangements

38. The CEO of Cylch has a number of business interests, including currently being a Company Director of 18 other companies all involved in the recycling and re-use sector. During our investigation it became apparent that there was recharging taking place between Cylch and some of these organisations, in particular Cylch Quality Learning (CQL).
39. In September 2010 CQL was constituted as a company limited by guarantee to operate as a self-financing social enterprise. Cylch's CEO was the Chairman of CQL. Our testing showed that Cylch paid for services, such as rent and utilities, on behalf of CQL, and that these costs were then invoiced to CQL. As part of the investigation we were informed that the reason behind this was that Cylch already had an established credit history, including bank account, whereas these new companies and organisations did not. Therefore Cylch contracted with the supplier to overcome this lack of contracting/credit history issue.
40. Further Cylch took up a contract with the Wales Council for Voluntary Action (WCVA) as CQL was not legally constituted at the time. The contract was to deliver training as part of the Intermediate Labour Market (ILM) scheme. CQL were the sub-contractor, providing qualification and training services. The ILM scheme required match funding which was intended to come from the profit generated by the scheme which was to be gifted back to Cylch by CQL, Cylch would then provide the match funding with this profit element. CQL invoiced Cylch monthly for the training costs and Cylch then drew this down from the WCVA. However due to the lack of clarity over the recharging

arrangements between Cylch and CQL our investigation showed that there was confusion over the amount of money owed between the two organisations. This ultimately led to CQL going into administration in October 2012.

41. It is of concern that these recharging arrangements took place for a number of reasons, firstly there are administrative costs associated with the recharging, all of which were incurred by Cylch. Secondly, where Cylch contracted with other organisations on behalf of the CEO's other business interests, Cylch carried the contracting risk and in the case of CQL, the risk crystallised resulting in a financial liability to Cylch, which they recovered from CQL. This ultimately led to CQL going into administration.
42. Our testing also showed that many of these companies incurred late filing notices from Companies House or were dormant companies that were required to file annual returns with Companies House. Our findings showed that all of these costs were paid by Cylch, even though there was no justification for Cylch paying these costs as they related to an entirely separate legal entity. The late filing of returns also indicates that there were governance issues in these other organisations.
43. Even though there is no evidence to suggest that Cylch's CEO has personally gained through the recharging arrangements, the transacting between organisations where individuals have shared business interests exposes the individuals and organisations to the risk of criticism and reputational damage.

Plastic Sorting Limited (PSL)

44. PSL was set up to produce high quality clean plastic flake for sale to customers, who then made final products from it. PSL was set up by a group of individuals that had operated in this sector and saw a business opportunity. The CEO of Cylch was also the Chairman of PSL to represent the 60% social enterprise stake in the company.
45. We understand that due to technical difficulties with the machinery and adverse market conditions in respect of plastic flake, PSL got into financial difficulties. Further there was a "falling out" of the original founders of the company, resulting in one of them being "bought out."
46. The funding received by PSL from the Welsh Government (via Cylch) was:

CIP Fund	£1,041,157
Capital Fund	£1,000,000
Plastic Loan Fund	£1,000,000

47. Notwithstanding the failings of how the CIP fund was administered within Cylch, our investigation showed that there is a complete lack of evidence to demonstrate that the other funding provided to PSL was considered by the Cylch's Board and approved. We understand that the CEO made the decision in consultation with Cylch's Chair, but there was no evidence to support this process of approval.
48. We have identified failings in the way in which the Capital Fund and the Plastic Loan Fund were awarded to PSL. Cylch were required by the Welsh Government to tender for the administration of these funds. Charity Bank ran a competitive tendering exercise to award these funds but none of the

applications including the submission by PSL, were considered good enough to be awarded the funding. However our investigation showed that this funding was subsequently awarded to PSL, irrespective of their poor tender submission.

49. It was also of concern that the amount PSL were loaned through the CIP fund was significantly higher than any other loan granted via the CIP. Whilst we acknowledge that the loan was subject to Charity Bank's due diligence processes, there was no evidence that this was considered by Cylch's Board nor the risks of providing further funding to PSL. We would have also expected Cylch's Board to query with Charity Bank why PSL were permitted to take on such a huge amount of debt. This is a further indication of the lack of financial skills and expertise within Cylch's Board Members.
50. PSL went into administration in January 2012 and at the time of writing this report it was uncertain the amount of funding that Cylch would recover although Cylch's accountants have advised us that it is likely to be approximately £250,000 (as at 9th May 2013). We are also aware that during 2012 the company which took over PSL, Viridis, has received a further £470,000 funding from the Welsh Government.

Financial Controls

51. Our investigation demonstrated that there was an appropriate level of segregation of duties between the finance officer and the CEO who authorised financial transactions. Our testing did however show that whilst the Board have oversight of financial information, none of the Board members are cheque signatories. Good practice would suggest that at least one member of the Board is also a cheque signatory for high value items. This principle is also applicable for payments made via electronic transfer.
52. Cylch currently use a firm of accountants, Agincourt Accountants, to provide them with expert financial and accounting advice and assistance. As part of our investigation we met with the Agincourt on several occasions. There is a member of staff within Cylch who has responsibility for the day-to-day undertaking of financial transactions and entering them onto the SAGE accounting system but this is done under the advice of the accountants. The current accountants were appointed in 2011; previously another accountancy firm were used.
53. When the current accountants were appointed it became apparent that in the prior year (2009/10) the CIP funds had not been accounted for on an appropriate basis. This resulted in a significant amount of prior year adjustments for 2010/11. Further, upon our review of the 2010/11 accounts, there appeared to be some unusual items in the accounts. Most notably the notes to the accounts contain the narrative that implies that transactions have occurred to "avoid State aid issues" we were informed that this was an error that should have been identified at the proof reading stage. Further the CEO wrote the notes to the accounts, despite having little or no formal accounting knowledge.
54. This lack of financial skills within Cylch has resulted in professional fees being incurred. In the future Cylch should seek to reduce these costs through ensuring that staff and Trustees are fully equipped with the skills necessary to effectively discharge their duties. We understand that in the future Cylch will

be changing its business focus which should make the production of Cylch accounts more straightforward.

55. Our testing of expenditure also showed that a considerable amount was incurred on car hire. Of particular significance was the amount incurred by the Managing Director of CQL, which was paid for by Cylch and then recharged to CQL, although there is no clear audit trail evidencing this recharging arrangement. We were informed that this expenditure was due to employees living in North Wales and travelling to South Wales on a regular basis. Our testing showed that some periods of car hire for one individual were concurrent over many months, resulting in considerable expenditure. We do not consider that this represents value for money.

Next Steps

56. Once officials have considered the content of this report it should be shared with Cylch to ensure that they are fully aware of the recommendations made and that they agree to implement them with immediate effect.

RECOMMENDATIONS

For the Welsh Government

Ref	Recommendation	Management Response
1	The Welsh Government should ensure that appropriate monitoring is put in place between themselves and grant recipients to ensure that they gain assurance that grant funding is being appropriately utilised and the expenditure represents value for money	Accepted <u>Current monitoring:</u> We have worked closely with Cylch to develop key performance indicators in relation to providing services to its members which represent value for money. Through monitoring of the existing grant a clear breakdown of monthly expenditure has been requested. Quarterly funding has not been signed off until satisfactory quarterly reporting has been received. Save for a few minor queries, for example presentation and format of information, there has been no reason to hold back quarterly core funding. <u>Future monitoring:</u> We will work closely with the Grants Centre of Excellence (GCoE) to issue the Funding Award Letter. The Award Letter will make the following conditions of Grant; A clear division on what grant can and cannot be spent on. Monthly Monitoring meetings where Cylch will present evidence on progress towards the Targets. We will ensure that all expenditure represents good value for money. Recommendations to Cylch (if accepted by Cylch) will be included as targets under Schedule 2 of the Award Letter.

		Internal Audit Services will visit Cylch at the end of the three month funding period to check on progress against its recommendations. Target Implementation Date: April 2013 Responsible Officer: Jasper Roberts
2.	Funds have been returned to Cylch from the Charity Bank, representing the balance of loans repaid. The Welsh Government should seek clarification on the purpose that these funds are now going to be used for.	Accepted The funds returned to Cylch from the Charity Bank will fund FareShare Cymru to develop the FareShare network, and, to support 3Gs Zero Waste Project with revenue funding to deliver on the outcomes for the Zero Waste Project. Details of actual and forecast expenditure must be provided as a condition of Grant under Schedule 1 of the Funding Award Letter. Target Implementation Date: April 2013 Responsible Officer: Jasper Roberts

For Cylch

Ref	Recommendation	Management Response
1.	The composition of the Board should accord with best practice guidance and include representatives that are independent of Cylch, to ensure that there is adequate challenge and scrutiny.	Accepted This has been acknowledged and accepted by Cylch in the drafting of the new business plan. Within the proposed governance

		changes, the plan introduces an Advisory Panel to be made up of people mostly independent of Cylch full membership but with a range of sector interests including environment and business development. The current Acting CEO has been successful in securing the agreement of representatives from other associated organisations as a start for this Advisory Panel. The purpose of the Advisory Panel is to provide an independent contribution to the Cylch Board. It also provides a platform to invite people from the Advisory Panel to then formally join the Cylch Board. The existing trustees that will remain on the Board mostly represent independent interests (i.e. not Cylch members). Some representation of the Cylch membership should be retained on the Board however. These changes will be proposed at the next AGM so that the Cylch Mems and Arts can be adjusted accordingly. Target Implementation Date: Within one year for full implementation (subject to recommendations being accepted by the Cylch membership) Responsible Officer: Trustees/CEO
2.	The Board should ensure that its members are equipped with the relevant skills and expertise in order to effectively discharge their duties as Trustees. In particular the Board should ensure	Accepted The Board have drafted a 'skills matrix' and propose

	that there are appropriate financial skills amongst Trustees.	to recruit board members based on a range of knowledge and skills, including financial skills, to ensure effective oversight and scrutiny. This will now be used as part of future recruitment to the board, if the changes are approved. Target Implementation Date: ASAP but within the next year if changes approved. Responsible Officer: CEO
3.	There should be clear separation between the Board of Trustees and the management of Cylch.	Accepted Already actioned – the current Acting CEO is not a trustee and when formally recruited the ongoing CEO post will remain a non-trustee position. Target Implementation Date: January 2013 Responsible Officer: Acting CEO
4.	There should be a clear audit trail in place documenting and recording key decisions that are made by management and the Board. Cylch should ensure that their record keeping is significantly improved to ensure that they are able to demonstrate the rationale and justification behind decisions that are made.	Accepted Monthly Senior Management Team (SMT) meetings are now being held to cover immediate and ongoing operational activities. Minutes of these meetings are being kept with recommendations for the Board identified. Once routine Board meetings are re-convened the process of recording minutes that include the SMT recommendations as well as the strategic and key considerations of the Board itself will be implemented.

		Target Implementation Date: April 2013 Responsible Officer: Company Secretary
5.	Cylch should ensure that all business decisions are financially sound and represent value for money.	Accepted Target Implementation Date: April 2013 Responsible Officer: CEO
6.	Cylch should ensure that the outstanding loans are managed on a formal basis and regularly monitored.	Accepted Target Implementation Date: May 2013 Responsible Officer: CEO
7.	Appropriate performance management arrangements should be put in place for Cylch's CEO	Accepted The new business plan has included draft Job Descriptions for all proposed staff including the CEO post. All staff will undergo staff appraisals from line managers. The CEO post will undergo a similar annual appraisal with member(s) of the Board. Target Implementation Date: May 2013 Responsible Officer: Chair /CEO
8.	Conflicts of interest should be appropriately disclosed, recorded and managed.	Accepted Target Implementation Date: May 2013 Responsible Officer: Company Secretary
9.	The recharging arrangements between Cylch and other organisations should cease with immediate effect.	Accepted Beyond the 3 outstanding 'recharge' invoices waiting to be paid back to Cylch,

		all other recharge arrangements are in the process of being stopped. Target Implementation Date: May 2013 Responsible Officer: Acting CEO
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