National Audit Office

Report
by the Comptroller
and Auditor General

**Department for Communities and Local Government
and Department for Business, Innovation & Skills**

Progress report on the Regional Growth Fund

HC 1097 SESSION 2013-14 25 FEBRUARY 2014

Summary

1 The government established the Regional Growth Fund (the Fund) in June 2010 with two objectives:

- to encourage private-sector enterprise by providing support for projects with the significant potential for economic growth and additional sustainable private-sector employment; and
- to support in particular those areas and communities that currently depend on the public sector to make the transition to sustainable private-sector-led growth and prosperity.

2 The Department for Communities and Local Government and the Department for Business, Innovation & Skills (the Departments) are responsible for the Fund. A cross-government secretariat (the Secretariat) provides administration support, with additional support provided in the regions by growth delivery teams within the Department for Communities and Local Government.

3 Since October 2010, private-sector firms and public–private partnerships have bid, or will shortly be invited to bid for £1 million or more each, over six bidding rounds, from a total Fund of £3.2 billion.[1] Bidders have to set out how their proposed scheme supports the Fund's objectives and how they will support jobs and growth not otherwise possible. Each scheme is either:

- a project – where the Fund supports a specific contracted business activity, or a package of smaller projects; or
- a programme – where the Fund is awarded to a programme operator which identifies and contracts for projects. Programme operators include local authorities, Local Enterprise Partnerships and banks.

4 We published our first report on the Fund in May 2012.[2] We concluded that the schemes selected should deliver jobs more cost-effectively for the taxpayer than the schemes not selected, but value for money was not optimised because a significant proportion of the Fund was allocated to schemes that offered relatively few jobs for the public money invested.

1 Our report only considers the £2.6 billion allocated to the first four rounds of the Fund. A fifth bidding round was completed in January 2014, and a sixth bidding round is expected in summer 2014. The government announced an additional £600 million in the June 2013 spending round to fund these two rounds.

2 Comptroller and Auditor General, *The Regional Growth Fund*, Session 2012-13, HC 17, National Audit Office, May 2012.

5 In its report on the Fund[3] in September 2012, the Committee of Public Accounts (the Committee) was disappointed that the Fund had started slowly and was concerned that:

- the threshold for the value for money offered by each bid had been set too low;
- not enough of the Fund had reached projects and was largely unspent or parked with programme operators; and
- plans for evaluating the Fund's long-term impact had not been developed.

Scope of our report

6 This report updates the Committee on the Fund's progress since its September 2012 report, and the key actions the Departments and the Secretariat took in response. We do not provide an updated conclusion on value for money of the Fund as a whole. We provide analysis and commentary on the Fund's performance since the Committee's last report. The Committee's full conclusions and recommendations, and the government's responses, are set out in Appendix One.

7 Our detailed findings on the Fund should be seen in the context of its key role in the government's wider programme of local growth initiatives. Our December 2013 report, *Funding and structures for local economic growth*,[4] set out this wider context and concluded that:

- progress by initiatives such as Local Enterprise Partnerships has been mixed, and job creation has been slow in Enterprise Zones and through the Growing Places Fund, as well as the Regional Growth Fund;
- the transition from the old to the new schemes has not been orderly and there has been a significant dip in growth spending;
- without sufficient transparency or a comparable picture of performance across schemes, the government's new structures for achieving local economic growth have not yet demonstrated that they are capable of delivering value for money;
- to secure value for money, central government needs to ensure that sufficient capacity is in place both centrally and locally to oversee initiatives, and make sure that timescales are realistic and that accountability is clear; and
- the Departments need to manage the range of local growth initiatives as a programme, and address how they intend to evaluate performance and monitor outcomes across the programme as a whole.

3 HC Committee of Public Accounts, *The Regional Growth Fund*, Fifth Report of Session 2012-13, HC 104, September 2012.
4 Comptroller and Auditor General, *Funding and structures for local economic growth*, Session 2013-14, HC 542, National Audit Office, December 2013.

Key findings on the Fund's progress since September 2012

Management, governance, and alignment with other growth initiatives

8 **The Fund's governance, accountability and links to other programmes have improved over time.** The Departments established a programme board in January 2012. This provided a much more effective and accountable tier of management between operational staff and Accounting Officers. In June 2012, the programme board also established formally a finance and investment subcommittee, which provides additional oversight and challenge including final sign-off on offers to bidders. More broadly, in June 2013, the government formed a local growth cabinet committee, chaired by the Deputy Prime Minister, to oversee initiatives affecting local economic growth. This committee's role includes deciding which bids are selected to receive awards from the Fund (paragraphs 2.4 to 2.8).

Choosing projects and agreeing terms

9 **The government has set expectations, in later bidding rounds, on the benefits of each project relative to its costs, but it is still not using the information it generates to maximise value for money.** At the time of the Committee's report, the Fund's Accounting Officers said that they would ask for direction from ministers on any project or programme where the overall net economic benefit was less than the cost to the Fund. Both we and the Committee concluded that this threshold was too low. Ministers and the Accounting Officers introduced a revised expectation that the ratio of benefits to costs should be 2:1 before final offer letters are signed. Ministers selected some bids that initially had a benefit–cost ratio of less than 2:1. The Secretariat worked to improve the value these bids offered through the detailed negotiation of each bid's terms and conditions and due diligence, which happens after the formal competition between bids has concluded (paragraphs 3.2 to 3.4 and 3.8 to 3.9).

10 **The average cost of each net additional job at the point of selection increased substantially in the third and fourth bidding rounds.** The Secretariat's estimate of the average cost per net additional job of bids selected in round four is £52,300. This compares with £30,400 in the first round, £33,500 in the second, and £39,700 in the third. The overall expected average cost per net additional job is now £37,400, which is 13 per cent higher than the £33,000 from rounds one and two that we reported in May 2012. The Secretariat does not consider that the quality of applications has decreased, and considers it more likely that their appraisal of later rounds is less optimistic and that applicants have submitted more realistic applications in the first place (paragraphs 3.5 to 3.7).

11 The Secretariat sped up the process of agreeing final offers with bidders for the Fund's third bidding round. In early 2012, there were only 12 full-time-equivalent (FTE) economists working on appraisal and processing bids. At December 2013, this had increased to 20 FTE economists and other specialists, supported by ten due diligence accountants and a state aid specialist. For the third round, the Secretariat also introduced a six-month deadline for issuing final offers as well as increasing the number of staff working on bids. Some 68 per cent of the selected bids received their final offer letters within the six-month deadline. This performance compares with 12 per cent of bids in the first round and 30 per cent in the second round. The process for the fourth round was not complete at the end of December 2013, with all funds allocated in July 2013 and subject to final offer by 17 January 2014 (paragraphs 4.4 to 4.12).

12 The Secretariat could have done more to reduce the risk that bidders with poor past performance receive further funding. In round four, the Secretariat included a summary of programme bidders' past performance on the appraisal information used to make decisions, and used this knowledge to adjust programme bidders' assumptions for risk. However, they did not formally consider project bidders' past performance. They could also have presented this information more clearly to ministers to help them select bids. Five of the bids selected in the fourth bidding round – worth a total of £34 million (7 per cent of the £506 million allocated) – were made by organisations that were already accountable for an existing project or programme that the Secretariat's review highlighted in particular as being behind its targets, at the time. For two of these bids, the Secretariat postponed signing final offer letters until performance on the existing programmes improved. We identified three further examples, however, where the Secretariat had not taken similar action (Paragraph 3.10).

Funding to businesses and jobs resulting

13 Some £492 million has now reached projects but the majority of the Fund remains unspent. According to the Departments' management information, as of the end of December 2013 £917 million of the £2.6 billion funding allocated in the first four bidding rounds had been paid to projects or programmes. Of this amount, £425 million was being held by programme intermediaries (of which £10 million was for administration). Some £1,547 million was still with central government and had been allocated to schemes. A balance of £136 million was from projects or programmes that have withdrawn, and where the money had not yet been reallocated (paragraphs 6.1 to 6.4).

14 **The number of jobs created and safeguarded has increased by 22,100 since September 2012.** As of September 2012 projects and programmes had created or safeguarded 22,300 jobs. Following the Committee's recommendation, the government published an annual monitoring report in July 2013 that set out the number of jobs created and safeguarded as of March 2013. At that time, the Fund had created or safeguarded 32,000 jobs compared with a target of 31,500. However, this target did not include 5,300 expected jobs that will not be created or safeguarded because the project or programme had withdrawn. The Departments' latest data indicate that in the period since March 2013, projects and programmes have created or safeguarded another 12,400 jobs, bringing the total to 44,400. Just under half of the jobs to date, however, were created or safeguarded by just five schemes, and the other half were delivered by the remaining 291 operational schemes in rounds one to three (paragraphs 5.8 to 5.9).

15 **The Secretariat was slow to introduce a robust management information system to monitor the Fund's performance.** Until July 2013, the Departments relied on local records for basic statistics on expenditure, as well as jobs created and safeguarded. In July 2013 they introduced a web-based management information system but some of the data were input incorrectly. The Secretariat coordinated a major exercise to correct errors and accuracy has improved, but this was time-consuming and data issues have yet to be resolved entirely. The Secretariat acknowledges that some inaccuracies and risks to quality remain. The Secretariat currently relies on periodic manual checks to identify and correct errors. This is less efficient than preventing similar errors recurring in future through automatic checks. The Secretariat reports that, in response to our review, it intends to introduce more automatic checks into the system (paragraphs 5.5 to 5.7).

Financial management

16 **HM Treasury has revised and clarified its guidance on endowments, which funded some programmes operated by intermediary bodies in rounds one and two of the Fund.** The Committee was concerned that endowments, over which departments have little control, had been used to avoid a potential underspend in 2011-12. In July 2013, HM Treasury issued a revised version of *Managing Public Money*, which made clear that this form of funding is always novel and contentious, and that it must never be used to manage the risk of underspend. The Secretariat does not expect any further programmes to be funded via endowments (paragraphs 7.3 to 7.6).

Evaluating the Fund's impact

17 The Secretariat has made progress with its plans to evaluate the Fund's impact. In its report, the Committee said that it was unacceptable that the Departments did not yet have a clear plan for evaluating the Fund's impact. In May 2013, the Secretariat commissioned an external consultant to undertake a scoping study to identify a practical evaluation methodology. The Secretariat expects this work to be completed in early 2014, and will then use this study to begin a full evaluation of the Fund (paragraphs 8.3 to 8.5).

Conclusion

18 Since September 2012, the Departments have improved the Fund's governance and taken on more skilled staff. They have sped up the process of making final offers to bidders and made progress in commissioning a formal evaluation of the Fund's impact. Despite this, they face a significant challenge, particularly in 2014-15, to spend a budget of £1.4 billion, largely because they have not been able to spend money as quickly as originally expected. Their task of spending this budget will be made more difficult if they do not address the remaining risks to the quality of management information. Looking ahead, there is still a significant amount of public money to allocate through the Fund. As well as the £600 million allocated to rounds five and six, at least £136 million is available from projects that have now withdrawn from earlier rounds. Our review indicates that value for money depends on the Departments further tightening controls on the jobs and other benefits that bids offer, relative to their cost.

Recommendations

19 The Secretariat should introduce new targets, include more automatic checks and develop its evaluation processes. It should:

a Introduce more sophisticated targets on the value for money offered by projects and programmes across bidding rounds. The Secretariat has the information it needs to provide this analysis but is not using it as effectively as it could.

b Improve its management information system by including more automatic checks to reduce errors. Good-quality data are essential to managing the Fund and reporting on its progress. It is not efficient to rely on checks later in the process to identify errors that then need investigating and correcting, and not as effective as establishing controls within the system that prevent such errors.

c Develop its processes for evaluating previous performance of repeat bidders. The Secretariat needs to formalise the use of information in the appraisal process to minimise the risk that poor performance is rewarded.