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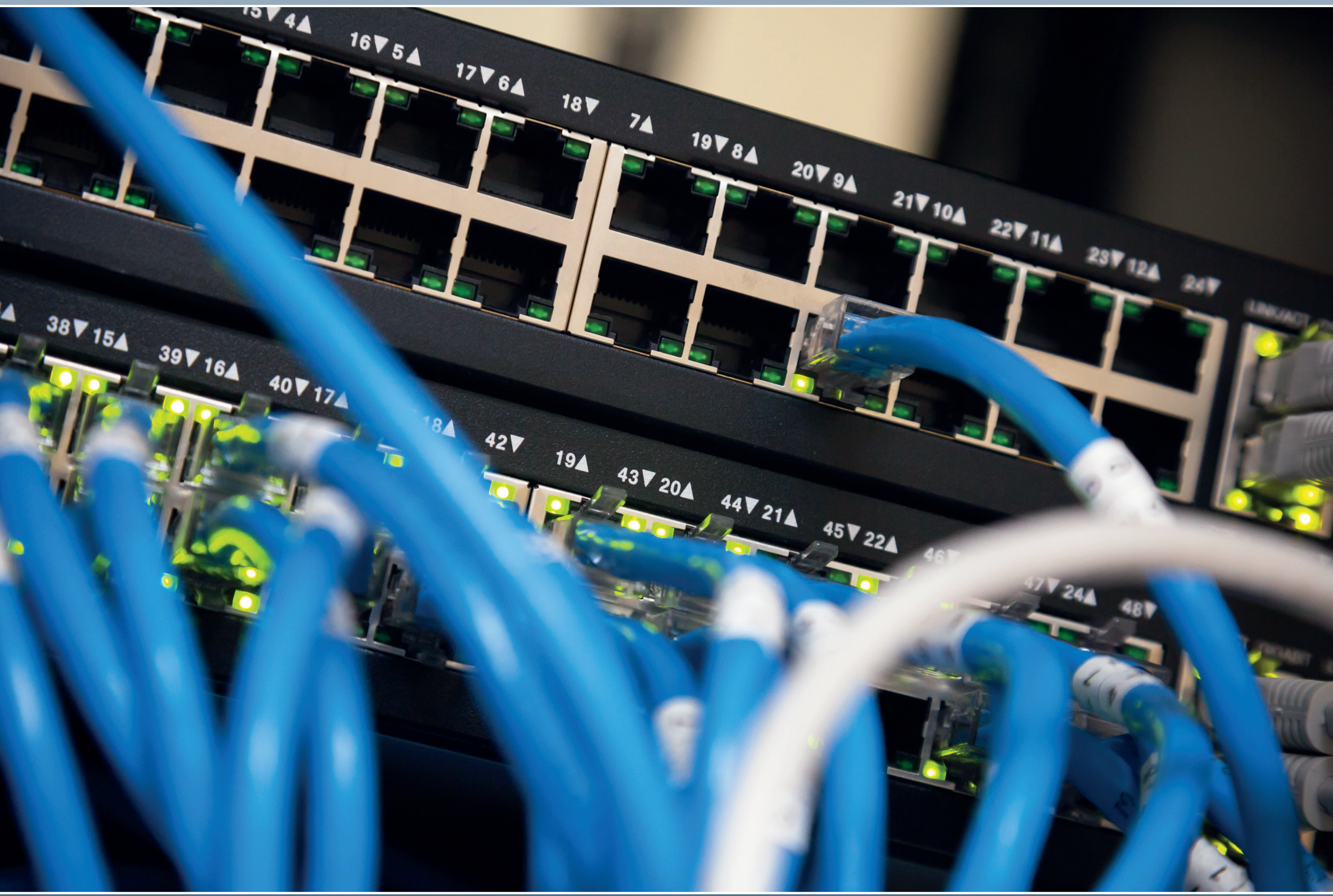
Northern Ireland Audit Office

Cross-border broadband initiative: the Bytel project



REPORT BY THE COMPTROLLER AND AUDITOR GENERAL

03 March 2015

NIAO

Northern Ireland Audit Office

Cross-border broadband initiative: the Bytel project

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Comptroller and Auditor General

Northern Ireland Audit Office
03 March 2015

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Abbreviations

BTI	Bioscience and Technology Institute
CPD	Central Procurement Directorate
DARD	Department of Agriculture and Rural Development
DCENR	Department of Communications, Environment and Natural Resources (RoI)
DCMNR	Department of Communications, Marine and Natural Resources (RoI)
DETI	Department of Enterprise, Trade and Investment
DFP	Department of Finance and Personnel
DoF	Department of Finance (RoI)
DSO	Departmental Solicitors Office
ECA	European Court of Auditors
ERDF	European Regional Development Fund
EU	European Union
JIA	Joint Implementing Agents
NIAO	Northern Ireland Audit Office
NSMC	North South Ministerial Council
PAC	Public Accounts Committee
PACE	Police and Criminal Evidence
SEUPB	Special EU Programmes Body
SLA	Service Level Agreements

Glossary of Terms

Article 4 review	Article 4 reviews examine the delivery of goods/services within an EU supported project, whether the expenditure claimed for has actually been incurred and the project's compliance with EU regulations. An Article 4 review is required for all EU funded projects.
Article 10 review	Article 10 reviews check the effectiveness of management and control systems and the project's compliance with EU Regulations. Article 10 reviews are undertaken for a sample of EU funded projects.
Benefit/Contribution-in-kind	EU Commission Regulation (EC) No 448/2004 states that in-kind contributions are eligible expenditure for EU assistance, provided that they consist of the provision of land or real estate, equipment or materials, research or professional activity or unpaid voluntary work.
Nortel racks	Equipment which is used as part of a telecommunications networking system.

Executive Summary

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Introduction

1. This report examines a cross-border broadband project which aimed to provide high speed connectivity linking Belfast, Craigavon, Armagh, Dundalk and Dublin. The project promoter was Bytel Ltd and the company established a subsidiary, Bytel Networks Ltd, to deliver the project.

2. The project received funding from the European Union (EU) Interreg III programme under a measure to improve inter-regional economic infrastructure. The Special EU Programmes Body (SEUPB) implements the policies of the North South Ministerial Council (NSMC) and was accountable to the European Commission, the Northern Ireland Executive and the Irish Government for the management and delivery of the Interreg programme. Departmental responsibility for SEUPB lies with the Department of Finance and Personnel (DFP) in Northern Ireland and the Department of Public Expenditure and Reform in Ireland. SEUPB appointed the Department of Enterprise, Trade and Investment (DETI) in Northern Ireland and the Department of Communications, Environment and Natural Resources (DCENR) in the Republic of Ireland[1] as Joint Implementing Agents (JIAs) for the measure which funded the Bytel project.

3. In October 2004, the JIAs offered Bytel funding of €4.3 million against estimated total project costs of €12.4 million. The funding package comprised €3.74 million from the Interreg III programme and €0.56 million of match funding from DCENR. The split of total project funding was €2.1 million from DETI and €2.2 million from DCENR.

4. A technical review of the project commissioned by DETI in 2012 and completed in 2013 concluded that although the project delivered was different from that originally proposed, the project objectives included in the Letter of Offer were achieved. There were also a number of additional benefits, including access to important broadband networks which had largely fallen dormant and improvement in network resilience in the Republic of Ireland.

5. Actual total project costs were significantly lower than the planned €12.4 million. The technical review suggests €3.9 million. Although the JIAs were aware of changes to the project in 2004 and 2005 they did not assess their financial impact nor re-assess the level of grant payable. The full €4.3 million of assistance was paid to Bytel between December 2004 and December 2005.

6. A forensic review by consultants commissioned in 2011 and completed in March 2012 identified serious weaknesses in the JIAs' management and oversight of the project. This confirmed that 97 per cent of expenditure on the project was irregular for EU grant. The project was withdrawn from the Interreg programme in March 2012.

1 Until June 2007, DCENR was named DCMNR (Department of Communications, Marine and Natural Resources).

7. DETI began legal proceedings in November 2010 to recover €4.3 million grant paid. These proceedings are ongoing.

Key findings

8. There were major failings in the handling of the project. In particular:

Project assessment and appraisal

9. The assessment and appraisal process was not sufficiently robust. The project was initially assessed in June 2004 and rejected for support. The project was re-assessed in July 2004 and narrowly passed the threshold for funding of projects. A significant factor in the assessment was a proposed partnership with Aurora Telecom which brought €7.8 million of value to the project and which was viewed as critical to its success. However, the strength of this relationship was not tested and Aurora's withdrawal from the project in December 2004 resulted in the specification and costs changing significantly.

10. There was a lack of clarity over the source and ownership of project infrastructure assets. In particular, it was unclear how Bytel could fund its contribution-in-kind for the project.

11. The actual costs of delivering the project were significantly lower than those set out in the original proposal but grant was paid on the basis of that proposal.

Checking and authorising grant claims

12. The JIAs were responsible for checking and approving grant claims. Between November 2004 and November 2005, four grant claims were submitted for a total of €4.3 million. These claims were paid in full.

13. There were pressures on the JIAs to pay grant within tight EU deadlines. Two claims which accounted for €3.67 million of the grant paid were submitted immediately before deadlines. This created a risk that ineligible expenditure would be funded or that items which were not supported by proper documentation would not be challenged. The evidence suggests that the JIAs' primary responsibility to ensure that expenditure was eligible for grant funding became secondary to the need to ensure that grant was paid.

14. Bytel's first claim included €1.3 million for hardware known as Nortel racks. This claim was paid in full by the JIAs. However, this expenditure was not eligible under the terms of the Letter of Offer and the required approvals to ensure its eligibility were not sought or received. The value of the asset was never independently or conclusively verified. Furthermore, it was never used in the project and whilst consultants who reviewed the project in 2012 considered it appropriate in 2004 to have relied on an appraisal valuation of €1.3 million, in light of the evidence which has emerged since then, they concluded that this valuation was

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not credible. There is evidence from a number of sources that the likely procurement cost of the equipment was €30,000. Grant was also paid in respect of other expenditure which was ineligible under the Letter of Offer; for example, €239,000 for cabling work undertaken which was outside the scope of the original project.

15. The final claim consisted of a one-page statement from Bytel outlining its high level valuation of €17.8 million for a benefit-in-kind contribution to the project. Bytel was paid grant of €2.07 million in respect of this. No evidence was provided in the claim to support the valuation. There are significant concerns over the valuation, existence, ownership and completion of the assets and infrastructure referred to in the claim.

The investigations

16. Allegations about the project were made by a director of the company in June 2006. These referred to anomalies in the accounts of Bytel and a related company (XMCC), XMCC ordering supplies on Bytel's behalf, the withdrawal of Interreg funds from both companies by Bytel directors and the claiming of grant for assets not owned by Bytel.

17. DETI did not carry out a sufficiently robust and independent examination of these allegations. The investigation was carried out by DETI Telecommunications Branch which had responsibility for managing the project, including processing grant claims. It concluded that there were no matters for concern. However, subsequent reviews have identified significant concerns with grant claims and the payment of grant which should have been evident to the investigation.

18. Further serious allegations about the project were made to the NIAO by a whistleblower in June 2008. The allegations were referred to DETI. An initial review of the whistleblower's allegations by DETI Internal Audit in January 2009 identified significant concerns. A further review in September 2009 by consultants commissioned by DETI considered that the Department would, more likely than not, be required to declare an irregularity to the EU in relation to the project.

19. DETI did not notify SEUPB of these issues in a timely manner. In 2006, DETI told SEUPB that there were no matters of concern arising from the allegations made about the project. The Department did not notify SEUPB of the 2008 whistleblower allegations or the findings of the September 2009 consultants' review until February 2011. A full forensic review of the project was then commissioned by SEUPB on behalf of key stakeholders.

Value for money

20. The Bytel project delivered poor value for money. The total grant paid to Bytel was €4.3 million. However, the

technical review commissioned by DETI in December 2012 concluded that Bytel had incurred total costs of €3.93 million to deliver the network. It also reported that Bytel had received €3 million from Eircom for work carried out on Eircom's Saturn Ring network[2].

21. The project's withdrawal from the Interreg programme in March 2012 resulted in DETI and DCENR having to fund €2 million and €2.3 million respectively. The final deadline for commitment of expenditure to the Interreg III programme was June 2009. Had Bytel been withdrawn earlier, there may have been an opportunity to seek mitigating actions that could have resulted in some or all of the Interreg funding being utilised in other projects. DETI and SEUPB told us that this would have been challenging. However, the withdrawal of the project after the deadline meant that SEUPB was unable to re-allocate Interreg grant of €2 million in respect of DETI and €1.76 million in respect of DCENR. This funding was lost to both member states.

22. In September 2009 the Bytel assets were sold to Hibernia Atlantic and incorporated within Project Kelvin[3]. Under the terms of the Letter of Offer, the sale of the assets should have triggered clawback of the grant paid to Bytel. This did not happen. DETI did not receive confirmation that the Bytel assets had been sold until the technical review was completed in 2013.

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2 The Saturn Ring network consists of 400km of fibre which provides access to the principal cities and towns in Northern Ireland.

3 Project Kelvin involved the provision of a submarine connection into Northern Ireland from a transatlantic cable. It also created a `terrestrial' network around Northern Ireland, and into the Republic of Ireland covering a range of towns including Armagh, Dundalk and Drogheda. Total project costs amounted to €29.6 million, €22.2 million of which was met through ERDF funding.

Part One:
Introduction and Background

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Introduction and Background

The Bytel project

1.1 This report examines the Bytel project which aimed to provide high-speed broadband connectivity linking Belfast, Craigavon, Armagh, Dundalk and Dublin. The project was supported by the European Union (EU) Interreg III programme, which ran from 2000 to 2006.

1.2 The Interreg III programme was financed under the European Regional Development Fund (ERDF). Its main objective was to stimulate co-operation between EU regions. The Special EU Programmes Body (SEUPB) implements the policies of the North South Ministerial Council (NSMC) and was accountable to the European Commission, the Northern Ireland Executive and the Irish Government for management and delivery of Interreg III. Departmental sponsorship for SEUPB lies with the Department of Finance and Personnel (DFP) in Northern Ireland and the Department of Public Expenditure and Reform in the Republic of Ireland.

1.3 The Bytel project was assisted under a specific Interreg III priority measure which aimed to improve inter-regional economic infrastructure. The Department of Enterprise, Trade and Investment (DETI) in Northern Ireland and the Department of Communications, Environment and Natural Resources (DCENR) in the Republic of Ireland[4] were appointed as Joint Implementing Agents (JIAs) for this measure by SEUPB.

1.4 In February 2004, following a competitive procurement process led by DFP's Central Procurement Directorate (CPD), DETI and DCENR appointed a management agent (Western Connect) to provide technical, legal and financial expertise on the appraisal, selection, monitoring and implementation of Interreg III projects.

1.5 In April 2004, Bytel Limited, a Belfast-based company, applied for Interreg III funding for a cross-border high-speed broadband project. This application was assessed by Western Connect and initially recommended for rejection in June 2004, due to a range of concerns which included high project costs and doubts as to whether it represented value for money. However, the Interreg IIIA Steering Committee, whose function was to select projects for assistance, deferred a final decision on support for the project. The JIAs, Western Connect and Bytel subsequently worked to address the concerns over the project. In July 2004, the application was re-assessed and passed the assessment threshold required to secure funding.

1.6 Following the re-assessment, the project application was approved by the Steering Committee on the basis of a positive recommendation by the JIAs and the approval of the economic appraisal. A Letter of Offer was issued jointly by DETI and DCENR to Bytel Networks Ltd[5] in October 2004. This provided funding of €4.3 million against estimated total project costs of €12.4 million. The level of approved funding was 35 per cent of

4 Until June 2007, DCENR was named Department of Communications, Marine and Natural Resources (DCMNR).

5 Bytel Networks Ltd was a subsidiary of Bytel Ltd set up to deliver the cross-border broadband project funded by Interreg III.

total project costs, the maximum rate for Interreg grant.

1.7 The funding package offered comprised €3.74 million from the Interreg programme and €0.56 million of match funding from DCENR (**Figure 1**). The full €4.3 million of assistance was subsequently paid to Bytel between December 2004 and December 2005.

Figure 1: Grant funding offered for Bytel project[6]

Funding Source	€ million grant	% of total grant
DETI (Interreg funding)	2.09	48.6%
DCENR (Interreg funding)	1.65	38.4%
Anticipated Total Interreg Funding	**3.74**	**87.0%**
DCENR Match Funding	0.56	13.0%
Total Assistance	**4.30**	**100%**

Source: SEUPB

1.8 In June 2006, a Bytel director contacted DETI and made a number of allegations about the management and delivery of the project. DETI carried out an investigation and concluded that there were no issues for it to address. This proved subsequently not to be the case.

1.9 In June 2008, the Northern Ireland Audit Office (NIAO) received whistleblower allegations about the project and referred these to DETI for investigation. Whilst providing more comprehensive detail, some of these allegations broadly mirrored the concerns raised in 2006. The whistleblower alleged that:

- despite Bytel's very limited financial resources (annual profit of £30,000), two of its directors had each given personal sureties of £250,000, which helped ensure that the company was awarded the Interreg grant;
- the proposal for the project involved using equipment which was acquired by another Bytel-related company (XMCC) for "*tens of thousands of euros*" and then sold on to Bytel for over €1 million. The valuation of over €1 million was part of Bytel's Interreg grant claim but the equipment was never used in the project;
- Interreg grant of over €1 million which was paid to Bytel was immediately transferred to its related company (XMCC) and two Bytel directors took a payment of €100,000 each from this. XMCC then loaned Bytel €0.5 million to complete work on the project which allowed payment of further grant. XMCC only traded with Bytel; and
- the completed project did not create any new infrastructure but instead leased existing services.

6 The total actual amount paid for the Bytel project was €4.3 million in line with the initial offer. However, this was broken down as DETI (Interreg funding) €2.03 million, DCENR (Interreg funding) €1.76 million and DCENR (Match funding) €0.51 million.

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1.10 The Department's internal auditors completed a review of the whistleblower's allegations in January 2009. Following consultation with the Departmental Solicitors Office (DSO), Internal Audit appointed consultants (Consultants A) to review Bytel's four grant claims. The consultants reported in September 2009.

1.11 The September 2009 review confirmed that there were significant concerns about the sourcing and valuation of project assets and equipment, the eligibility of claimed expenditure and the limited documentation to support grant claims. Consultants A concluded that: *"there are a number of significant issues arising in relation to the eligibility of the expenditure claimed in respect of this project and therefore in relation to the efficacy of the Department's oversight and monitoring role"*. The consultants considered that the Department would likely be required to declare an irregularity in relation to the project, but highlighted the need for additional work to determine the quantum of this and the scope for recouping grant.

1.12 DETI did not notify SEUPB of concerns with the project until May 2010, when it submitted a report which indicated that there was "*a potential irregularity*" with the €4.3 million grant provided to Bytel. DETI concluded that all grant was potentially irregular and that the wording of the notification reflected the need for further work to determine the quantum of the irregularity. DCENR was informed of the irregularity in December 2010.

1.13 In February 2011, DETI provided SEUPB with a detailed description of the nature of the irregularity and of the findings from Consultants A's review. Following this, SEUPB immediately informed all relevant accounting officers of the irregularity and established a Stakeholder Project Board[7]. SEUPB also commissioned a forensic review of the project by Consultants A.

1.14 The forensic review concluded that €4.17 million (97%) of the €4.3 million grant paid to Bytel was ineligible for Interreg assistance. The review also identified significant shortcomings with the management of the project:

- the project had not been properly defined at the outset;
- although the approach to delivering the project and its costs had changed significantly shortly after the October 2004 Letter of Offer, a revised offer was not issued; and
- ineligible grant expenditure had been authorised and paid due to inadequate checking and scrutiny of grant claims.

1.15 Based on the outcome of the review, the Project Board agreed to withdraw the project in its entirety from the Interreg programme. The project was withdrawn from the programme in March 2012. Consequently DETI and DCENR had to fund all €4.3 million assistance paid to the project.

7 The report was commissioned on behalf of the Interreg Stakeholder Project Board which comprised SEUPB, DETI, DCENR, DoF and DFP.

1.16 A technical review of the project commissioned by DETI in 2012 concluded that it had delivered the stated objectives set out in the Letter of Offer. In particular, although the project as initially specified would have provided broadband connectivity to the east coast of Ireland, the completed project also provided additional points of presence in Omagh and Londonderry and improved the resilience of the network in the Republic of Ireland through connections at Bridgend and Letterkenny. The review also found that the project provided enhanced connectivity and had improved competition to the Northern Ireland telecoms market.

1.17 However, the technical review found that the actual project costs were substantially less than those set out in the original proposal. The assistance of €4.3 million paid to Bytel was based on estimated total project costs of €12.4 million. The technical review estimated that total expenditure on the project was €3.93 million. It also reported that Bytel had received €3 million from Eircom for work undertaken on Eircom's Saturn Ring network.

1.18 **Appendix 1** provides a timeline of the main developments associated with the Bytel project.

Scope of our examination

1.19 We examined the following areas:

- the appraisal of the project;
- management and oversight of the project, with particular emphasis on the checking of grant claims;
- the investigation of concerns which were raised about the project; and
- the outcomes and overall value for money delivered by the project.

1.20 In key respects, the findings of our examination of Bytel bear significant similarities to issues raised by the Public Accounts Committee's (PAC's) May 2012 report on the Bioscience and Technology Institute (BTI). That project received £2.2 million funding from DETI, the Industrial Development Board, the Industrial Technology and Research Unit and the International Fund for Ireland. In particular, both projects exhibited shortcomings in respect of appraisal, project monitoring and checking of grant claims.

Methodology

1.21 Our examination drew on the findings of the forensic review of the project completed for the project's key stakeholders by Consultants A in March 2012 and the technical review completed for DETI by Consultants B in March 2013. We also:

- reviewed DETI and SEUPB documentation; and

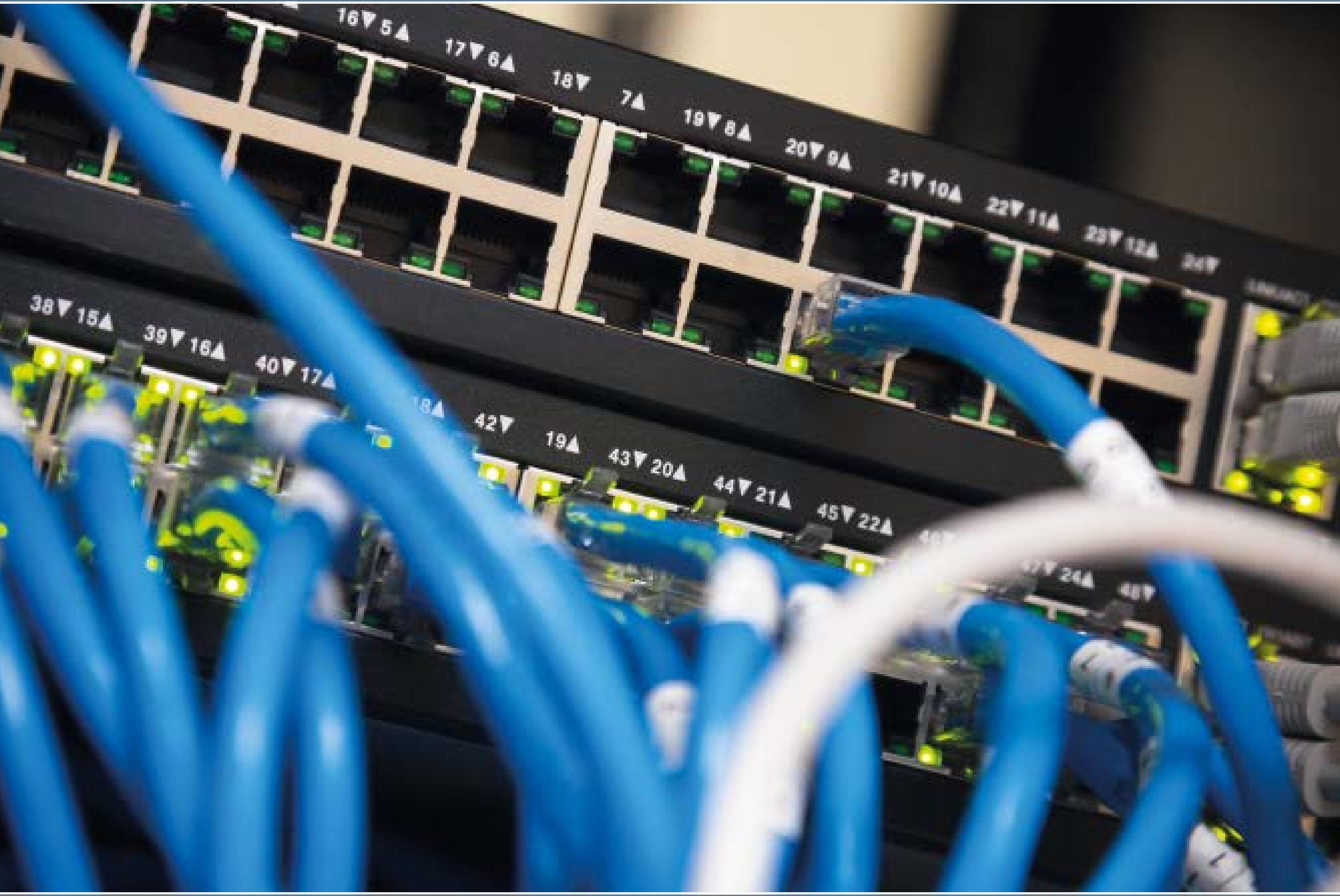
Part One:
Introduction and Background

- obtained information from key DETI and SEUPB officials and the lead consultant who carried out the forensic review.

This report is the result of a co-ordinated examination between the Northern Ireland Audit Office and the Office of the Irish Comptroller and Auditor General. Given the cross-border nature of the issues examined, this approach ensured that the review was as comprehensive as possible. The report of the Irish Comptroller and Auditor General is included as an annex to this report.

Part Two:

Assessment and Appraisal of the Bytel project



Part Two:
Assessment and Appraisal of the Bytel project

The Bytel project was subject to an assessment and appraisal process

2.1 This section of the report considers the assessment and appraisal of the Bytel project.

2.2 Individual Service Level Agreements (SLAs) between SEUPB and the JIAs set out the relative responsibilities of each body for Interreg III supported projects. The SLAs placed responsibility on the Departments for:

- assessing and appraising projects;
- issuing offers of grant;
- agreeing required outcomes with project promoters;
- project monitoring;
- checking grant claims and approving grant payments, including vouching eligibility of expenditure incurred and ensuring claims were supported by all relevant supporting information[8]; and
- post-project evaluation.

2.3 In February 2004, DETI and DCENR appointed Western Connect as a management agent to oversee elements of the application and assessment process for projects supported by the Interreg IIIA telecommunications measure. Western Connect's role ended in October 2005, when the EU budget for technical assistance was exhausted. The project was ultimately approved for funding by an Interreg Steering Committee on the basis of the assessment work undertaken by Western Connect, DETI, DCENR and the economic appraisal.

More detailed probing at the assessment stage may have led to the project not being approved for funding

2.4 Applications for proposed Interreg III projects were subject to an initial two-staged assessment process. Projects which passed the initial assessment were then subject to an economic appraisal process. The appraisal was considered by the Steering Committee for a final funding decision.

2.5 The Bytel project was initially assessed in June 2004 by a panel comprising two staff members from Western Connect. Bytel's application for Interreg support was rejected for reasons which included:

- the project did not meet Interreg criteria;
- project costs were excessively high and did not provide value for money (the project had total estimated costs of €13.15 million and Bytel was seeking assistance of €5.9 million);
- concerns over the applicant's financial position given the level of investment being sought; and

8 For the Bytel project, Western Connect checked and vouched the first two grant claims against the supporting documentation. DETI performed this role for the last two claims.

- insufficient detail as to what was included in the benefit-in-kind from Aurora, valued at €6 million, being brought to the project.

2.6 In our view, the initial assessment identified key risks which later crystallised and undermined the delivery of the project. In particular, the project was subsequently delivered for a fraction of the original estimate of costs and the benefit-in-kind from Aurora did not form part of the completed project.

2.7 Following this initial rejection, the JIAs, Western Connect and Bytel engaged in efforts to address the concerns. Revisions to the proposal included reduction in the estimated project costs to €12.4 million. In July 2004, the Bytel proposal was again submitted for assessment.

2.8 The project narrowly passed the threshold required to proceed to economic appraisal stage. A key element in favour of the project was the north-south nature of the application, to be delivered through a proposed partnership with Aurora Telecom. The evaluation panel relied upon a letter from Aurora which was signed by a senior projects manager. The letter indicated a normal commercial transaction with Bytel. At that time, the evaluation panel had no reason to doubt the authority of the senior projects manager to make commitments on behalf of Aurora. However, no internal approvals for a formal agreement or partnership had been given within Aurora or Bord Gáis (Aurora's parent company). No formal agreement or partnership was ever established between Aurora and Bytel.

2.9 A technical review of the project, completed by Consultants B for DETI in 2013, concluded that, before approving the project for support, the assessment panel should have obtained confirmation from Board level in Aurora of its relationship with Bytel. We endorse this view.

2.10 This case highlights the risks associated with projects which are heavily dependent on the contribution of a third party. It is crucial that the nature and strength of a partner's commitment, or the existence of a formal agreement, is validated. Aurora was to contribute €7.8 million of infrastructure and assets to the Bytel project and its withdrawal in December 2004 led to the project definition being changed significantly. This was a significant factor in the serious concerns which arose subsequently over the funding and management of the project.

There were shortcomings with the project definition and economic appraisal

2.11 It is good practice to establish the project definition at an early stage of the appraisal, setting out the objectives, scope and deliverables of a project. There was a particular need for a robust project definition for the Bytel project,

Part Two:
Assessment and Appraisal of the Bytel project

given its technical nature and use of a complex mix of assets and infrastructure.

2.12 Consultants A identified weaknesses with the Bytel project definition, including a lack of clarity over the source and ownership of assets required to deliver the project. They concluded that the commercial rationale for the project was unclear: specifically, the project definition did not set out how the Bytel companies, with limited finances, could fund their contribution-in-kind, or why Aurora was contributing €7.8 million assets to a project from which it was set to derive no economic benefit. Subsequently, a letter from Aurora to DETI (in November 2004, after the project appraisal was completed and the Letter of Offer issued) set out a number of benefits which would accrue to the company.

2.13 The economic appraisal did not probe these matters in any depth. Nevertheless, the appraisal did address a number of key risks and uncertainties associated with the project. In particular, the appraisal identified a lack of clarity over the nature of the relationship between Bytel and Aurora. It recommended that the Letter of Offer for the project include a condition that the basis of the relationship be a normal commercial arms length agreement. This would have helped to confirm the largest source of match funding for the project. However, no such provision was included in the Letter of Offer.

2.14 There were some shortcomings with the appraisal. Although the project was highly complex in nature, the appraisal team did not include sufficient technical expertise and consequently, it fell short in accurately identifying project infrastructure costs. It estimated likely cabling costs as €7.8 million; the subsequent technical review by Consultants B concluded that the project could have been delivered with cabling costs of €1.95 million. In our view, the appraisal tended to rely on information provided by Bytel, with only limited independent verification of this.

2.15 We also consider that more detailed probing of a number of key issues at the assessment and appraisal stage could have alerted the JIAs, Western Connect and the Interreg Steering Committee to clear warning signs over the viability of the proposed project. In particular, more information should have been sought on:

- how Bytel proposed to fund its share of project costs;
- whether Aurora had formally entered into an arrangement with Bytel, through which it would contribute almost €8 million of assets to the project; and
- the source and cost of the project's assets and infrastructure.

2.16 Had these risks been addressed at the assessment and appraisal stage, we consider that the serious issues which arose subsequently over the implementation of the project could have been avoided.

The project was not re-appraised and eligible grant funding levels re-calculated when the specification changed significantly

2.17 The Letter of Offer issued by DETI and DCENR to Bytel Networks Ltd in October 2004 provided funding of €4.3 million against estimated total project costs of €12.4 million. The level of funding was 35 per cent of total costs and represented the maximum available Interreg grant rate. Of the total costs, €7.8 million (63 per cent) related to assets and infrastructure to be provided by Aurora Telecom. However, in December 2004 Aurora withdrew from the project.

2.18 After the withdrawal of Aurora, Bytel entered into discussions with Eircom. Following protracted negotiations, Bytel and Eircom entered into agreements in September 2005.

2.19 Under the agreements Eircom would lease bandwidth to Bytel in return for Bytel completing work for Eircom on the network. Both transactions were valued at €3 million.

2.20 Aurora's withdrawal and the subsequent agreements with Eircom represented a major change to the technical specification of the project which altered fundamentally the revenue and capital costs. The Eircom agreement reduced total project costs from €12.4 million to €7.6 million. In addition, the change in technical specification also resulted in equipment known as Nortel racks, which had been valued at €1.3 million within the economic appraisal, no longer being required to deliver the project.

2.21 Under the terms of the Letter of Offer, Bytel was required to receive approval from the JIAs for any significant project changes. These included changes to the scope, delivery or aim of the project, sources and amounts of funding and changes to estimated expenditure or revenue. Where claims differed significantly from the original application and approval was not received for these, the Letter of Offer stated that assistance paid could be deemed invalid and partially or fully recouped from the project promoter.

2.22 DETI and DCENR were aware of the changes to the project but did not assess the financial impact of Aurora's withdrawal. In August 2005, DCENR notified SEUPB of the change from Aurora to Eircom. However, SEUPB told us that the significance of this change to the project was not communicated to it. Most importantly, there is no documented evidence that Bytel was given formal approval to proceed with the revised project.

2.23 A standard review of the project in 2006 to assess compliance with EU Regulations noted that the project had changed and that approval was

Part Two:
Assessment and Appraisal of the Bytel project

required. At the time, DETI's response was that there had been no significant change to the project. DCENR and SEUPB were notified to that effect.

2.24 In our view, the significant changes to the project should have triggered a re-appraisal and a re-assessment of the grant offered. However, the JIAs did not take these steps and the €4.3 million grant approved for the original proposed project was paid in full. Consultants A concluded that this was "*a fundamental failure in* [the Departments'] *oversight of this project*".

2.25 There are important lessons to be learned from the assessment and appraisal of the Bytel project. Previous reports by PAC, including the Committee's review of BTI (paragraph 1.20), made recommendations on similar themes. We consider that the issues raised by the Bytel project indicate that some recommendations need to be re-enforced.

Recommendation 1

Processes have changed significantly in relation to implementation of the current Interreg programme. Nevertheless, there are a number of key lessons to be learned from this project:

- where a partnership is central to the delivery of a project, the nature and strength of the partnership must be confirmed;
- risks and issues of concern identified at appraisal stage should be managed through relevant conditions in offers of assistance. Funding should not be released to projects until conditions are met; and
- when a project is subject to significant change, a re-appraisal must always be undertaken by the funder; where the change has financial consequences, the amount of eligible grant must be re-calculated and relevant revisions made to the offer of assistance.

Part Three:
Checking and authorisation of grant claims

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Checking and authorisation of grant claims

3.1 This part of the report assesses arrangements for the checking and authorisation of Bytel grant claims, drawing on the findings of Consultants A and Consultants B.

DETI and DCENR were responsible for checking grant claims and approving payments

3.2 In its role as management agent, Western Connect checked and vouched the first two grant claims against supporting documentation supplied by Bytel. This function was performed by DETI for the final two claims. Following the checking and vouching of claims, DETI signed payment authorisation forms for all four claims. Western Connect countersigned these forms for the first two claims, and DCENR for the final two. These forms stated that expenditure incurred was correct, eligible and due for payment. Between November 2004 and November 2005, four claims totalling €4.3 million were submitted for the project. These were paid in full (**Figure 2**).

There were pressures on the Joint Implementing Agents to pay grant within tight deadlines

3.3 All EU funding programmes are subject to an annual spending target known as N+2. This requires funds to be spent within two years of allocation or potentially be lost by member states. This places an onus on member states and all parties involved in the programme to ensure available funding is fully utilised. However, it may also create the risk that financial control is weakened. For example, N+2 pressures have the potential to lead to ineligible expenditure being approved for payment or grant claims being processed without adequate supporting documentation.

3.4 N+2 pressures were particularly keenly felt within Telecommunications Branch. The Bytel project accounted for a significant proportion (almost 55 per cent) of DETI's overall Interreg telecommunications budget and the importance of Bytel expenditure to meet N+2 expenditure targets was referred to in DETI internal correspondence. In October 2005, the DETI Board was informed that achievement of the N+2

Figure 2: Bytel grant claims

Claim	Date submitted	Date paid	Amount paid €
1	15 November 2004	2 December 2004	1,600,000
2	16 September 2005	13 October 2005	375,000
3	25 October 2005	8 December 2005	250,000
4	11 November 2005	8 December 2005	2,075,000
Total			**4,300,000**

Source: NIAO, based on review of Bytel grant claims target would largely be dependent on expenditure from the Bytel project.

3.5 The first and the final grant claims together accounted for 85 per cent of grant paid for the project. These two claims were submitted in November 2004 and November 2005 respectively. There is evidence that this created tension between the JIAs' need to ensure that grant was paid and their primary responsibility to ensure that expenditure was eligible for grant funding. For example:

- the Letter of Offer dated 28 October 2004 required that €1.6 million of funding be spent by 19 November 2004, only 22 days later; and
- the first three grant claims were paid at 100 per cent rather than the overall grant rate of 35 per cent.

3.6 Consultants B, who reviewed the project for DETI in 2013, highlighted the very short period between the Letter of Offer and the first deadline for grant expenditure. The consultants concluded that *"the ambitious nature of the timetable, coupled with the real and immediate prospect of losing the grant funding, could have placed inordinate pressure on those involved to achieve a positive result so that the project could proceed"*.

3.7 In our view, the submission of two large claims so close to the N+2 deadlines created the risk that ineligible expenditure would be funded or that items which were not supported by proper documentation would not be stringently checked or challenged. In practice, there were significant shortcomings within the grant payment process which raise serious concerns over the regularity of the payments to Bytel.

The checking and verification of Bytel grant claims was inadequate

Grant Claim 1 (€1,599,877 – November 2004)

3.8 Bytel's first grant claim for almost €1.6 million was paid in full by DETI. Some €1.3 million (81 per cent) of the claim related to Nortel racks (paragraph 2.20). A number of serious concerns were subsequently identified with the claim for this equipment, in relation to the eligibility of the equipment for grant funding, the valuation of the equipment, its procurement from a Bytel-related company (XMCC) and its non-use in the completed project (**Figure 3**).

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Checking and authorisation of grant claims

Figure 3: Summary of findings on Nortel equipment

Issue	Findings	NIAO Conclusions
The Nortel equipment was ineligible for Interreg funding	The project Letter of Offer stipulated that the cost of the Nortel equipment would be fully met by the project promoter and that no Interreg contribution would be made towards this. However, Bytel claimed and was paid €1.3 million of grant for the equipment. It was originally intended that Bytel would make a payment of €1.8 million to Aurora Telecom as part of the agreement between the parties, and that this would form part of the first grant claim. However, the agreement was not in place to allow this to happen. In the face of the possibility of EU funding being lost due to an impending N+2 deadline, the JIAs agreed that the Nortel racks could be grant-aided within the first claim. The proposition was that this grant payment would be deducted from subsequent claims so that the overall grant offered would not be exceeded; however, this did not happen. SEUPB was also notified that the JIAs had agreed that the Nortel equipment should be grant-aided. A report on a project verification check in 2006 recorded that the necessary process for revision of budgets had been followed to allow this equipment to be funded.	There is no evidence available to demonstrate that the relevant approvals were obtained to allow this equipment to be grant-aided.
There is insufficient evidence of the physical inspection of the Nortel equipment	DETI records refer to the equipment having been inspected by Western Connect. However, there is insufficient evidence to demonstrate how Western Connect verified the existence of the equipment. Consultants B found that, at the time of the first grant claim, DETI had raised concerns with Western Connect and Bytel over the existence of the equipment and the importance of not paying for equipment in advance, but did not receive full answers to the questions raised. DETI Internal Audit found that vouching of the Bytel grant claims had not involved any physical examination of equipment. The Nortel equipment was unavailable for inspection during the post-project evaluation in 2007.	There is insufficient evidence to support the physical inspection of an asset for which €1.3 million grant was paid.

There is evidence that the equipment's value was substantially less than the €1.3 million claimed	The economic appraisal of the Bytel project included a €1.3 million valuation for the Nortel racks. This amount was subsequently claimed by Bytel and paid. However, this valuation was based on information provided by Bytel and was an estimate of the likely costs of acquiring new Nortel equipment. It did not reflect the actual cost of the equipment procured for the project and for which grant was being claimed. DETI Internal Audit's observation in January 2009 that the economic appraisal had only consisted of a reasonableness check on project hardware costs illustrates the limitation of this valuation. There is considerable doubt over the credibility of the €1.3 million valuation for the Nortel equipment. Consultants A, who reviewed the project in 2012, believed that on balance, it was appropriate in November 2004 to have relied on the economic appraisal valuation of €1.3 million for this equipment. However, in light of information that emerged since then, these consultants concluded that a €1.3 million valuation was not credible. They also concluded that the equipment was not used in the project. In 2008, a whistleblower alleged that the equipment cost €30,000. Evidence that the equipment cost substantially less than €1.3 million was also identified by Consultants A and B, and DETI Internal Audit (**Appendix 2**).	The JIAs failed to obtain reliable evidence of the actual cost of equipment purchased before paying grant. €1.3 million grant was paid for equipment which, in all likelihood, was procured for €30,000.

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The Nortel equipment was procured from a Bytel-related company	All items within the first claim, including the Nortel racks, were obtained from XMCC, a company owned and controlled by the Bytel chairman and registered at Bytel's address. There is no evidence of a legitimate reason for Bytel's use of XMCC. If expenditure for items supplied by XMCC had been genuine, then Bytel could either have declared these as a benefit-in-kind and had them subject to an independent valuation or produced relevant third party supplier invoices. In the absence of a credible explanation, Consultants A suggested potential reasons for Bytel using XMCC to procure items for the project were: • to support claims for ineligible expenditure; • to lend credibility to the value being claimed for equipment; and • to support a contention that expenditure was actually incurred. We asked DETI whether it was aware of the use of XMCC to supply items for the Bytel project and what steps it took to ensure that such an arrangement was properly scrutinised and managed. DETI told us that in order to meet N+2 deadlines and avoid the project being abandoned, the Nortel equipment which was originally to be introduced to the project as a benefit-in-kind was brought into the project as capital equipment against which grant could be claimed. XMCC invoiced Bytel Networks Ltd for the supply of the equipment. DETI also stated that the JIAs grant-aided Bytel Networks Ltd for the equipment in good faith and there was no indication at the time that the equipment was not going to be used in the project. In our view, DETI and DCENR should have sought an independent valuation of the equipment in these circumstances.	There is no satisfactory explanation as to why items were procured through XMCC. The use of a related company to supply goods and services was not subject to an effective challenge by DETI. The claim was paid solely on the basis of invoices from XMCC and without any third party evidence to demonstrate the source and acquisition cost of the equipment.

The Nortel equipment was never used in the project	The requirement for the Nortel equipment had been identified as part of Bytel's proposed arrangement with Aurora. However, Aurora's withdrawal from the project in December 2004 and Bytel's signing of agreements with Eircom in September 2005 significantly changed the project's technical specification. As a result, the Nortel equipment was not required and was not used in the completed project.	The project should have been re-appraised following Aurora's withdrawal and the offer of assistance revised (paragraph 2.24). This would likely have highlighted the change in project costs and funding and the fact that the grant-aided Nortel racks were not used in the project.

Source: NIAO

3.9 The review of the project by Consultants A in March 2012 concluded that all of the expenditure claimed for in the first grant claim was ineligible for Interreg support. This was due to the use of XMCC to provide goods and services, the acquisition of items before the Letter of Offer was issued, lack of evidence of proper tendering and procurement and the absence of evidence to support the purchase and valuation of items claimed for (**Appendix 3**).

3.10 With regard to the Nortel equipment, we are concerned at the failure to:

- seek and obtain the necessary approval to ensure that equipment was eligible for assistance before paying grant;
- obtain sufficiently reliable and independent evidence of the actual value of equipment;
- challenge the use of a Bytel-owned company to supply the equipment and obtain the original supplier's invoice;
- ensure that the Letter of Offer was revised when the delivery partner and technical specification changed significantly; and
- re-coup grant when it became clear that the equipment would not be used within the project.

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3.11 We also consider that stronger scrutiny and challenge should have been exercised over the other items within the claim, particularly where there was no evidence of tendering or that third party suppliers were paid for goods and services.

3.12 The JIAs' management agent, Western Connect, checked the first two Bytel grant claims. DETI told us that, at the time of checking the claims, the JIAs had no concerns about the quality of service provided by the management agent. However, in our view, the issues identified subsequently with this claim indicate that the quality of checking carried out was inadequate. Western Connect's role as management agent ceased in October 2005, when EU funding for technical assistance was exhausted.

Grant Claim 2 (€375,050 – September 2005)

3.13 Some €322,464 (86 per cent) of the second grant claim related to payments to contractors for laying ducts and fibres on the broadband network.

3.14 Consultants A identified some issues around the eligibility of relatively small amounts for grant payment but deemed €368,420 (98 per cent) of grant paid to be eligible for Interreg support (**Appendix 3**).

Grant Claim 3 (€250,189 – October 2005)

3.15 Almost all (€238,591 or 95 per cent) of the third grant claim related to payments to a contractor for laying ducts.

3.16 Consultants A concluded that €243,018 (97 per cent) of grant paid in this claim was for ineligible expenditure (**Appendix 3**). Most significantly, a claim for payment of €238,591 for cabling work undertaken in Londonderry was deemed to be outside the scope of the original project.

Grant Claim 4 (€2,074,864 – November 2005)

3.17 The final grant claim related to a benefit-in-kind[9] to the project related to ducting, fibre connections and the provision of internet points of presence at ten locations on a 120km route between Belfast and Dublin. Bytel valued this at €17.8 million. The company claimed, and was paid, €2.07 million grant in respect of this. The grant paid was effectively the balancing figure required to draw down the total €4.3 million grant approved for the original project.

3.18 The claim consisted of a one-page statement which contained only a high level valuation of the benefit-in-kind (**Appendix 4**)[10]:

- provision of 120km ducting and sub-ducting from Belfast to Dublin (€16 million);

9 An EU Regulation introduced in 2004 states that in-kind contributions are eligible expenditure for EU assistance, provided that they consist of the provision of land or real estate, equipment or materials, research or professional activity or unpaid voluntary work.

10 As part of the fourth grant claim, Bytel stated that it had included a map of the network duct route as supporting documentation. DETI told us that it was unable to locate a copy of this map.

- continuous fibre connection along the route (€1 million); and
- internet points of presence at ten locations (€0.8 million).

3.19 The reviews by both Consultants A and Consultants B expressed significant concerns over the valuation, existence, ownership and completion of the assets and infrastructure which formed the basis of the claimed benefit-in-kind (**Figure 4**).

Figure 4: Summary of conclusions by Consultants A and Consultants B on the final grant claim

Issue	Concerns
Valuation	The €17.8 million valuation for 120km of ducting was far in excess of the costs outlined within the project application, economic appraisal and Letter of Offer, which amounted to €7.8 million for 195km of ducting. Previous claims had related to project infrastructure but the final claim sought payment for a service (Eircom bandwidth) which was not provided for under the terms of the Letter of Offer.
Existence and Ownership	There were no third party invoices to support claims for civil engineering works. There was no evidence that Bytel had carried out these works, with the possible exception of some work in or around Belfast and Armagh. Rather than creating the infrastructure, Bytel had seemingly entered into agreements with infrastructure owners to gain access to existing assets. However, the grant claim submitted by Bytel was based on the cost of creating broadband capacity, rather than the leasing costs actually incurred.
Completion	The project was incomplete at the time when the final grant claim was submitted and a dedicated link between Dublin and Dundalk was not in place until some months later. Despite this, Bytel claimed, and was paid, grant for contributing points of presence at these locations.

Source: Consultants A and Consultants B

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3.20 The €17.8 million benefit-in-kind within the final grant claim effectively represented Bytel's valuation of the broadband network provided, rather than the actual costs incurred in delivering it. Consultants A concluded that Bytel's calculation of the benefit-in-kind was "*incorrect and illogical*" and found no evidence to support the values attributed to it. Consequently, the consultants deemed that all €2.07 million grant paid in the final claim was ineligible.

3.21 The final claim was based solely on the balance of grant remaining and was intended to draw down the maximum €4.3 million grant approved at the outset of the project. We agree with Consultants A that the decision to approve payment of over €2 million grant on the basis of a single page of documentation, which contained only a high-level breakdown of the benefit-in-kind, was inexplicable. Specifically, the JIAs did not:

- challenge the paucity of documentation provided for such a large claim or seek appropriate evidence of what was actually delivered and the actual costs incurred; and
- question how Bytel, with its modest financial turnover and poor trading performance, would have the resources to contribute a €17.8 million benefit-in-kind to the project.

3.22 Western Connect reported to the JIAs in October 2005 that the final claim would complete drawdown of the remaining Interreg grant. The JIAs were content to pay out the balance of grant at that time and, following the checking of the claim and supporting documentation , payment authorisation forms were signed by both Departments as being correct, eligible and due for payment.

A number of reviews failed to address the concerns with the project

3.23 In addition to grant claims being checked, the project was subject to a number of controls in accordance with EU requirements:

- December 2004 – an SEUPB certification spot check to ensure that there was adequate documentation to support payments made;
- February 2005 – an Article 4 review (see glossary) was undertaken by DETI's management agent. Further Article 4 reviews were undertaken by DETI in March and July 2007; and
- June 2006 – an Article 10 review (see glossary) was completed by external consultants to check the effectiveness of management and control systems and compliance with EU Regulations.

3.24 These reviews offered further opportunities to identify and address any underlying concerns with the project at a relatively early stage. However, only the Article 10 review identified issues associated with the changes in the project structure and partnerships and the absence of procurement documentation for items which had been claimed for.

3.25 Whilst the Article 10 review had raised queries over the procurement of the Nortel equipment, it had ultimately placed assurance on the valuation provided within the economic appraisal. The consultants who undertook the review told us that they had received assurance from Western Connect that a public procurement process was not followed for the purchase of the Nortel racks because the single supplier arrangement in place had been approved by both it and DETI.

3.26 The Article 10 review also concluded that there was a need for formal written approval for the changes in the project structure which had been brought about due to Aurora's withdrawal. However, Consultants A concluded that SEUPB, which was responsible for following up on the implementation of Article 10 recommendations, had accepted an assurance from DETI that a new Letter of Offer for the project was not required as *"there was no change to the funding package"*.

3.27 In our view, this assurance was incorrect given the substantial implications for funding resulting from the changes in the delivery partner and technical specification of the project. We consider that SEUPB should have sought a more detailed breakdown of the cost structure of the revised project to help it determine whether the Article 10 recommendations had been properly addressed and whether the offer of assistance should be revised.

There are fundamental lessons to be learned from the checking of the grant claims

3.28 There are a number of key lessons to be learned from the checking of the grant claims.

Recommendation 2

In checking and authorising grant claims for payment, public bodies must apply a high level of diligence and challenge over key risk areas. In particular, public bodies should review their guidelines and processes for checking grant claims to ensure that:

- risks and pressures created by deadlines for payment of grants are effectively managed. Where feasible, public bodies should seek to ensure that grant claims are not submitted very close to deadlines and that proper checking of claims is carried out;
- appropriate evidence is retained of the physical inspection of significant assets on which grant is claimed;
- clear guidance is provided on the circumstances in which the use of a related company is permissible and what steps should be taken to manage this, including the need for reliable evidence for the value

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of goods and services provided by related companies; and

- guidance is clear on the evidence required to validate the existence, ownership and valuation of benefits-in-kind before claims are authorised for payment.

In addition to ensuring that the best practice for reviewing and checking grant claims is clearly set out in relevant guidance and procedures, it is important that funding bodies ensure that staff managing grant programmes comply with the required standards.

Part Four:
The investigations of the Bytel project

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The investigations of the Bytel project

4.1 This part of the report reviews the investigations undertaken in response to allegations about the Bytel project.

DETI did not carry out a meaningful investigation of allegations received in 2006

4.2 During 2006 a dispute arose between two directors of Bytel. In June 2006, one of the directors contacted DETI with a number of allegations about the operation of the company and the delivery of the extreme broadband project. The director alleged that:

- there were anomalies in the accounts of Bytel and its related company, XMCC;
- XMCC had ordered supplies on Bytel's behalf;
- Bytel directors had withdrawn funds from both companies which should have been ring-fenced for the Interreg project; and
- in claiming grant, the project promoters had stated that value was delivered from assets which were not owned by Bytel.

4.3 DETI Telecommunications Branch carried out an investigation of the allegations in July 2006. The investigation concluded that all claims submitted by Bytel were in respect of expenditure incurred and that the claims had been supported by the correct invoices and bank statements. The investigation also concluded that claims submitted were for products and services which were eligible for Interreg support.

4.4 The forensic review of the Bytel project by Consultants A concluded that DETI's 2006 investigation and its conclusions were seriously flawed. The consultants considered that the assertions from the 2006 investigation, particularly in relation to the final grant claim in which over €2 million was paid on the basis of a single page of supporting documentation, were completely at odds with the reality of the situation. The consultants also concluded that the review was not sufficiently independent and should not have been undertaken by Telecommunications Branch, as it was responsible for the project's oversight and the authorisation of grant payments.

4.5 We endorse this view. The investigation did not adequately address the wider allegations relating to anomalies in Bytel accounts and the alleged withdrawal by Bytel directors of Interreg grant from company funds, and its findings were not supported by adequate evidence and supporting documentation.

4.6 Subsequent reviews of the project identified significant concerns over the grant claims, including the procurement of goods from a Bytel-related company, non-compliance with relevant tendering requirements, absence of third party invoices for goods and services procured and the paucity of documentation to support the final grant claim. It is difficult to see how the DETI investigation in 2006 could have concluded that there were no matters of concern.

4.7 Senior management in DETI were alerted to the 2006 allegations. However, they relied on the assurances provided by Telecommunications Branch and no further investigations were initiated at that stage. In our view, the allegations were sufficiently serious to have warranted a much more rigorous and independent investigation than was actually undertaken. A detailed independent review at this stage would have highlighted serious concerns and the need for a comprehensive forensic investigation. Instead, the investigation which followed was unduly protracted.

Serious allegations were made by a whistleblower in 2008

4.8 In June 2008, two years after the Bytel director had reported concerns to DETI, the NIAO received allegations from a whistleblower about an unnamed DETI-sponsored project which was funded by Interreg (**Figure 5**). NIAO referred the allegations to DETI for investigation. Neither SEUPB nor its sponsor departments in Northern Ireland and Ireland were made aware of the whistleblower allegations at this time. DCENR also told us that it was not informed of the allegations.

4.9 In September 2008, the whistleblower provided further information to the NIAO that the companies involved were:

- Bytel Ltd;
- Bytel Networks Ltd; and
- XMCC – a company registered at the same address as Bytel Ltd and owned and controlled by the Bytel Ltd Chairman.

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The investigations of the Bytel project

Figure 5: Summary of 2008 whistleblower allegations

In 2004, Bytel Ltd had turnover of £0.5 million to £1 million, and a declared annual profit of £30,000. This company, which was totally owned by one person (Director A), had applied to deliver an Interreg project which offered the opportunity to claim a "multi-million € grant".

Bytel Networks Ltd was set up to deliver the project, with shares issued on the basis that 40 per cent belonged to Bytel Ltd, 20 per cent to Director A, 20 per cent to Director B (who became Managing Director of Bytel Networks Ltd) and 20 per cent equally among four minority shareholders.

Bytel Networks Ltd submitted a formal proposal to DETI to deliver the Interreg project. Although neither Bytel company had any funds, Director A and Director B each gave personal sureties of £250,000. Bytel Networks Ltd was awarded the project.

XMCC (a dormant business owned by Director A) was re-activated, with Director B given a 50 per cent shareholding. The proposal for the Interreg project being delivered by Bytel Networks Ltd involved using equipment which, in its prime, would have been very expensive. XMCC acquired this for "*tens of thousands of euros*", and then sold it to Bytel Networks Ltd for over €1 million. Assets from Bytel Ltd were also sold to Bytel Networks Ltd via XMCC, but Bytel Ltd continued to use these. These assets and equipment formed part of the first Interreg grant claim.

Interreg grant of over £1 million was paid to Bytel Networks Ltd but was immediately transferred to XMCC and Director A and Director B both took an initial payment of €100,000 each from this. XMCC then loaned Bytel Networks Ltd €500,000 to complete work on the project which allowed payment of further grant. XMCC never traded with any company other than Bytel Networks Ltd.

Source: NIAO

4.10 The whistleblower alleged that Bytel Networks Ltd had purchased various items of equipment from XMCC for €1.6 million in November 2004, including the Nortel racks for €1.3 million. However, the whistleblower stated that XMCC had acquired this equipment, which was virtually obsolete, for €30,000. XMCC inflated the true value of this equipment so that Bytel Networks Ltd could claim €1.3 million grant from DETI.

Initial reviews of allegations identified issues of concern

4.11 In January 2009, DETI's Internal Audit completed an initial review of the allegations. Internal Audit identified concerns over the sourcing and valuation of equipment and assets, the checking of grant claims and possible non-compliance with Interreg grant requirements. A key finding from the review was that grant of €2.07 million was paid on the final claim on the basis of a single page of supporting documentation which provided no evidence of expenditure incurred by Bytel to deliver the project. In our view, Internal Audit identified the main issues of concern associated with the management of the project.

4.12 In March 2009, Internal Audit commissioned Consultants A to undertake further investigatory work. The consultants were asked to:

- review background papers;
- visit Bytel to vouch documentation in support of claimed expenditure;
- verify the delivery of products and services and confirm that funded assets had been used for the purposes intended;
- verify the relevance and accuracy of expenditure incurred to the project; and
- assess compliance with the Letter of Offer and EU Regulations.

4.13 This work was completed in September 2009 and confirmed cause for concern around the project. In particular, the draft report prepared by the consultants highlighted:

- the use of invoices from a related company (XMCC) to claim grant funding, with no confirmation of the actual expenditure to the third party suppliers of the equipment;
- the ineligibility of grant claims related to hardware, including the Nortel racks, and ducting work in Londonderry;
- a paucity of documentation to support the final grant claim and valuation of equipment claimed; and
- whether it was appropriate to claim grant for a benefit-in-kind.

4.14 The consultants concluded that there were significant issues arising in relation to the eligibility of the expenditure claimed and therefore in relation to the efficacy of the Department's oversight and monitoring role. The consultants considered that the Department would, more likely than not, be required to declare an irregularity in relation to the project. However, they also highlighted that the quantum of any irregularity, and the potential for recouping grant from Bytel would require a more detailed understanding of correspondence between the project's key stakeholders, and of Bytel's financial status.

Further substantive investigation of the project was not commissioned until 2011

4.15 In September 2009, Internal Audit told the consultants that it would refer the findings to DETI senior management. Internal Audit also held further discussions with the consultants in 2010

Part Four:
The investigations of the Bytel project

about the potential to commence a further detailed PACE investigation[11] of the issues around Bytel. However, this further investigation did not commence. In February 2011, DETI notified SEUPB of the consultants' draft report. SEUPB immediately notified all relevant accounting officers of the irregularity and established a Project Board comprising all stakeholders. SEUPB also commissioned a forensic review of the project by Consultants A.

DETI did not disclose serious concerns about the project to SEUPB and DCENR nor declare an irregularity in a timely manner

4.16 SEUPB guidance issued in 2003 sets out the action to be taken in response to the identification, recording, reporting and investigation of irregularities[12] involving EU Structural Funds. This guidance placed responsibility on Implementing Agents to notify SEUPB of irregularities. In cases where irregularities give rise to grave concern over the use of public monies, the guidance required SEUPB and accountable departments to be notified immediately.

4.17 In our view, from at least 2008 there were clear concerns over the grants that had been paid to the Bytel project. However, DETI did not notify SEUPB or DCENR of the serious concerns in a timely manner. It was also slow to formally declare a potential irregularity on the project and report the full details of this to SEUPB.

4.18 In 2006, DETI had informed SEUPB of the allegations made by a company director about the project. However, it also told SEUPB that its review of these allegations had found that all grant payments were in order and these had been made in respect of expenditure already incurred and which was supported by receipts and bank statements. In our view, these assurances did not reflect the facts of the case.

4.19 DETI discussed the allegations and the investigation of the irregularity with SEUPB in June 2010. However, it did not notify SEUPB of the 2008 whistleblower allegations or the findings of the draft report prepared by the consultants, until February 2011. This was at odds with DETI's responsibilities under its SLA with SEUPB, which required it to submit to SEUPB any audit report in relation to programme expenditure. DETI has attributed these delays to staffing issues within the Department at that time. In our view, the failure to share crucial information about the Bytel project with SEUPB in a timely manner prevented a timely investigation of the project.

4.20 In May 2010, DETI submitted a Structural Funds Irregularity Report, the first notification to SEUPB of any concerns about the project. This stated that €4.3 million of Bytel grant "*may be ineligible*" and referred to "*a potential irregularity*". The report did not provide any substantive information or conclusions on the nature of the irregularity. DETI told us that this

11 An investigation which would comply with the requirements of the Police and Criminal Evidence (Northern Ireland) Order 1989.

12 Interreg guidance states that an irregularity within the programme includes any administrative or financial mismanagement that comes about either by act or omission whether or not there is an actual loss of funds.

was attributable to the fact that the consultants' September 2009 report had concluded that further work was required to assess the extent and nature of the irregularity.

4.21 After receiving the Irregularity Report, SEUPB requested more details from DETI throughout the second half of 2010 but obtained no further information. In September 2010, DETI Internal Audit confirmed the potential irregularity to SEUPB but no details were disclosed. DCENR was not informed of the potential irregularity until December 2010.

4.22 In September 2010, Internal Audit provided an unqualified audit opinion for the Interreg programme which included the Bytel project. Given the very serious concerns which were apparent with the project at that time, we asked DETI for the basis on which Internal Audit had formed this view. DETI's Internal Audit had carried out tests on the reconciliation of expenditure to accounting records, the performance of control checks and declaration of irregularities. As a result of these tests, Internal Audit determined that it was appropriate to provide an unqualified opinion but also to specifically highlight the Bytel project in its overall conclusion. This noted that the potential irregularity of €4.3 million remained open pending the outcome of an investigation of the eligibility of programme expenditure.

4.23 SEUPB wrote to DETI in December 2010 requesting clarification and further information and, in February 2011, DETI provided SEUPB with a detailed description of the nature of the irregularity and the findings of the consultants' review. Subsequently, SEUPB, with the approval of other key stakeholders[13] commissioned the comprehensive forensic review of the project by Consultants A.

Opportunities to identify and address problems with the project were missed

4.24 We are concerned at the length of time taken to raise an irregularity and to commence a full investigation into the project, given the serious nature of the allegations made. The investigatory process was unacceptably protracted and a number of opportunities were missed to initiate decisive action much earlier than February 2011. As early as 2006, concerns were raised about the project. In January 2009, Internal Audit had identified sufficient concerns to warrant a detailed investigation and this was underpinned by the initial report by Consultants A in September 2009.

4.25 DETI told us that it has learned a number of important lessons from the investigation process. These include:

- the need for specialist advice to assist significant investigations, particularly where these are technical in nature;

13 Stakeholders included DETI, DCENR, DFP, DoF, NIAO and the Central Investigations Unit of DARD (a unit which provides advice to SEUPB in cases of suspected fraud).

Part Four:
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- a requirement for regular structured reporting to an oversight forum to oversee progress in significant investigations, with regular meetings scheduled and minuted;
- the need to consult public sector counter-fraud specialists at an early stage in an investigatory process; and
- the need for qualified external technical assistance in the appraisal, implementation, mid-term and post-project evaluation stages of complex projects. The Department noted that the technical review it commissioned in 2012 was key to establishing the facts around the project.

Recommendation 3

Policies on investigation of whistleblower allegations should be reviewed to ensure that guidance reflects best practice and is being applied appropriately. In particular, those charged with handling whistleblower allegations should ensure that all relevant stakeholders are informed at the earliest opportunity. Where allegations are of a serious nature and involve suspected misuse of public money, a properly resourced forensic investigation should be undertaken at the earliest possible stage.

Part Five:
Value for money

Part Five:
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5.1 In this part of the report, we assess whether the Bytel project achieved its objectives and delivered value for money.

The initial post-project evaluation was very limited and did not assess key aspects of the project

5.2 A post-project evaluation of the Bytel project was completed for the Joint Implementing Agents (JIAs) in December 2007. This reported positively in respect of some project outcomes, such as the installation and integrity of the network, the functionality of network points of presence and the economic benefits accruing from the project.

5.3 The evaluation comprised two parts - a technology assessment and a commercial impact assessment. The technology assessment took the form of site inspections at the Bytel sites and the commercial impact assessment was based on an interview with Bytel. Overall, the evaluation provided only a limited assessment of the project.

5.4 Consultants A's review of the post-project evaluation concluded that it did not comply with Green Book[14] standards and exhibited some basic weaknesses. For example, it:

- provided only a vague analysis of the project's economic impact which was based on discussions with Bytel staff; and
- did not consider actual costs incurred against planned costs, nor conclude on the degree to which individual project objectives in the Letter of Offer were achieved.

5.5 The limitations of the post-project evaluation were acknowledged by the senior consultant responsible for undertaking it, indicating to Consultants A that it had been "*a very light review*". The consultants who undertook the evaluation told us that it considered that it had been completed in accordance with the scope of services required by the JIAs who had not raised any concerns about the appraisal at the time. In our view, the JIAs should not have accepted such an incomplete evaluation and should have challenged its basic weaknesses.

A technical review concluded that the project achieved all its stated objectives and helped improve broadband infrastructure in Northern Ireland and the Republic of Ireland

5.6 In view of the significant concerns which had emerged over the course of the project, DETI commissioned Consultants B in December 2012 to carry out a technical review, to consider the outcomes achieved by the project and identify the associated costs incurred by Bytel in delivering it. The consultants concluded that all seven objectives for the project included in the Letter of Offer were achieved (**Figure 6**).

14 The Northern Ireland Practical Guide to the Green Book is the relevant Department for Finance and Personnel guidance for Northern Ireland Central Government bodies undertaking Post-Project Evaluations.

Figure 6: Summary of achievement of project objectives

Project objectives	Was the objective achieved?
• To provide extreme broadband connectivity linking Belfast, Craigavon, Armagh, Dundalk and Drogheda.	Yes
• To provide local access in the border counties to extreme broadband services by the use of flexible break out points from the network.	Yes
• To provide business, education and research and development users with extreme broadband services to pursue complex applications which would not otherwise be feasible.	Yes
• To create a platform for more competition and lead to more uniformity of bandwidth service charging throughout Ireland.	Yes
• To provide an independent locally-owned all Ireland fibre network which will enable connectivity by cross border county businesses to European and global networks.	Yes
• To create a multi-fibre network which will allow users, both individual and businesses, choice in their bandwidth supplier and expand the potential range of applications due to extreme broadband services.	Yes
• To contribute towards stimulating demand for broadband by businesses in the area, contributing to the competitiveness of those businesses and the regional economy as a whole.	Yes

Source: Consultants B

5.7 The Letter of Offer also set out seven specific outcomes which were anticipated from the project (**Appendix 5**). Consultants B concluded that all of these had been achieved to some degree, with particularly strong outcomes delivered in some aspects:

- all areas covered within the completed Bytel network, including the cross-border region, had been provided with a competitive pricing structure for broadband services;
- internet service providers had been incentivised to operate in the border area; and
- the improvement of internet connectivity in the border counties had made a substantial improvement to removing the perceived artificial telecommunications barrier which existed in broadband services prior to 2006.

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5.8 In addition to the objectives and outcomes set out in the Letter of Offer, Consultants B considered that the completed Bytel network delivered a number of additional benefits. These largely centred around the Eircom agreement having provided access to the strategically important Saturn Ring network in Northern Ireland which, in the mid-2000s, had largely fallen dormant.

5.9 Whilst the proposed Aurora agreement would only have provided connectivity to the east coast of Ireland, the use of the Saturn Ring network facilitated access to the north-west. This resulted in additional network points of presence in Omagh and Londonderry which were not envisaged within the application or Letter of Offer, and the resilience of the network in the Republic of Ireland being improved through connections at Bridgend and Letterkenny.

5.10 Consultants B also concluded that the re-opening of the Saturn Ring network acted as a catalyst for other benefits to the local digital telecommunications industry which materialised subsequently. For example:

- it was pivotal in ensuring that Eircom re-entered the Northern Ireland telecommunications market, thereby improving competition; and
- it facilitated the completion of important downstream telecommunications projects - in September 2009, the sale of Bytel assets to Hibernia Atlantic ensured that Project Kelvin[15] could be completed. As well as extending the network from Armagh to Omagh, Londonderry and Letterkenny, Project Kelvin provided connectivity from the North Atlantic to the north of Coleraine, onward to Southport and back to Dublin through submarine links (**Appendix 6**).

5.11 The evidence provided by Consultants B suggests that the completed Bytel project delivered a number of important benefits and made an important contribution to the development of broadband infrastructure in both Northern Ireland and the Republic of Ireland. However, this in itself does not provide assurance that the project delivered value for money.

The original project was significantly over-specified

5.12 The economic appraisal and Letter of Offer for the project identified total project costs of €12.4 million. However, the technical assessment undertaken by Consultants B concluded that this was €5.36 million higher than required to deliver the project's stated objectives. The consultants found that the cabling costs set out in the economic appraisal were very high (€7.8 million) and estimated the cost of the cabling required at only €1.95 million.

5.13 The consultants also estimated that the cost of the actual network delivered

15 Project Kelvin involved the provision of a submarine connection from a transatlantic cable into Northern Ireland. It also created a 'terrestrial' network around Northern Ireland, and into the Republic of Ireland covering a range of towns including Armagh, Dundalk and Drogheda. Total project costs amounted to €29.6 million, €22.2 million of which was met through ERDF funding.

by Bytel was €3.93 million. Eircom also paid Bytel €3 million for work undertaken on Eircom's Saturn Ring network. We consider that this illustrates that the original project, with total costs of €12.4 million, was significantly over-specified. The subsequent delivery of a project for a fraction of these costs raises questions over the technical assessment and estimate of costs for the original project.

5.14 In our view, a more robust and effective technical assessment as part of the appraisal of the original project should have identified the scope for delivery at significantly lower costs with a proportionately lower level of grant required.

The failure to re-appraise the project resulted in grant being significantly overpaid

5.15 Bytel claimed, and was paid, the full €4.3 million grant approved for the original proposed €12.4 million project. However, Consultants B estimated that it only incurred total expenditure of €3.93 million to deliver the revised project. This sum included €3 million paid by Bytel to Eircom for the lease of bandwidth.

5.16 The agreements between Bytel and Eircom required Bytel to complete fibre cabling work on Eircom's Saturn Ring network. Eircom paid Bytel €3 million for this work.

5.17 The Letter of Offer for the project stipulated that grant was only to be provided in respect of actual eligible costs. If the JIAs had applied this condition, the amount of grant to be paid to Bytel would have been considerably less than the €4.3 million actually released.

5.18 Under the terms of the Letter of Offer, the €3 million paid to Eircom was ineligible for Interreg funding as it did not relate to the original project. Had the project been re-appraised when its technical specification changed and the expenditure under the Eircom agreements been classified as eligible, the maximum grant payable would have been €1.38 million (based on 35 per cent of €3.93 million total costs incurred, but excluding any benefit-in-kind). This is €2.92 million less than was actually paid (**Figure 7**).

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Figure 7: Summary of Estimated Project Costs and Grant payable to the Bytel project

	Cost € million	Maximum grant rate as % of costs	Maximum grant € million	Excess grant paid € million
Original Project Definition (including benefit-in-kind of €7.8 million)	12.4 (estimated)	35%	4.3	–
Delivered Project (including payment to Eircom and excluding benefit-in-kind)	3.93	35%	1.38	2.92 (4.30 less 1.38)

Source: NIAO

DETI and DCENR incurred substantial costs and losses

5.19 In February 2011 a meeting of key stakeholders[16] agreed that a full forensic investigation was required to address the outstanding issues with the project. SEUPB commissioned Consultants A in April 2011 to review all aspects of the irregularity.

5.20 The consultants' report was completed in March 2012. As a result of the findings (**Appendix 7**), the project board confirmed that all expenditure on the Bytel project should be declared irregular and that the project be withdrawn from the Interreg programme. This meant that DETI had to fund €2 million in assistance paid to the project with DCENR funding the balance of €2.3 million. It also helped ensure that there was no duplication of EU funding in respect of Bytel and Project Kelvin[17].

5.21 The final deadline for expenditure to be committed to the Interreg III programme was June 2009 (extended by the EC from December 2008). Had the decision to withdraw Bytel from the programme been taken at an earlier stage, there may have been an opportunity to seek mitigating actions that could have resulted in some or all of the Interreg funding being utilised in other projects. This could have ensured that both Northern Ireland and the Republic of Ireland utilised their full entitlement to Interreg funding. DETI and SEUPB told us that, in practice, this would have been challenging, given the long development and implementation timeframes associated with Interreg programmes. However, the withdrawal of the project after this deadline meant that SEUPB was unable to consider the re-allocation of Interreg grant of €2.03 million in respect of DETI (€1.76 million in respect of DCENR was also foregone). This EU funding was lost to both member states.

16 As well as SEUPB, the other stakeholders included DETI, DCENR, DFP, DoF, NIAO, SEUPB Internal Audit and a representative from the Central Investigations Unit of DARD (a unit which provides advice to SEUPB in cases of suspected fraud).

17 In 2009, Bytel sold assets to Hibernia Atlantic which helped facilitate the completion of Project Kelvin (another Interreg supported project). In January 2010, the European Court of Auditors identified potential concerns that the Bytel assets sold to Hibernia may have been grant-aided twice by Interreg.

5.22 Despite the serious allegations and concerns raised about the project in both 2006 and 2008, an appropriately detailed and probing investigation into Bytel was not completed until March 2012. DETI told us that it is by no means certain that an earlier investigation would have progressed quickly enough to a point whereby a decision could have been made to withdraw Bytel from the programme within sufficient time to identify a replacement project. In our view, an earlier investigation would have alerted the JIAs and SEUPB to the project irregularities. It is likely that this would have resulted in the project being withdrawn from the Interreg programme much sooner and that available EU funding could then have been re-directed to other projects.

5.23 In our view, the payment of the full €4.3 million assistance by DETI and DCENR and the loss of a further potential €3.79 million EU funding represented a disappointing outcome. While the project delivered significant benefits to the broadband infrastructure in Northern Ireland and the Republic of Ireland, the maximum grant payable should have been restricted to €1.38 million (**Figure 7**).

5.24 Under the terms of the Letter of Offer, if the grant-aided assets were sold within four years of the grant being paid, then all grant was to be repaid. The sale of the assets by Bytel to Hibernia Atlantic in September 2009 (paragraph 5.10) should have triggered the clawback of grant. However, the JIAs did not initiate action to recover the grant paid. The review by Consultants A completed in March 2012 could not conclude on whether Bytel had sold grant aided assets and this was only confirmed to have been the case when the technical review was completed by Consultants B in 2013.

5.25 Given the significant overpayment of grant and loss of available EU funding, we conclude that the project provided poor value for money. Had DETI taken decisive steps to investigate the concerns around the project sooner and more robustly and to respond effectively to the findings of reviews, we consider it likely that a much more cost-effective outcome could have been achieved.

5.26 SEUPB told us that, for the 2007-2014 Interreg programme, the system of implementing agents to administer Interreg-funded projects was replaced with a centralised system of project monitoring and verification of expenditure and the use of lead partners for project implementation. Within this process, SEUPB told us that rigorous systems of project monitoring and vouching and verification of expenditure have been established.

DETI has ongoing legal proceedings to recover the €4.3 million grant paid to Bytel

5.27 In view of the concerns identified by its review of the project, DETI Internal Audit sought initial legal advice from the Departmental Solicitors Office (DSO)

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in February 2009 on the potential to clawback grant from Bytel. The DSO advised that a full and independent vouch of project expenditure should be undertaken and, in March 2009, DETI Internal Audit commissioned Consultants A to undertake this review (paragraph 4.12).

5.28 Having assessed the findings of this review, DETI told us that it instructed the DSO to issue a writ against Bytel for the recovery of all €4.3 million grant paid to the project. However, although the consultants' review was completed in September 2009, DETI did not instruct the DSO to issue the writ until November 2010. The writ was served on Bytel in November 2011. DETI told us that it had taken so long to instruct the DSO to issue and serve the writ because the draft report completed in September 2009 had not reached a definitive conclusion on the eligibility of grant. At that time, DETI told us that it intended to engage Consultants A to undertake follow-up work, and that the writ was issued in December 2010 to protect its interests. As the full investigation by Consultants A was still ongoing, and the writ was valid for one year, this was served on Bytel in November 2011.

5.29 DETI did not issue a full Statement of Claim[18] against Bytel until March 2013. DETI told us that preparation of a full Statement of Claim required the completion of the review by Consultants A, and the technical review being undertaken by Consultants B to be progressed to a sufficient extent to inform the claim. To date, Bytel has not responded.

5.30 DETI also told us that it had examined other projects in which Bytel was involved and which were funded by the Intrerreg telecommunications measure. It has identified no concerns.

Shortcomings within the Bytel project mirror those in another DETI-sponsored project

5.31 In May 2012, the Public Accounts Committee (PAC) reported on the reasons for the failure of the Bioscience and Technology Institute (BTI) which received £2.2 million funding from DETI, the Industrial Development Board, the Industrial Technology and Research Unit and the International Fund for Ireland.

5.32 In a number of respects, the shortcomings identified by PAC for BTI are similar to those of the Bytel project (see **Figure 8**):

18 A Statement of Claim is the written statement of a plaintiff, setting out their case, the facts they intend to rely on and the relief they seek, to the defendant.

Figure 8: Comparison of shortcomings identified in the BTI and Bytel projects

BTI	Bytel
Within the BTI appraisal, there was uncertainty around the sources of funding and estimates of project costs.	The Bytel appraisal and project definition contained insufficient evidence to support the valuation of project hardware, software and infrastructure, and there was a lack of clarity over source and ownership of project assets.
BTI was not re-appraised following a significant change to its specification.	The Bytel project was not re-appraised following a significant change in the project's technical specification and costs.
To meet funding deadlines, DETI amended the BTI Letter of Offer to ensure that equipment worth £350,000 was eligible for grant. However, this equipment was never subsequently used in the project.	Grant of €1.3 million was paid for equipment which was not eligible for Interreg support and which was not used in the project.
Project monitoring of BTI by DETI and Invest NI was, in the view of PAC, virtually non-existent.	The standard of project management and oversight by the JIAs of the Bytel project was poor.
There were significant shortcomings with the checking of grant claims. In particular, DETI did not challenge the lack of tendering to procure goods and services and the lack of third party invoices to support claimed expenditure.	The Bytel grant claims were not subject to adequate checking. Key assets were not physically inspected, adequate documentation was not provided to support claims and valuation of equipment provided for the project by a related company was not challenged.

Appendices:

Appendix 1: (paragraph 1.18)

Timeline of main developments with the Bytel project

Date	Development
April 2004	Bytel Ltd submits Interreg IIIA application seeking €5.9m grant against €13.1m total project costs.
June 2004	Assessment panel rejects Bytel project application.
July 2004	Bytel project application re-submitted to assessment panel. Approval for up to €4.5m grant provided. Project approved by the SEUPB Steering Group.
October 2004	Letter of Offer issued for project for total grant of €4.3m (based on €12.4m total project costs).
November 2004 – November 2005	Four grant claims submitted for a total of €4.3m. Grant claims paid in full.
June 2006	Bytel director makes allegations to DETI about the delivery of the Bytel project.
June and September 2008	NIAO receive whistleblower allegations about the Bytel project and refer these to DETI for investigation.
January 2009	Internal Audit review of whistleblower allegations concludes that further investigatory work is required.
March 2009	DETI Internal Audit commission Consultants A to review Bytel grant claims.
September 2009	Consultants A's initial report received by DETI Head of Internal Audit.
May 2010	DETI reports irregularity on Bytel project to SEUPB but provide no substantive detail on this.
November 2010	DETI instructs DSO to issue a writ for €4.3m against Bytel.
December 2010	SEUPB writes to DETI formally requesting details of the Bytel irregularity.
February 2011	DETI advises SEUPB of full details of the irregularity and the existence of Consultants A's initial report. Meeting of representatives (DETI, DCENR, SEUPB, DFP, DARD, DoF - RoI and NIAO) approves commencement of full forensic audit of the Bytel project.
April 2011	Consultants A appointed to undertake forensic review.
August 2011	Consultants A produce an initial draft report detailing findings of forensic review.
November 2011	DETI serves writ for €4.3m on Bytel.
February 2012	Consultants A final draft report.
March 2012	Final report produced by Consultants A. Bytel project withdrawn from the Interreg programme, meaning that all €4.3m assistance provided for the project is met by DETI (€2m) and DCENR (€2.3m).
March 2013	Technical review of Bytel project completed by Consultants B. DETI serves Statement of Claim against Bytel.

Source: NIAO

Appendix 2: (paragraph 3.8 and Figure 3)

Summary of findings on the value of Nortel equipment

Source	Findings
Consultants A	• There were indicators that XMCC made a significant profit on the acquisition cost of the Nortel racks. XMCC's 2005 accounts showed that a considerable surplus which had been made by the company that year was distributed to Bytel shareholders. This would potentially support an allegation made by a whistleblower in 2008 that XMCC acquired the Nortel equipment for €30,000 and sold it to Bytel Networks Ltd for €1.3 million (paragraph 4.10 and Figure 5). • Consultants A sought information from the Bytel chairman on the procurement, ownership and condition of the equipment. The consultants considered that they did not receive satisfactory answers to their questions and indicated that the equipment was effectively useless and required significant restoration work if it was to be used. The consultants concluded that "*there is significant uncertainty over the actual economic value of the Nortel equipment in 2004 and a very strong suggestion that its value was less than €1.3 million*". Based on evidence available, the consultants stated "*it appears that the cash cost of the equipment to the Bytel family of companies was only €30,000*".
Consultants B	• There were serious concerns over the €1.3 million valuation of the equipment and no available third-party invoices to substantiate its true value.
DETI Internal Audit	• XMCC's 2005 accounts indicated that the company may have sold an asset for significantly more than it had cost. • Bytel was unable to produce an original supplier invoice for the equipment.

Source: Consultants A and Consultants B and DETI Internal Audit

Appendix 3: (paragraphs 3.9, 3.14 and 3.16)

Details of expenditure deemed ineligible by Consultants A's review of Bytel grant claims

Note – this analysis does not include the `Nortel racks' (Grant Claim 1), the duct laying undertaken in Londonderry (Grant Claim 3) or the claimed benefit-in-kind (Grant Claim 4) as these have been reviewed in detail in Part 3 of the report.

Grant Claim 1

Type and value (€) of equipment and services claimed for	Reasons for ineligibility
Rent - €38,344	Bytel premises were owned by SDL (another Bytel-related company). Whilst there was written confirmation that SDL received this money from XMCC, there was insufficient detail to verify the calculation and reasonableness of the rental charge.
Air Conditioning - €7,775	This expenditure was incurred prior to the Letter of Offer being issued, and the need for the equipment was not identified in the Letter of Offer. There was also a lack of evidence that the supplier was paid for the work, and that proper tendering procedures were followed.
Cisco Equipment - €193,565	The need for the equipment was not identified in the Project Application, Economic Appraisal or Letter of Offer. There were also concerns that a proper procurement process was not followed, and no evidence that the supplier was paid for it.
Duct Structure - €60,287	The supply of this equipment pre-dated the Letter of Offer, and, again, there was no evidence that the supplier was paid. There was also insufficient detail in the Letter of Offer and Economic Appraisal to confirm that this expenditure related directly to the anticipated capital project costs.

Appendix 3: (continued)

Grant Claim 2

Type and value (€) of equipment and services claimed for	Reasons for ineligibility
Insurance €5,750	The claim submitted for €20,750 was supported by a third party invoice and by a copy bankers draft showing payment had been made to the broker. However, as the Bytel appraisal and Letter of Offer only allowed insurance costs of €15,000, €5,750 was deemed ineligible.
Power Units €900	The power units were required to power the Nortel racks. As the Nortel equipment was not used in the project, the claim for €900 was deemed ineligible.

Grant Claim 3

Type and value (€) of equipment and services claimed for	Reasons for ineligibility
HP Cabinets €4,427	This equipment was re-invoiced through XMCC. As these cabinets were to be used to house the Cisco equipment (see Grant Claim 1), this expenditure was also deemed ineligible.

Appendix 4: (paragraph 3.18)

Copy of final Bytel grant claim

RE: Bytel Contribution to North South INTERREG Project

Bytel Networks Ltd (BNL) is providing the following asset as a matched contribution to the north south cross border project. The asset specified below is the property of Bytel Networks and will continue to be an integral part of the north south business for the duration specified by INTERREG. It is important to note that the provision of this BNL owned asset is central to our ability to deliver extreme broadband services to the INTERREG region.

The Bytel Networks contribution to the project is as follows:

Description	**Value**
120 KM Duct route from Belfast to Dublin including sub duct	€16,000,000
Continuous fibre connection along the route	€1,000,000
Internet Points of Presence at Benmore (Belfast), NISP (Belfast), Bryson Street, (Belfast), Heron Road (Belfast) Portadown, Dundalk, Drogheda, City West (Dublin), Armagh and Newry	€800,000
Total	***17,800,000***

In total, the value of our contribution is €17,800,000

BNL confirms that the finalized cost model for this project is as follows

Source of Funding	**Value**	**Percentage**
Bytel Contribution	17,800,000	80%
INTERREG Grant	4,300,000	20%
Total	***22,100,000***	***100%***

BNL is happy to have the existence of the duct network audited at any time during the project and we have included a map of the duct route as supporting documentation for the verification of this claim.

Appendix 5: (paragraph 5.7)

Specific outcomes anticipated from the Bytel project which Consultants B considered were achieved

- Provide an all-Ireland flat pricing structure for connectivity based upon €50k per 100mb per annum.
- Reduce the costs for broadband services in border counties as a result of the pricing structure.
- Encourage the emergence of internet service providers in the border area based on the pricing structure above.
- Facilitate Small and Medium Enterprises in the border economy participation in the global economy by providing a `pay as you go' pricing model for start-ups / SMEs.
- Remove the artificial telecommunications barrier in broadband services.
- Provide equal / fair access to extreme broadband services to border communities.
- Encourage cross-border working within and between businesses.

Appendix 6: (paragraph 5.10)

Potential overlap between Bytel and Project Kelvin

1. In September 2009 (almost four years after the final Bytel grant claim was paid), Bytel Networks Ltd completed an Asset Transfer agreement with Hibernia Atlantic UK Limited. The agreement governed the sale of infrastructure assets which included ducts, sub-ducts and tubes and fibres in Belfast, Portadown, Armagh, Monaghan, Omagh, Strabane and Londonderry.

2. This Asset Transfer helped facilitate the completion of Project Kelvin, which was being delivered by Hibernia Atlantic. Project Kelvin involved the provision of a submarine connection from a transatlantic cable into Northern Ireland, together with the creation of a `terrestrial' digital network in Northern Ireland, and the Republic of Ireland, which covered a range of towns including Armagh, Dundalk and Drogheda. Total project costs amounted to €29.6 million, €22.2 million of which was met through ERDF funding.

3. In January 2010, an inspection by the European Court of Auditors (ECA) raised a number of queries relating to the procurement of Project Kelvin. Whilst discussions with SEUPB, DETI and DCENR helped resolve almost all of the substantive issues raised by the ECA, an issue relating to a potential overlap between Bytel and Project Kelvin remained unresolved. Essentially, the ECA were concerned that some of the assets used by Hibernia to complete Project Kelvin had previously received Interreg funding during the Bytel project. This apparent use of EU funding twice for the same assets would have represented a breach of European legislation.

4. As part of its forensic review of the Bytel project, Consultants A examined the available documentation and concluded that on the basis of this documentation alone, it was not possible to determine whether there was any overlap of assets between the two projects. Consultants A indicated that engagement with the relevant asset owners, technical advice and a physical inspection of assets would be necessary to conclude on this matter. However, on the basis of its technical review, Consultants B concluded "*it is our opinion that all of the assets that were built under the Bytel Extreme Broadband Project were later transferred to Hibernia Atlantic under the Asset Transfer agreement*".

5. Ultimately, the withdrawal of the Bytel project from the Interreg III A programme in February 2012 helped ensure that there was no duplication of EU funding in respect of Bytel and Project Kelvin (see paragraph 5.20).

6. Consultants B also examined the financial details of the Hibernia / Bytel Asset Transfer. Whilst estimating that the total costs of all assets transferred was €5.27 million, they noted that the "*consideration*" paid by Hibernia to Bytel for these had only amounted to €1 million, together with any eligible VAT. On the basis of Consultants B analysis, Hibernia had therefore acquired the Bytel assets for around 20 per cent

Appendix 6: (continued)

of the total cost of completing these. Consultants B also estimated that whilst the total cost of the Bytel assets built under the Interreg funded Extreme Broadband Project was €512,118, these assets were sold to Hibernia for €97,000 (around one-fifth of their estimated cost).

Appendix 7: (paragraph 5.20)

Review of eligibility of Bytel grant expenditure by Consultants A

The initial findings of the consultants' review were reported to stakeholders in August 2011. The investigation identified significant shortcomings with the management of the project, which included:

- the failure to define the project properly at the outset;
- the failure to re-appraise the project and issue a new Letter of Offer when the approach to delivering the project changed significantly; and
- authorisation and payment of grant for ineligible expenditure which was attributable to inadequate checking and scrutiny of grant claims by DETI.

Based on a strict interpretation of the conditions of the Letter of Offer and the relevant EU Regulations, the consultants concluded that €4.17 million (97 per cent) of the €4.3 million grant should not have been paid to Bytel. Only €131,457 (3 per cent) of expenditure claimed was deemed eligible for Interreg assistance.

Summary of review of eligibility of Bytel grant expenditure by Consultants A

Grant Claim	Expenditure claimed (€)	Ineligible expenditure (€)	Eligible expenditure (€)
1	1,599,877	1,599,877	0
2	375,070	6,650	368,420
3	250,189	243,018	7,171
4	17,800,000	17,800,000	0
Total	**20,025,136**	**19,649,545**	**375,591**
Grant payable at 35% of eligible expenditure			**131,457**

Source: Consultants A

Annex:

Comptroller and Auditor General Special Report - Management of a Cross-Border Broadband Initiative: the Bytel Project

Comptroller and Auditor General
Special Report

Management of a Cross-Border Broadband Initiative: the Bytel Project

Report number 90 March 2015

Report of the Comptroller and Auditor General

Department of Communications, Energy and Natural Resources

Management of a Cross-Border Broadband Initiative: the Bytel Project

I have, in accordance with the provisions of Section 9 of the Comptroller and Auditor General (Amendment) Act 1993 carried out a review of the management of a cross-border broadband initiative (the Bytel project).

This report was prepared on the basis of information, documentation and explanations obtained from bodies and persons referred to in the report and on work carried out by the Northern Ireland Audit Office. The Department of Communications, Energy and Natural Resources, the Special European Union Programmes Body and the Department of Enterprise, Trade and Investment (Northern Ireland) were asked to review and comment on the draft report. In addition, extracts from the draft report were sent for comment to Bord Gáis Networks. Where appropriate, the comments received were incorporated in the final version of the report.

References to any third parties (named or otherwise) are incidental to the purposes of assessing the performance by the Department of Communications, Energy and Natural Resources of administrative functions. Consequently, the report should not be read as constituting any comment, opinion or judgement by me in respect of any third party.

I hereby submit my report for presentation to Dáil Éireann in accordance with Section 11 of the Act.

Seamus McCarthy
Comptroller and Auditor General
3 March 2015

Contents

Abbreviations

DCENR	Department of Communications, Energy and Natural Resources
DETI	Department of Enterprise, Trade and Investment (Northern Ireland)
ERDF	European Regional Development Fund
EU	European Union
SEUPB	Special European Union Programmes Body

Summary

Summary

The Special European Union Programmes Body (SEUPB) is one of six cross-border bodies set up as part of the Good Friday Agreement. The main role of SEUPB is to manage cross-border European Union (EU) structural funds programmes in the border region of Ireland and in Northern Ireland. SEUPB is audited jointly by the Comptrollers and Auditors General in Ireland and Northern Ireland.

Interreg is an EU programme whose objective is to stimulate co-operation between EU regions through measures carried out on a cross-border basis. It is financed through the European Regional Development Fund (ERDF), with co-financing provided by member states. As the designated managing authority, SEUPB was responsible for the management and delivery of the Interreg III programme in Ireland.

Interreg III ran from 2000 to 2006 and all projects funded under the programme had to be finalised by the end of 2008 (later extended to June 2009). 74% of the Interreg III funding was provided by the EU, with the balance (26%) provided by the two member states (referred to as co-financing). The proportion of co-financing varied for different projects. The co-financing provided by member states is referred to as matching funds.

This report examines a project (the Bytel project) that aimed to provide high-speed broadband connectivity linking Belfast, Craigavon, Armagh, Dundalk and Dublin. It was intended that this project would be funded under Interreg III, but due to an irregularity, it was withdrawn from the programme. The project's withdrawal after the June 2009 deadline for expenditure to be committed to Interreg III meant that the €3.79 million which it was expected would be recovered under the Interreg programme could not be recouped, and could not be replaced by other eligible projects.

The report is the result of a co-ordinated examination between the Office of the Comptroller and Auditor General and the Northern Ireland Audit Office (NIAO).

The Bytel Project

The Bytel project received funding under a specific Interreg III measure that aimed to improve inter-regional economic infrastructure, including broadband communications. SEUPB appointed the Department of Communications, Energy and Natural Resources (DCENR) in Ireland and the Department of Enterprise, Trade and Investment (DETI) in Northern Ireland, as joint implementing agents for that measure.

In October 2004, Bytel Networks Limited (Bytel), a Belfast-based company, was offered funding of €4.3 million for the project against estimated total project costs of €12.4 million – the maximum potential grant funding based on the 35% upper limit grant rate. The grant offered comprised €3.79 million of ERDF funding and €0.51 million in matching funding. €2.27 million was provided by DCENR, including all of the matching funding, and €2.03 million by DETI.

Grants totalling €4.3 million were paid to Bytel between December 2004 and December 2005. However, a consultant's review in 2013 concluded that the cost of delivering the project was considerably lower than €12.4 million, on which the €4.3 million grant was based. The consultant concluded that Bytel had incurred total costs of €3.93 million and on this basis the maximum grant payable would have been just under €1.4 million.

EU funding for Interreg III was recouped through claims for payment from the ERDF. In 2012, the Bytel project was withdrawn from the final payment claim following a detailed review by consultants commissioned by SEUPB who concluded that 97% of the expenditure claimed by Bytel was not eligible for grant aid under the Interreg programme.

The total loss to the Irish Exchequer from the Bytel project is €2.27 million. This comprises €1.76 million in Exchequer funding to Bytel on the understanding that it would be eligible for reclaiming under Interreg III and €0.51 million in matching State funding that was also paid to Bytel.

A forensic review by consultants in 2011 identified serious weaknesses in the management and oversight of the project by the joint implementing agents. However, an evaluation in 2013 found that the project had achieved its objectives.

Roles of joint implementing agents

The two Departments disagree about the responsibilities each had in relation to the project.

Both Departments had equal responsibility for administering the programme under the terms of the service level agreements that each had with SEUPB. However, DCENR has stated that, in practice, either it or DETI took the lead role in the day-to-day handling and processing of payment claims for individual projects, and that the Department exercising the lead role was referred to as the 'lead implementing agent'. DCENR stated that, in its view, DETI was the lead implementing agent for the Bytel project.

DETI, on the other hand, states that the role of lead implementing agent was not defined for Interreg III and that each Department had equal responsibility as joint implementing agents.

While there are indications that an informal arrangement was in place making DETI the lead implementing agent, DCENR had clear responsibilities under its agreement with SEUPB. Controls over project payments were further complicated by the appointment by DETI and DCENR of a managing agent, Western Connect, to provide technical, legal and financial expertise on the appraisal, selection and implementation of the measure.

Project assessment and appraisal

In June 2004, the first proposal submitted by Bytel was rejected for support. A revised application was assessed in July 2004 and narrowly passed the threshold required for funding of projects. There were a number of shortcomings in the appraisal.

- There were weaknesses in the definition of what was to be delivered by Bytel and a lack of clarity over the source and ownership of the assets required to deliver the project.
- There was little evidence in the appraisal to support project costs.
- A partnership between Bytel and a company called Aurora Telecom (Aurora), which the project proposal indicated was to contribute €7.8 million of value to the project, was viewed as critical to the project's success. However, neither of the two Departments appear to have engaged with Aurora to confirm that a partnership existed between it and Bytel.

Change to project specification

Under the terms of the letter of offer from DETI and DCENR, Bytel was required to get approval from the two Departments for any significant project changes.

In December 2004, two months after the Departments issued their letter of offer, Aurora withdrew its offer of support from the project. By this time, €1.6 million had already been paid to Bytel. In September 2005, Bytel entered into an agreement with a company called Eircom UK under which Eircom UK would provide access to its existing infrastructure in Northern Ireland and, in exchange, Bytel would undertake to complete additional fibre cable laying in Northern Ireland.

This agreement changed the nature of the project from building a network on existing cables (infrastructure) to a project where Eircom UK delivered bandwidth (service). The effect of the agreement was also to reduce the total costs of the Bytel project by €4.8 million or 39%. Despite these changes, no review of the project or of the offer of grant support was carried out and no written approval was issued to proceed with the revised project.

Checking and authorising of grant claims

Service level agreements between SEUPB and the two Departments required that grant payments made by SEUPB to the project were based on claims that had been verified by the joint implementing agents and approved by them as eligible expenditure.

Between November 2004 and November 2005, Bytel submitted four grant claims totalling €4.3 million. The final claim — for €2.07 million — contained no back-up or verification evidence. Despite this, the claims were paid in full.

DCENR relied on DETI and on other advisors for assurance that expenditure claimed by the project promoter was valid, and considered that it had no role in this area. The approach taken by DCENR showed a lack of awareness of the risks in circumstances where it was placing reliance on others for assurance about the validity of payments and there was no evidence to show that it had put appropriate controls or checks in place.

Handling of allegations about the Bytel project

In June 2006, a director of Bytel made allegations to DETI regarding false accounting practices and withdrawal of funds which should have been ring fenced for the Bytel project. DETI conducted an internal investigation and concluded that no further action was necessary. However, DETI’s investigation was not sufficiently rigorous and independent and its finding was not supported by adequate evidence or supporting documentation.

DCENR was made aware of the allegations by email from DETI in June 2006 and was encouraged by DETI to attend a meeting with the person who had made the allegations. No representative from DCENR attended the meeting, but it was provided with minutes of the meeting. Internal DCENR documents indicate that it was satisfied that DETI had checked that the Bytel claims were legitimate and that the project would deliver in accordance with the letter of offer.

In 2008, a whistleblower made further allegations about the project to the NIAO, which passed the allegations on to DETI for investigation. DETI commissioned an external review of the project which was completed in September 2009. The consultant found that DETI would probably be required to declare an irregularity to the EU in relation to the project. However, DCENR was only informed of an alleged irregularity in December 2010.

Subsequently, a further review of the project, commissioned by SEUPB on behalf of a committee of representatives of relevant departments, was carried out. The report, in March 2012, found that

- 97% (€4.2 million) of the €4.3 million paid to Bytel should not have been paid as it was based on ineligible expenditure
- the management of the project was inadequate in a number of respects including the authorisation of grant payments against expenditure which was clearly ineligible, or which became ineligible once the project changed or about which serious questions should have been asked
- there had been a failure to properly investigate the 2006 allegations and a failure to act in a timely way on the issues raised by the whistleblower in June 2008.

Communications between the implementing agents

Communications between DCENR and DETI, as joint implementing agents, were carried out on an ad hoc basis. This was inappropriate for an important inter-regional infrastructural project which was in receipt of grants of €4.3 million and for a sub-measure with an €8 million overall spend. The failure to put appropriate communication arrangements in place may have been a contributory factor to the poor sharing of information with DCENR by DETI.

Report

1 Introduction

1.1 The Special European Union Programmes Body (SEUPB) is one of six cross-border bodies set up as part of the Good Friday Agreement. The main role of SEUPB is to manage cross-border European Union (EU) structural funds programmes in the border region of Ireland and in Northern Ireland. SEUPB is audited jointly by the Comptrollers and Auditors General in Ireland and Northern Ireland.

1.2 Interreg is an EU programme whose objective is to stimulate co-operation between EU regions through measures carried out on a cross-border basis. It is financed through the European Regional Development Fund (ERDF), with co-financing provided by member states. As the designated managing authority, SEUPB was responsible for the management and delivery of the Interreg III programme in Ireland.

1.3 Interreg III ran from 2000 to 2006 and all projects funded under the programme had to be finalised by the end of 2008 (later extended to June 2009). Grants were paid to beneficiaries through SEUPB, using advance funding provided by the EU and funds drawn from the relevant government departments in Ireland and Northern Ireland. SEUPB submitted claims for reimbursement of the ERDF element of the funding and, on receipt of payment from the European Commission, SEUPB repaid those amounts to the departments.

1.4 Interreg III included a measure – sub-measure 2.1 C – that aimed to improve inter-regional economic infrastructure, including broadband communications. SEUPB appointed the Department of Communications, Energy and Natural Resources (DCENR)[1] in Ireland and the Department of Enterprise, Trade and Investment (DETI) in Northern Ireland, as joint implementing agents for sub-measure 2.1 C.[2]

1.5 Both DCENR and DETI signed service level agreements with SEUPB. The responsibilities of the two Departments as set out in the service level agreements were identical. DCENR had responsibility for funds payable from its Vote, and from the State's allocation of Interreg III funding, including administering grant applications, authorising grant payments and advancing funds to SEUPB.

1.6 In 2004, a Belfast-based company, Bytel Networks Limited (Bytel), was approved for grants totalling €4.3 million for a proposed project to provide very fast broadband connectivity between Belfast, Craigavon, Armagh, Dundalk and Dublin.[3] The estimated total cost of the project was €12.4 million.

1.7 SEUPB paid Bytel grants totalling €4.3 million between December 2004 and December 2005. DCENR advanced funds of €0.5 million to SEUPB. In addition, €3.8 million was paid from the Interreg III funding allocation – €1.8 million from DCENR's allocation and €2.0 million from DETI's.

1 The Department of Communications, Energy and Natural Resources is the current title of the Department. In 2004, its title was the Department of Communications, Marine and Natural Resources.

2 The operational programme for Interreg III provided that the managing authority could delegate certain functions in relation to management of the programme to implementing bodies, provided that it was assured that sufficient and sound management and financial control systems were in place.

3 Bytel Networks Limited is a limited company within the Bytel group of companies and was established for the purposes of delivering the broadband project.

Allegations about the Bytel Project

1.8 In 2006, a Bytel director raised concerns with DETI in relation to the management of the project. DETI conducted an internal review of the allegations and concluded that no further action was necessary. DCENR was aware that allegations had been made and accepted the findings of the internal review.

1.9 In 2008, the Northern Ireland Audit Office received allegations from a whistleblower about the Bytel project and forwarded these to DETI which commissioned an external review of the project.

1.10 Under the terms of the service level agreement with SEUPB, DETI was obliged to submit a copy of any report commissioned in relation to Interreg programme expenditure, and immediately to notify SEUPB and DCENR of any potential funding irregularities. This did not happen during 2008 or 2009.

1.11 In May 2010, DETI notified SEUPB of a potential irregularity but provided no substantive details. SEUPB informed DCENR of an alleged irregularity by email in December 2010.

1.12 DETI formally notified SEUPB of the alleged irregularity in February 2011. The Chief Executive Officer of SEUPB informed the Accounting Officer of DCENR of the alleged irregularity in February 2011.

Action Taken

1.13 In April 2011, SEUPB commissioned an independent report to review all aspects of the project in terms of appraisal, funding eligibility, implementation, monitoring and post-monitoring procedures.

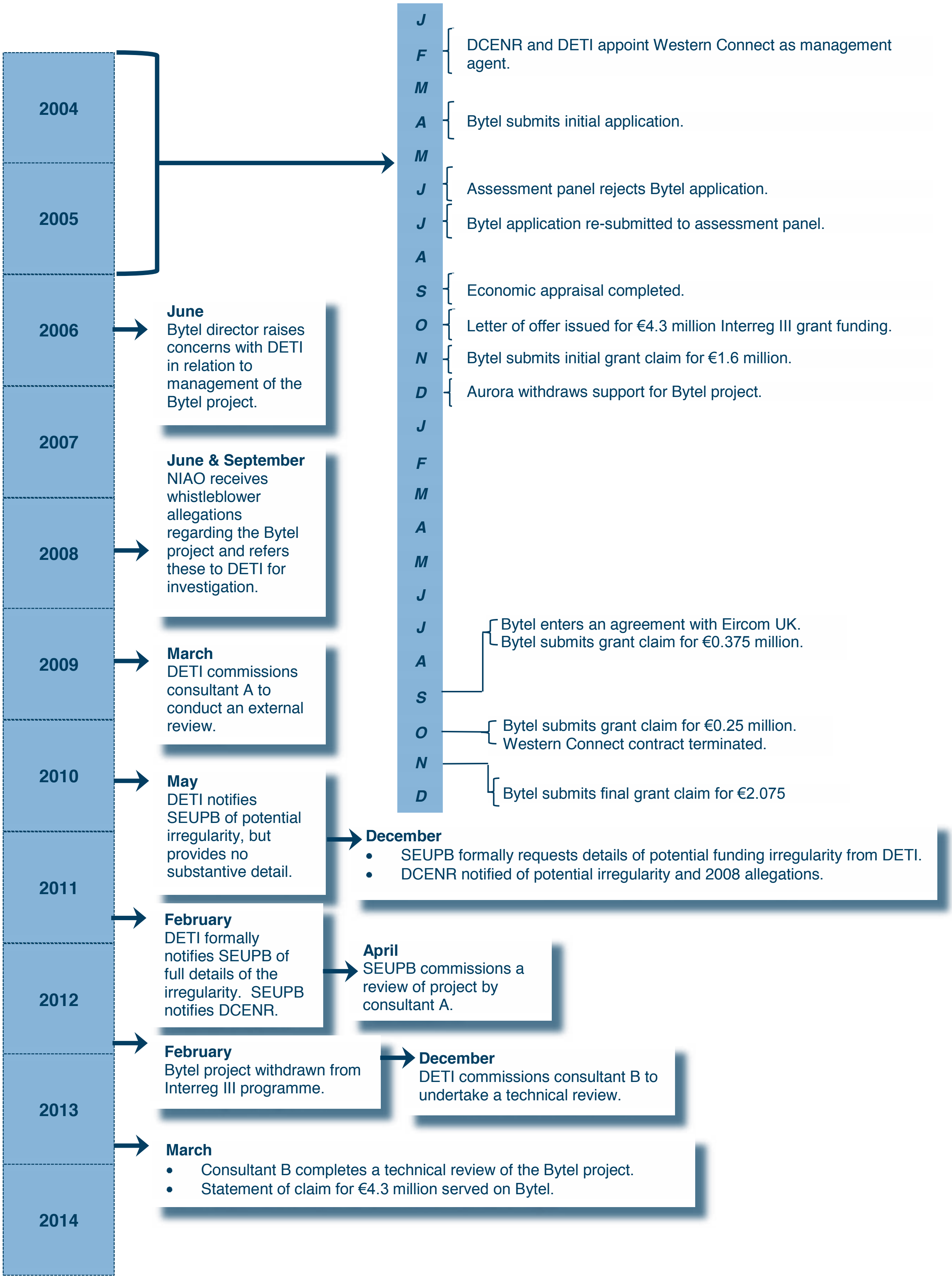
1.14 An interim draft report was completed in August 2011. The report was completed in March 2012. It concluded that 97% of the €4.3 million grant payments to Bytel did not satisfy Interreg III funding eligibility criteria. Based on the findings of the independent report, a decision was taken by the review committee to withdraw the project from the Interreg III claim to the EU.[1] Thus, the expected funding of €3.8 million from the ERDF was, ultimately, not received.

Timeline of Events

1.15 Figure 1.1 presents a timeline summarising the events.

1 Members of the committee included representatives from SEUPB, DCENR, DETI, the Department of Finance and the Department of Finance and Personnel.

Figure 1.1 Timeline of key events in the Bytel Project



Source: Office of the Comptroller and Auditor General

Focus of the Report

1.16 This report considers the role of DCENR in the management of the Bytel project.

1.17 Given that DCENR approved payment of grants of €4.3 million in funding to a project for which it was found that 97% of grant payments were ineligible, the examination also considers to what extent DCENR has taken steps to prevent a similar recurrence.

1.18 This report is the result of a co-ordinated examination between the Office of the Comptroller and Auditor General and the Northern Ireland Audit Office (NIAO). Given the nature of the issues being examined, such an approach ensured as complete and comprehensive an examination as possible. As Bytel was located in Northern Ireland, the detailed work in relation to the grant payments was carried out by the NIAO. The NIAO's report is attached as an appendix to this report.

2 EU Interreg III Programme

2.1 The overall aim of the EU Interreg III programme, which covered the period 2000 to 2006, was to "address the economic and social disadvantage which can exist from the existence of a border, by promoting the creation of programme networks involving, and also benefiting, local communities".[1]

2.2 Total EU funding for Interreg III, across the EU, was €4.9 billion. The programme consisted of three strands.

- Strand A – cross border co-operation between adjacent regions (67% of the funding): the aim of this strand was to develop cross border social and economic centres through common development strategies.
- Strand B – transnational co-operation (27%): the aim of this strand was to promote better integration within the EU through the formation of large groups of European regions.
- Strand C – inter-regional co-operation (6%): this strand aimed to improve the effectiveness of regional development policies and instruments through large scale information exchange and sharing of experience.

2.3 Under Interreg III rules, projects had to be co-financed by the EU and member states involved in the projects. Member state contributions are referred to as matching funds.

2.4 The EU allocated €137 million for cross-border projects in Ireland. This amounted to 2.8% of EU funding available under the Interreg III programme. Ireland and Northern Ireland allocated matching funds of €48 million – 26% of the total funding of €185 million allocated to the programme.

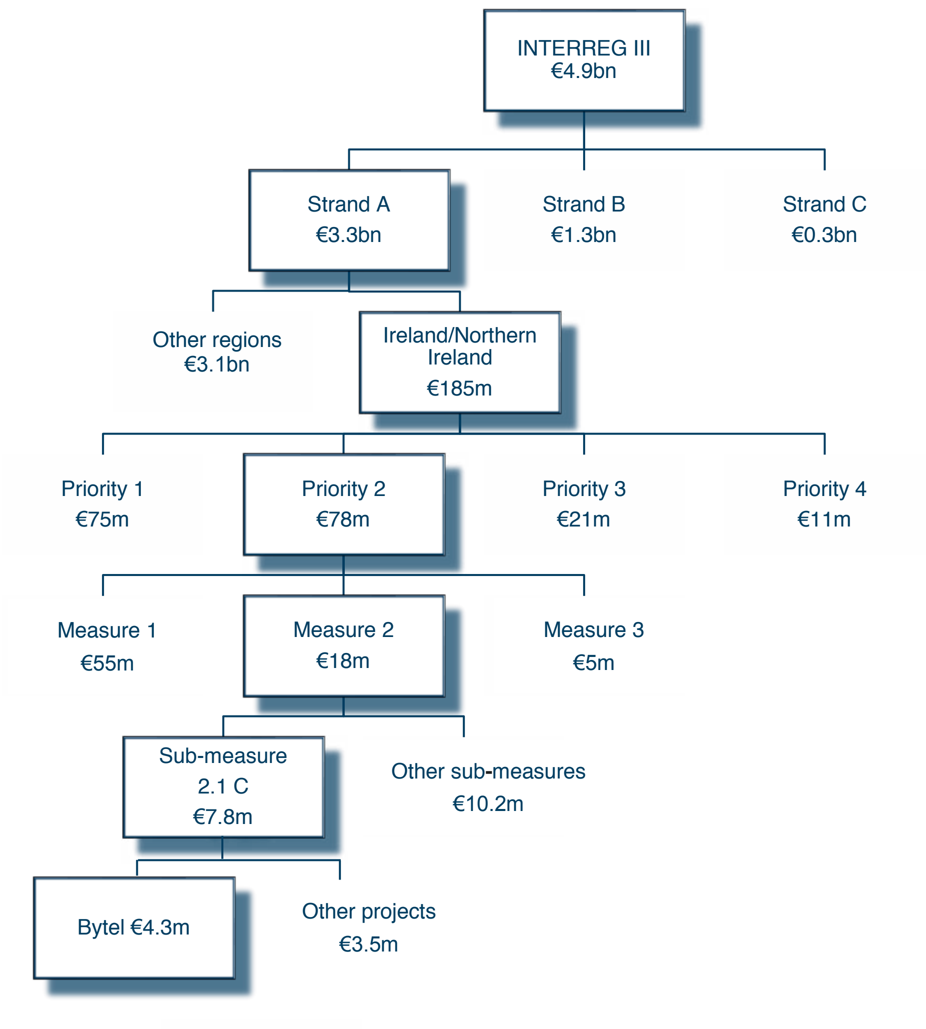
2.5 The available funding was allocated to a number of projects under each of the Interreg III strands. Around €8 million was allocated to a specific strand A measure described as 'supporting physical infrastructure and the environment – inter regional economic infrastructure' (sub-measure 2.1 C). The Bytel project was funded under that measure (see Figure 2.1). The grant allocated to the Bytel project (€4.3 million) represented 55% of the total funding available under the specific measure. The other projects funded under this sub-measure were

- the Armagh Monaghan Digital Corridor pilot proposal (€ 0.93 million)
- Northwest Community Connect project (€0.25 million)
- Blackwater Valley broadband (€0.16 million)
- a project linking the Northern Ireland Regional Area Network (higher education sector) to Ireland's National Education and Research Network (€0.51 million)
- a broadband awareness campaign (€1.68 million).

2.6 In the Interreg III programme, projects could not be fully grant funded. The maximum grant available for the Bytel project was 35% of eligible project expenditure. Expenditure incurred on projects was deemed eligible or ineligible by reference to a letter of offer and applicable EU regulations.

1 Special EU Programmes Body (2003) INTERREG IIIA Mini Guide.

Figure 2.1 INTERREG III (2000 – 2006) funding allocation sequence



Source: Special EU Programmes Body

Notes: a Priorities – key strategic objectives aimed at specific policy areas.

b Measures – activities supporting the delivery of Interreg priorities.

Programme and Project Oversight

2.7 An overview of the complex arrangements put in place for the administration and funding of the Interreg III programme in Ireland is set out in Figure 2.2.

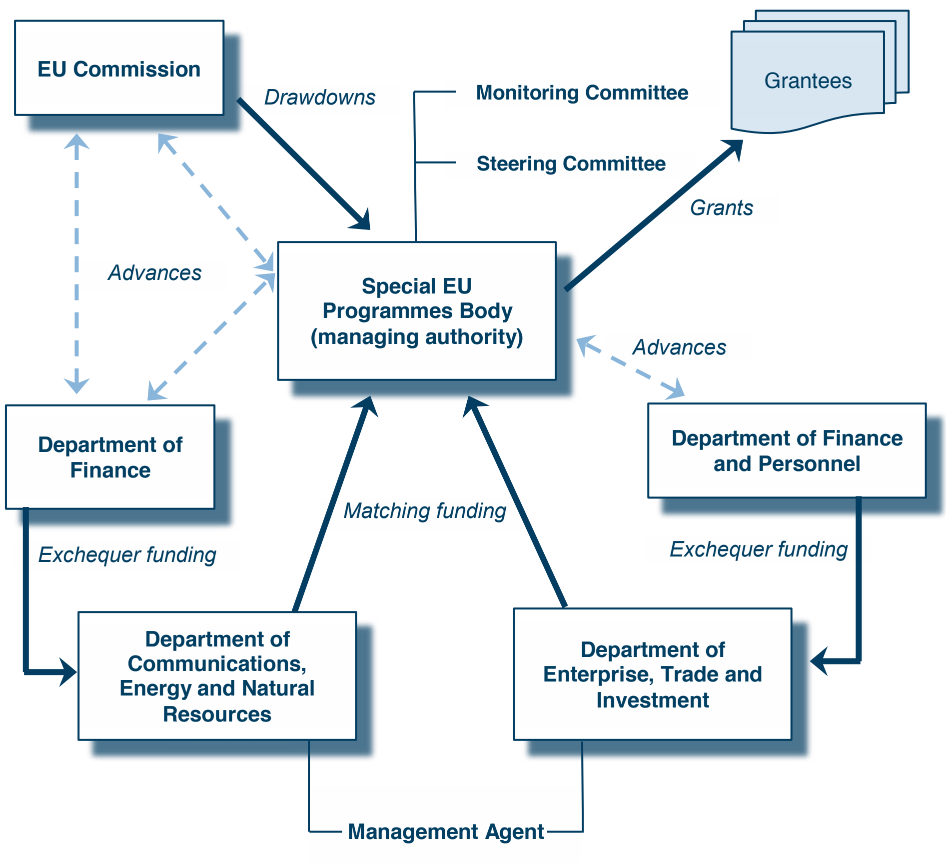
2.8 SEUPB was the designated managing authority and paying authority for the Interreg III programme for Ireland/Northern Ireland. Those roles in respect of Interreg I and Interreg II had been performed by the Department of Finance in Ireland and the Department of Finance and Personnel in Northern Ireland.

Managing Authority

2.9 As managing authority, SEUPB had overall responsibility for implementing the Interreg III programme on the island of Ireland. Under EU regulations, SEUPB was required to put in place financial processes and procedures to ensure effective delivery of the programme. This included the establishment of a central payments system and the appointment of joint implementing agents for each programme measure.

2.10 As the managing authority, SEUPB set up an Interreg III monitoring committee which consisted of thirty members, including representatives from the Department of Finance, the Department of Finance and Personnel, the European Commission and the Border Midland and Western Regional Assembly. The role of the committee was to oversee the Interreg III programme. The monitoring committee met on 14 occasions between 2000 and 2008.

Figure 2.2 Overview of arrangements for administration and funding of the Interreg III programme in Ireland and Northern Ireland



Source: Office of the Comptroller and Auditor General

2.11 In line with EU regulations, SEUPB also appointed a steering committee which consisted of 19 members, including representatives from the Department of Finance, the Department of Finance and Personnel, and from trade unions, and three advisors from Enterprise Ireland, Invest NI and Intertrade Ireland. The primary function of the steering committee was to select projects for Interreg III assistance. The committee met 23 times over the course of the programme (between 2003 and 2006). The committee recommended funding of €4.3 million for Bytel in November 2004.

2.12 Other SEUPB managing authority responsibilities included ensuring projects were selected in accordance with criteria approved by the monitoring committee, preparing implementation reports for submission to the EU and performing control checks on at least 5% of programme expenditure.

Paying Authority

2.13 As a paying authority, SEUPB was responsible for managing a dedicated Interreg III bank account, issuing advance payment requests to the implementing agents, compiling and certifying claims to the EU for drawdown of ERDF funds and disbursement of grant payments to Interreg III project promoters.

Implementing Agents

2.14 Joint implementing agents were government departments or other suitable agencies entrusted with responsibility for the implementation of the Interreg III Programme in accordance with a service level agreement with SEUPB.

2.15 SEUPB appointed DCENR and DETI as joint implementing agents to administer sub-measure 2.1 C. The implementing agents were jointly obliged to facilitate funding applications, undertake project assessment, verify project expenditure, authorise grant payments and monitor and review projects.

2.16 While both Departments had equal responsibility for administering the programme, DCENR has stated that, in practice, either it or DETI took the lead role in the day-to-day handling and processing of payment claims for individual projects, and that the department exercising the lead role was referred to as the 'lead implementing agent'. DCENR stated that, in its view, while there was no written agreement with DETI about its role as lead implementing agent, de facto, DETI assumed and operated in this role for the project.[1]

2.17 DETI, on the other hand, stated that the role of lead implementing agent was not defined for Interreg III and that each department had joint responsibilities as joint implementing agents.

2.18 The relationship between DCENR and DETI was not formalised for the Interreg III programme and it was not referred to in the bilateral service level agreements with SEUPB. Officials of the Departments met on an ad hoc basis, as required, regarding the implementation of projects.

DCENR stated that it was the ad implementing agent for the roadband Awareness ampaign and that DETI was the ad implementing agent for the :her projects funded under the ıb-measure.

Recoupment of ERDF Funds

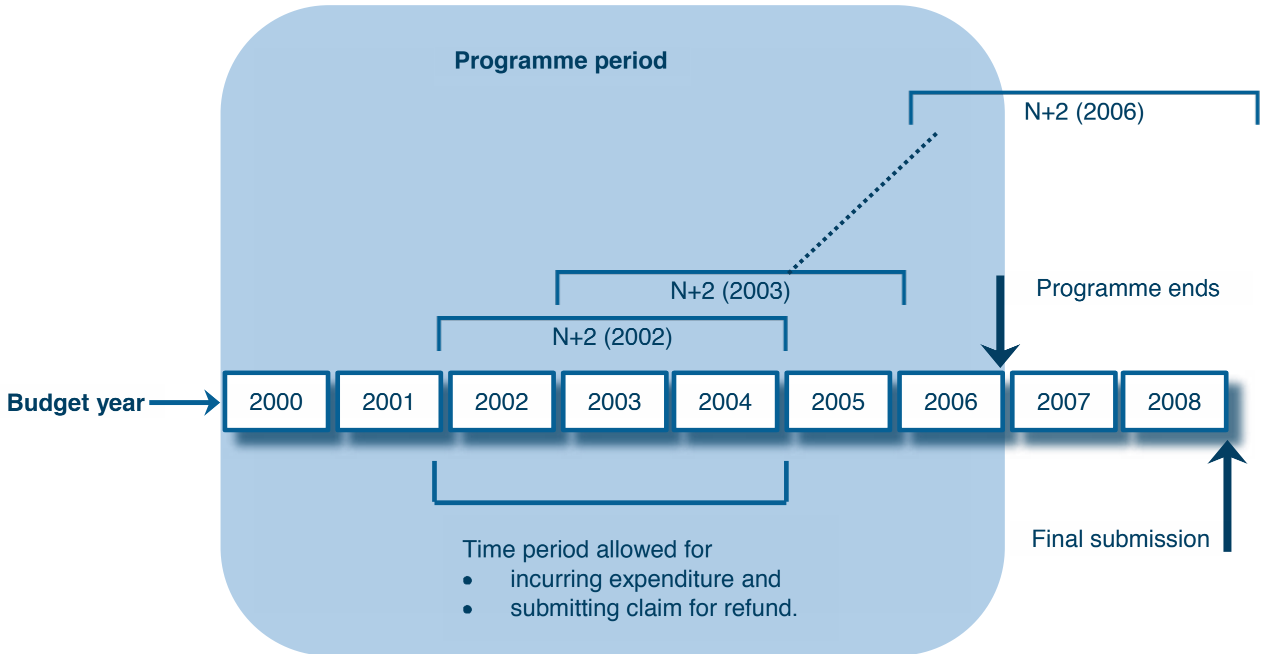
2.19 Funding of EU programmes is managed through a complex process of initial advances from the EU, advances from national Exchequers, matching national funding and subsequent claims submitted to the EU for drawdowns based on verified grant expenditure. Budgets are allocated to time periods and time limits are imposed through the 'N+2' rule (see Figure 2.3), to control the process, and to avoid peaks in spending at the end of the programme.

Figure 2.3 Time limit for spending funds – the N+2 rule

An EU regulation – referred to as the N+2 rule – requires member states to spend funds, at a programme level, by the end of the second year following the year in which they are allocated.[a] Unspent allocations are automatically withdrawn by the Commission. The N+2 rule was applicable to the Interreg III programme. If an N+2 target for a specific measure is not met in any year, the available funds may be spent on another measure in the programme. The N+2 target is calculated on a cumulative basis over the life of a programme.

The N+2 rule is intended to avoid a peak of project commitments towards the end of a programme, but it also creates a risk of weakened financial controls, as member states strive to ensure all available funding is fully expended within the two-year timeframe.

The Interreg III programme period covered the years 2000 to 2006. However, due to start up delays, the programme was not launched until November 2002.



Source: Office of the Comptroller and Auditor General

Note: a Article 31.2 of Regulation 1260/1999.

2.20 The EU advanced to SEUPB €9.6 million (7%) of the total Interreg III allocation to fund initial payments. Because of delays in processing claims and drawdowns, additional funds were advanced to SEUPB from voted Exchequer funds by the Department of Finance and the Department of Finance and Personnel. Assuming no disallowances or withdrawal of claims, these advances were repayable to the Departments, once all claims were settled.

2.21 Over the period 2004 to 2010, SEUPB could have recouped a maximum €137 million ERDF contribution in respect of the Interreg III Ireland programme. However, the full amount was not recouped, due to the decision to withdraw the Bytel project from the Interreg III claim after the closing date for the programme.[1] If the project had been withdrawn prior to the close of the programme, there may have been an opportunity to take actions that could have resulted in some or all of the undrawn funding being utilised in other projects.

2.22 By late 2013, when SEUPB received the final ERDF receipt from the EU Commission, SEUPB had recouped €133 million in respect of 27 claims for Interreg III projects. The claims ranged from €61,000 to €30.5 million. Of the €133 million recouped by SEUPB for Interreg III projects

- Ireland received €61.6 million (46%), and
- Northern Ireland received €71.2 million (54%).

2.23 Prior to 2008, the Irish Exchequer's share of ERDF funding for project claims was paid directly to SEUPB – initially through an advance of 7% of the total programme funding and then through drawdowns of funds in respect of grants paid to project promoters.

2.24 From 2008, the Department of Finance began to pay the Exchequer's share of ERDF funding to SEUPB.[2] SEUPB repaid the Department when it received ERDF funding following submission of grant claims. When the claim in respect of the Bytel project was withdrawn, SEUPB reduced the amount it recorded as repayable to the Department of Public Expenditure and Reform by €1.76 million. SEUPB pointed out that it had no mechanism to recoup payments directly from DCENR.

1 The closing date for Interreg III was extended from June 2008 to June 2009.

2 In 2011, this function transferred to the Department of Public Expenditure and Reform.

3 Role of the Department of Communications, Energy and Natural Resources in the Bytel Project

3.1 Formally, DCENR and DETI had joint responsibilities in regard to the measure under which Bytel was funded. These are set out in identical service level agreements between each Department and SEUPB. The agreement between SEUPB and DCENR is dated August 2004 and that between SEUPB and DETI is dated October 2004. Under the agreements, each Department had responsibility for, inter alia,

- administering grant applications by, and offers of grants to, project promoters
- authorising grant payments.

Appraisal of Project Proposal

3.2 In February 2004, Western Connect, a Derry-based technical consultancy company, was appointed by the joint implementing agents to act as a management agent for Interreg measure 2.1 C. Western Connect provided technical, legal and financial expertise on the appraisal, selection and implementation of the measure. Western Connect provided these services until October 2005. The total paid to Western Connect was €138,000.

3.3 In April 2004, in response to a call by SEUPB for project proposals, Bytel Limited submitted an application for grant funding for a project that would use existing underground ducts and cables owned by a proposed project partner, Aurora Telecom (Aurora), to provide high speed broadband which would initially link Belfast, Craigavon, Armagh, Dundalk and Dublin, with subsequent phases to be agreed.[1] The application envisaged total project costs of €13.2 million and sought grant funding of €5.9 million under the Interreg III programme.

3.4 The application was rejected by a panel comprising two staff from Western Connect. In July 2004, Bytel Limited submitted a revised application, with lower project costs. The application was subject to a project assessment and an economic appraisal. DCENR and DETI were represented on the evaluation panel for the project assessment. In order to reach the economic appraisal stage, the project had to pass a threshold of 60 marks (out of 100) in the assessment. Overall, it scored 61 – just one above the threshold. The application scored four out of five for the north-south nature of its application (to be delivered through its proposed partnership with Aurora).

3.5 The economic appraisal was completed in September 2004. The appraisal recommended that, subject to key risks identified in the appraisal being addressed, the project should be funded. The risks identified included

- the capacity of Bytel to deliver the project (assessed as low risk)
- lack of demand for the completed network and
- failure of the relationship between Bytel and Aurora - considered not to be a high risk, on the basis of a letter from Aurora that it would provide the fibre optic cable required for the project.

1 Aurora Telecom is a subsidiary of Bord Gáis Networks, which operates under the aegis of DCENR.

3.6 In October 2004, a letter of offer from DCENR and DETI to Bytel committed grant funding of €4.3 million against total project costs of €12.4 million, the maximum potential funding based on the effective 35% grant rate.

3.7 The project appraisal, including the economic appraisal, is reviewed in detail in Appendix A.[1] That review highlights a number of shortcomings in the appraisal.

- There were weaknesses in the definition of what was to be delivered by Bytel and a lack of clarity over the source and ownership of the assets required to deliver the project.
- There was little evidence in the economic appraisal to support project costs (hardware, software and infrastructure).
- Although the partnership with Aurora was identified as being important for the delivery of the project, neither DETI nor DCENR engaged with Aurora to confirm its partnership with Bytel.[2]

Project Partnership

3.8 DCENR pointed out that an Aurora senior projects manager had, at a meeting in June 2004 with DCENR, DETI and Bytel, confirmed that it supported the Bytel project. However, no partnership agreement was discussed or agreed between Aurora and Bytel in relation to the project. A letter from the project manager to DETI in November 2004, stated that Aurora intended to install fibre optic cable from Dublin to Belfast by December 2005, which would be available for the 'extreme broadband project'. (The letter made no explicit reference to Bytel).

3.9 Bord Gáis Networks commenced a strategic review of Aurora (its subsidiary) in October 2004, and decided in December 2004 to withdraw its offer of support from the Bytel project – two months after the letter of offer issued from the Departments. By this time, the first payment of €1.6 million had already been made to Bytel.

3.10 The Accounting Officer stated that as DCENR regarded DETI as lead implementing agent, it was not DCENR's role to request from Aurora confirmation regarding the Bytel project.

Change to Project Specification

3.11 Following protracted negotiations, Bytel entered into agreements in September 2005 with Eircom UK under the terms of which

- Eircom UK was to provide certain access rights to its existing infrastructure in Northern Ireland
- in exchange, Bytel was to undertake to complete additional fibre cable laying in Northern Ireland.

Both of the exchange transactions were valued at €3 million. The agreements reduced the total Bytel project costs by €4.8 million to €7.6 million.

1 See part two of the report at Appendix A.

2 Aurora was to deliver €7.8 million, or 63%, of the assets required to complete the project.

3.12 Under the terms of the letter of offer, Bytel was required to get approval from DETI and DCENR for any significant project changes. In September 2005, Bytel informed DETI and DCENR of project delivery changes. Notwithstanding the very significant change to how the project was to be provided and the 39% reduction in the project funding requirement, no review was carried out and no written approval was issued to proceed with the revised project. The Departments did not issue a revised letter of offer.

3.13 From a technical perspective, the nature of the project changed between November 2004 and November 2005 from building a network on existing fibre cables (infrastructure) to a project where Eircom UK delivered bandwidth (service).[1] SEUPB has pointed out that it was not informed of the significance of the change in the nature of the project.

Time Limits for Spending Funds in 2004

3.14 The telecommunications measure which funded the Bytel project had an N+2 target requiring payments totalling €1.6 million by December 2004. In July 2004, the DCENR official dealing with the Interreg III telecommunications measure noted in an internal DCENR document that there was a possibility of missing the N+2 target, as no expenditure had been incurred on any projects in 2004. The official noted that there was a strong possibility of meeting the N+2 target if the Bytel project application was approved for funding. In the event, the letter of offer to Bytel issued in October 2004.

3.15 The Accounting Officer has stated that the internal document noted that there would be a full, independent appraisal of the Bytel project, and that DCENR did not ensure the approval of the Bytel project in order to meet the N+2 spending target.

3.16 The Bytel project commenced in early November 2004. Notwithstanding the fact that the project commencement date was just three weeks in advance of the 2004 N+2 deadline of 2 December 2004, a claim for €1.6 million was submitted by Bytel and verified by Western Connect prior to the deadline. This claim included €1.3 million for equipment that was not subsequently used for the project under the revised contract with Eircom UK. The letter of offer had specified the items for which grant funding would be available and had noted that no Interreg funding was available for that equipment.[2]

Payment of Claims

3.17 Bytel submitted four grant claims totalling €4.3 million (based on expenditure of €12.4 million) to SEUPB between November 2004 and November 2005. The initial claim, which accounted for 37% of the total grant allocation paid of €4.3 million, was submitted within three weeks of the letter of offer in October 2004. Notwithstanding that the level of grant funding for the project was 35% of total project costs, the first payment represented 100% of costs to that date. Claim details are set out in Figure 3.1.

1 Based on the report of a technical review of the project by independent consultants, completed in March 2013.

2 The letter of offer stated that the offer and subsequent grant draw down were subject to strict adherence to the project budget. The budget indicated that the equipment (€1.3 million), subsequently funded in the first payment, was to be fully funded by Bytel.

Figure 3.1 Bytel grant claims

Claim	Date submitted	Date paid	Amount paid €000
Claim 1	15 November 2004	2 December 2004	1,600
Claim 2	16 September 2005	13 October 2005	375
Claim 3	25 October 2005	8 December 2005	250
Claim 4	11 November 2005	8 December 2005	2,075
Total			**4,300**

Source: Department of Communications, Energy and Natural Resources

3.18 DCENR contributed €0.51 million (matching Exchequer funding) of the €4.3 million grant allocation to the Bytel project. In addition, €1.76 million was paid from the State's allocation of ERDF funding (to be claimed as eligible expenditure under the Interreg III programme). DETI contributed Interreg funding of €2.03 million to the project (see Figure 3.2).[1]

Figure 3.2 Bytel funding

Funding Source	DCENR €m	DETI €m	Total €m	
Interreg allocations	1.76	2.03	3.79	**88.2%**
Matching Exchequer funding	0.51	–	0.51	**11.8%**
Total	**2.27**	**2.03**	**4.30**	
	53%	**47%**		

Source: Department of Communications, Energy and Natural Resources

3.19 The service level agreements between SEUPB and the two Departments required that grant payments made by SEUPB to the project were based on claims that had been verified by the joint implementing agents and approved by them as eligible expenditure. DCENR has pointed out that it regarded DETI as the lead implementing agent and, as such, DETI had responsibility for checking and processing claims. In the event

- The first two grant payments made by SEUPB were authorised by DETI and Western Connect. These two payments included €232,000 of matching funding provided to SEUPB by DCENR.
- The final two claims were approved by both DETI and DCENR. These included the balance (€273,000) of the matching funding.

DCENR signed authorisation forms for the release of the matching funding it had provided to SEUPB for making payments to Bytel around the same dates the grants were paid to Bytel (November 2004, October 2005 and December 2005).

1 Under Interreg III rules projects had to be co-funded by member states. The Ireland Interreg III programme was 25% co-financed. The proportion of co-financing varied for different projects.

3.20 Notwithstanding that it directly approved, or was aware of, total payments of €4.3 million (including €2.27 million of Irish funding) in respect of the project, there was no evidence to show that DCENR sought the supporting documents or assessments of the claimed expenditure in order to give it assurance about the validity of the claims.

3.21 A detailed review of the checking and authorisation of the grant claims by DETI is set out in Appendix A.[1] The review found that the time pressures created by the N+2 deadline contributed to the poor quality of the checking of grant claims for the project and that the checking and verification of the grant claims was inadequate.

3.22 In addition to grant claims being checked, the project was subject to a number of controls in accordance with EU requirements

- December 2004 – an SEUPB certification spot check to ensure that there was adequate documentation to support payments made
- February 2005 – an Article 4 review was undertaken by Western Connect. Further Article 4 reviews were undertaken by DETI in March and July 2007[2]
- June 2006 – an Article 10 review was completed by external consultants.[3] This review identified issues regarding the project structure and procurement documentation. The issues are highlighted in part three of Appendix A.

Ineligible Expenditure

3.23 EU funding for Interreg III is recouped through claims for payment from the ERDF. However, in 2012, the Bytel project was withdrawn from the final payment claim following a detailed review by consultants (consultant A) commissioned by SEUPB who concluded that 97% of the expenditure claimed by Bytel was not eligible for grant aid under the Interreg programme. Reasons for the expenditure being considered ineligible included

- lack of evidence about the existence and valuation of equipment purchased for the project
- procurement of equipment from a company closely related to Bytel
- non-utilisation of equipment in the completed project
- costs incurred that were outside the scope of the project
- inadequate documentation to support claimed expenditure of €17.8 million in the final grant claim – the documentation provided consisted of a single page statement which was neither signed nor dated, and had no back-up or verification evidence.

1 See part three of the report at Appendix A.

2 Article 4 reviews are expenditure checks performed on all EU funded projects to ensure expenditure incurred is eligible and in compliance with EU regulations.

3 Article 10 reviews check the effectiveness of management and control systems and compliance with EU regulations.

Views of the Accounting Officer of DCENR

Approval of Project Expenditure

3.24 In regard to its role in approving project expenditure, a document from DCENR points out that[1]

- DCENR had no role in the verification, examination, approval or auditing of any of the project expenditure. That responsibility was contracted out to Western Connect in the first instance and was subsequently assumed by DETI as lead implementing agent.
- DCENR's only involvement in the ongoing financial management of the Bytel project was the approving of the release of monies from Ireland's ERDF pool and from its own funds (matching funding), on foot of requests to do so from SEUPB. DCENR fully complied with and acted upon the advice of those charged with carrying out the inspections and audits at all times in the process.
- DCENR depended on the evaluations carried out by the technical advisors to the project, by SEUPB and, subsequently by DETI. DCENR had no involvement in the vouching of expenditure and trusted that all vouching was done in accordance with best practice.
- At no point did pressures to make payments in order to meet Interreg requirements about the timeframe within which allocated money must be spent lead to any cutting of corners by DCENR. At all times, DCENR understood all payments to be valid, properly checked and appropriate to the project.

3.25 In regard to the €1.3 million included in the first payment claim for equipment that was not subsequently used on the project and that the letter of offer identified as not being grant-eligible, the DCENR document notes that it did not consider that the equipment was any less essential for the Eircom UK network than it would have been for the Aurora network. DCENR had not been made aware that the equipment was not required under the Eircom UK contract.

Comments by SEUPB

3.26 SEUPB stated that the DCENR document conveys an erroneous impression of the role of SEUPB, as responsibility for the assessment, approval, monitoring and evaluation of projects lay with the joint implementing agents. SEUPB pointed out that it had no role and had no access to technical advisors in relation to this project. SEUPB also stated that while it did procure an economic appraisal on behalf of DETI, the appraisal was assessed and approved in the first instance by DETI economists and subsequently by economists in the Department of Finance and Personnel supply section.

3.27 In the case of the Bytel project, SEUPB does not believe that N+2 pressures can be used as an excuse for what has happened. The joint implementing agents were aware that N+2 was a key management objective when they took up the responsibility for the management of that part of the programme. Adequate foresight and planning would have ensured that this did not happen.

1 The document was drawn up in October 2011 in response to a draft version of the consultant's report of March 2012 which had been commissioned by SEUPB.

DCENR's role as implementing agent

3.28 Notwithstanding that both DCENR and DETI had identical responsibilities under the service level agreements each had with SEUPB, the Accounting Officer has pointed out that, in practice, for administration of each Interreg III project, one of the Departments took the role of lead implementing agent. He stated that DETI was the lead implementing agent for the Bytel project and, in that role, was responsible for the regularity of expenditure on the project.

3.29 The Accounting Officer also stated that he does not agree that both DETI and DCENR were responsible for checking that the claims submitted by the project promoter were correct, eligible for grant and due for payment. He stated that it was not DCENR's function to check the supporting documents with claims from Bytel – it was the responsibility of either Western Connect as managing agent or DETI as lead implementing agent for the project to do this before approving payments. For the first two grant payments, Western Connect and DETI signed the payment forms and DCENR did not countersign them. For the remaining two payments, Western Connect was no longer involved and both DETI and DCENR signed the payment forms.

3.30 There was no written agreement between DCENR and DETI, nor was there any other documentation, setting out the responsibilities of each Department where one Department took the role of lead implementing agent. However, in support of his comments, the Accounting Officer noted that the main documentation on the Bytel project was held in Belfast and the payment claims from Bytel were vouched and checked in Northern Ireland. The first two payment claims were not forwarded to DCENR for countersigning. Payment authorisation forms were sent to DCENR for release of DCENR's match funding for making payments to Bytel.

3.31 In regard to assurance about the validity of claims, DCENR stated that Western Connect (as managing agent) gave general assurances about the controls it used in relation to the certification of expenditure claims from Bytel and another telecoms project at the time – for example, Western Connect stated that it checked original invoices and bank statements, matched equipment against invoices, ensured that expenditure was eligible under the terms of the letter of offer and that costs were reasonable. DCENR did not receive specific assurance about the Bytel claims.

Handling of Allegations about Bytel Project

3.32 Allegations were made to DETI in 2006 when a director of Bytel raised concerns in relation to a colleague regarding false accounting practices and withdrawal of funds which should have been ring fenced for the Bytel project. DETI conducted an internal review of the allegations and concluded that no further action was necessary, on the basis that the claims submitted by Bytel

- were for products and services that were eligible for Interreg support
- were in respect of expenditure actually incurred and
- had been supported by invoices and bank statements.

3.33 Further allegations were made about the project by a whistleblower to the NIAO in 2008. The NIAO referred these to DETI for investigation. DETI commissioned an external review of the project, which was completed in September 2009.

3.34 Notwithstanding a requirement under the terms of its service level agreement with SEUPB to inform it and DCENR of any report commissioned in relation to Interreg programme expenditure, DETI did not notify SEUPB about concerns with the project until May 2010 when it informed it that the grant paid to Bytel 'may be ineligible' for ERDF funding. DCENR was not made aware of a potential irregularity until late 2010 or of the detailed Bytel issue until February 2011.

3.35 A review of the investigations that were carried out found that[1]

- DETI's investigation of the June 2006 allegations, that the claims submitted by Bytel were valid, was not sufficiently rigorous and independent and its finding was not supported by adequate evidence or documentation.
- In response to the whistleblower's allegations in 2008, DETI's internal audit unit concluded an initial investigation in early 2009 which identified concerns about the adequacy of documentation supporting the grant claims and engaged a consultant (consultant A) to carry out further investigations. In September 2009, the consultant concluded that "there are a number of significant issues arising in relation to the eligibility of the expenditure claimed in respect of this project and therefore in relation to the efficacy of DETI's oversight and monitoring role. On the basis of the limited information available to me to date, I consider that DETI will, more likely than not, be required to declare an irregularity in relation to the project". Notwithstanding this finding, DETI did not notify SEUPB or DCENR of the whistleblower's allegations or of the consultant's September 2009 findings until December 2010.[2]

DCENR's Knowledge of the Allegations and Investigations

3.36 DCENR was made aware of the 2006 allegations by email from DETI in June 2006. The email noted that all payments to Bytel had been properly vouched and that the allegations seemed to mainly concern how Bytel had been allocating the money from Interreg. DETI noted that a meeting was scheduled with the person making the allegations, and expressed the view that DCENR should be represented at the meeting.

3.37 Notwithstanding DETI's view, no representative from DCENR attended the meeting. DCENR was provided with minutes of the meeting and an internal DCENR document notes that DETI's main concern was whether the claims for payment made by Bytel were legitimate and whether the project would deliver in accordance with the letter of offer – DETI had checked the claims and did not have any concerns in that respect.

3.38 DCENR was not informed of the 2008 allegations until December 2010 when the Chief Executive Officer of SEUPB wrote to DETI making inquiries about a potential irregularity in the Bytel project that had been flagged. The letter was copied by SEUPB to DCENR.

1 See part four of the report at Appendix A.

2 The consultant was subsequently commissioned by SEUPB to carry out the in-depth review of the project.

3.39 On foot of this, a committee of representatives of relevant departments was established to review the project.[1] In April 2011, SEUPB, acting on behalf of this committee, commissioned a review of the project by an independent consultant (consultant A). The report arising from the review was received by DCENR in March 2012. Some of the main findings of the review were

- 97% (€4.2 million) of the €4.3 million paid to Bytel should not have been paid as it was based on ineligible expenditure.
- The management of the project was inadequate in a number of respects including the authorisation of grant payments against expenditure which was clearly ineligible, or which became ineligible once the project changed or about which serious questions should have been asked.
- There had been a failure to properly investigate the 2006 allegations and a failure to act in a timely way on the issues raised by the whistleblower in June 2008.

3.40 The Chief Executive Officer of SEUPB pointed out that while 3% of the expenditure could be deemed to be eligible, the most prudent course of action was to withdraw the whole project from the final claim for payment to the European Commission for Interreg III. This course of action was endorsed by the review committee, which agreed to withdraw the project in its entirety from the programme.

3.41 The effect of withdrawing the project from the programme at that stage was that the €3.79 million which it was expected would be recovered under the Interreg programme could not be recouped, and could not be replaced by other eligible projects.

3.42 In response to a letter from SEUPB, the Accounting Officer of DCENR wrote to the Chief Executive Officer pointing out that

- DCENR relied on DETI to carry out the detailed checks and on DETI's recommendation in this respect. He noted that DCENR countersigned some of the expenditure claim forms but pointed out that there was an important distinction between the roles of DCENR and DETI.
- Until December 2010, DCENR had no knowledge of, or involvement in the whistleblower allegations made in 2008, the issues summarised in the consultant's report (consultant A) in September 2009 or the failure to share concerns about the Bytel project with stakeholders on a timely basis.
- In relation to the achievement of the project's objectives, DCENR had relied on a post-project evaluation carried out by independent consultants in 2007. That evaluation had not identified any shortcomings in the Bytel project and concluded that the project's technical objectives had been met.

1 Members of the committee included representatives from SEUPB, DCENR, DETI, the Department of Finance and the Department of Finance and Personnel.

Post Project Evaluation

3.43 Notwithstanding the withdrawal of the project from the claim for Interreg III funding, two evaluations found that the project had achieved its objectives.

- A post-project evaluation in 2007 found that appropriate, functioning equipment to prevailing industry standards had been installed at all points of the network. However, the March 2012 consultant's review (consultant A) found that the evaluation had some fundamental weaknesses.
- Following the 2008 whistleblower's allegations, and the decision to withdraw the project from the Interreg programme, a DETI-commissioned review in 2013 found that all seven objectives of the project had been met.

3.44 While the 2013 consultant's review (consultant B) found that the project delivered its objectives, it also found that the cost of delivering the project was considerably lower than €12.4 million, on which the 35% grant paid to Bytel (€4.3 million), was based. The consultant concluded that Bytel had incurred expenditure of €3.93 million (including the €3 million transaction with Eircom UK). On this basis, the maximum grant payable would have been just under €1.4 million.[1]

Communications between DCENR and DETI

3.45 DCENR stated that communications between it and DETI, as joint implementing agents, were carried out on an ad hoc basis. Some emails, other notes and minutes of three project meetings were made available to the examination.[2] DCENR attended two of the meetings. None of the minutes of the meetings refer to key issues including the withdrawal of Aurora and its impact on the project. The allegations made about the project all arose after the last of the meetings. In addition, seven status reports about Measure 2.1 C were drawn up by Western Connect between June 2004 and April 2005. Five of these reports related to the period before the issuing of the letter of offer to Bytel (in October 2004).

3.46 Some failures in communication are evident

- the apparent lack of awareness of DCENR of the possible withdrawal of Aurora as project partner
- the failure of DETI to keep DCENR informed at the earliest opportunity of issues that arose – in particular, the whistleblower's allegations in 2008.

Loss to the Irish Exchequer

3.47 The total loss to the Irish Exchequer from the Bytel project is €2.27 million. This comprises

- €1.76 million in Exchequer funding to Bytel on the understanding that it would be eligible for reclaiming under Interreg III
- €505,000 in matching State funding that was also paid to Bytel.

3.48 The Accounting Officer has pointed out that there were real benefits from the Bytel project and the total expenditure should not be considered a loss.

1 See part five of the report at Appendix A.

2 The meetings were held in June 2004, September 2004 and September 2005.

Follow-up Action

3.49 In December 2010, the Departmental Solicitors Office in Northern Ireland issued a court writ on Bytel. In March 2013, a statement of claim seeking recovery of the full amount of €4.3 million in grants paid on the broadband project was served on Bytel. Any monies recovered will be apportioned as appropriate between DCENR and DETI.

Conclusions and Recommendations

3.50 While there are indications that an informal arrangement was in place making DETI the lead implementing agent, DCENR had clear responsibilities that were set out in an agreement with SEUPB. There are a number of areas where DCENR should have applied more rigour to its approach.

- DCENR relied on DETI and on other advisors for assurance that expenditure claimed by the project promoter was valid, and considered that it had no role in this area. The approach taken by DCENR showed a lack of awareness of the risks, in circumstances where it was placing reliance for assurance about the validity of payments it was making on others, and there was no evidence to show that it had put appropriate controls or checks in place. DCENR should have sought appropriate documentary evidence to support the payments it was making, particularly in circumstances where payments were being made close to the time limits for spending allocated funds. Given the deficiencies in the documentation and checks made by DETI, found in the subsequent investigations, this kind of approach might have brought issues about the project to DCENR's attention at an early stage.
- A significant part of the project costs were associated with the proposed project partner and these fell significantly when the new project partner became involved. DCENR should have sought a re-appraisal of the project at this point. The documents indicate that DCENR's focus was mainly on the delivery of the project and not on the validity of the costs when the project partner changed.
- When the first allegations were made about the project in 2006, DCENR accepted an assurance from DETI that it had checked the payment claims made by Bytel but did not seek any documentation or evidence to support this. In addition, DCENR chose not to attend a meeting with the person who had made the allegations and thus missed an opportunity to probe the allegations and to draw out potential evidence.

3.51 The arrangements for communications between the implementing agents were informal and inappropriate for an important inter-regional infrastructural project which was in receipt of grants of €4.3 million and for a sub-measure with an €8 million overall spend. The failure to put appropriate communication arrangements in place may have been a contributory factor to the poor sharing of information with DCENR by DETI.

Recommendation 1

A formal project appraisal should take into account all of the key risks that are critical to the project's success and identify how these are to be addressed. Where successful delivery of a project is dependent on a partnership approach by project promoters, the partnership agreement should be reviewed as part of the appraisal.

Accounting Officer's response

Agreed. This is now standard procedure for projects under the Interreg IV programme. It should be noted that the Bytel project appraisal identified *"Risks and Uncertainties to be Addressed"*, including the risk of the Aurora partnership falling through, which it regarded as low risk in view of the letter from Aurora stating their commitment to the project.

SEUPB's Chief Executive Officer's response

Agreed. These events refer to a programme period that is completed and closed. New implementation arrangements have been put in place for the successor programme (Interreg IV) and clear guidelines exist for both the appraisal of projects and review of partnership arrangements. A detailed analysis of lessons learned from both programmes has been carried out to inform recommendations from SEUPB in relation to the assessment, approval and monitoring of projects for the Interreg V programme (2014 to 2020).

Recommendation 2

In circumstances where a project approved for grant-funding is subject to significant change, a formal project re-appraisal that considers both the project's objectives and revised costs should take place and appropriately approved revised terms of offer should be issued.

Accounting Officer's response

Agreed. More formal project steering boards were put in place for the monitoring of projects under the Interreg IV programme and DCENR takes an active oversight role in each project.

SEUPB's Chief Executive Officer's response

Agreed. Recommendations have been made by SEUPB in relation to the technical monitoring of projects for the new programme period 2014 to 2020 that take account of this recommendation. Changes had already been introduced into Interreg IV arrangements to ensure that these events could not be repeated.

Recommendation 3

In circumstances where there are joint implementing agents for a project, DCENR, if it is not acting as the lead implementing agent, should put robust processes in place in order to assure itself of the validity of grant claims prior to authorisation of payment.

Accounting Officer's response

Agreed. The roles under the relevant EC regulation (which was not in place for Interreg III) need to be respected i.e. where one body is designated as lead partner, it is a matter for that body to discharge the functions assigned to it as the lead partner. Having said that, in the management of a project under the Interreg IV programme where DCENR is not the lead partner/lead implementing agent, written assessments of payment claims by internationally recognised technical consultants were reviewed by DCENR before payments to the contractor were approved.

SEUPB's Chief Executive Officer's response

Agreed. The use of implementing agents for programme delivery was discontinued for the programme period 2014 to 2020. The system of verification of expenditure has been radically changed since Interreg III. A robust, centralised system of verification has been introduced, quality controlled and checked by a centralised financial control unit and certifying authority, and audited by the audit authority, who carry out regular sample checks on claims for expenditure before certifying to the European Commission as to the robustness of the control systems in place.

Recommendation 4

Joint implementing agents should put formal arrangements in place to ensure that key decisions about a project are agreed by both parties and adequately recorded. The communication arrangements should include protocols for ensuring that all key issues that arise are made known to both implementing agents.

Accounting Officer's response

Agreed. By way of example, there is a formal partnership agreement in place between DETI and DCENR for the implementation of a project under the Interreg IV programme (2007 to 2013), and project management procedures include an internal communications plan.

SEUPB's Chief Executive Officer's response

Agreed. However, the use of implementation agents for programme delivery has been discontinued for the programme period 2014 to 2020.

Recommendation 5

Effective controls should be put in place to ensure that grant claims that are submitted close to payment deadlines are adequately examined and tested to ensure their validity.

Accounting Officer's response

Agreed. Reputable technical consultants have been introduced where relevant to examine grant claims and verify expenditure to ensure the validity of expenditure claims.

SEUPB's Chief Executive Officer's response

Agreed. The introduction of a robust, centralised system of verification of claims for expenditure for the programme period 2007 to 2013 has ensured that N+2 pressures cannot be used as an excuse to set aside the need for high standards in governance.

Appendix A

(NIAO report - Cross-border broadband initiative: the Bytel project)

NIAO Reports 2014-2015

Title	Date Published
2014	
The Future Impact of Borrowing and Private Finance Initiative Commitments	14 January 2014
Improving Pupil Attendance: Follow-Up Report	25 February 2014
Belfast Metropolitan College's Titanic Quarter PPP Project	25 March 2014
Safer Births: Using Information to Improve Quality	29 April 2014
Continuous Improvement Arrangements in Policing	6 May 2014
Improving Social Housing through Stock Transfer	3 June 2014
Managing and Protecting Funds Held in Court	1 July 2014
Modernising benefit delivery in the Social Security Agency's local office network	11 November 2014
Local Government Auditor's Report - 2014	18 November 2014
Primary Care Prescribing	27 November 2014
Financial Auditing and Reporting: General Report by the Comptroller and Auditor General for Northern Ireland – 2014	9 December 2014
2015	
Continuous Improvement Arrangements in Policing	17 February 2015

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