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Management of public funding of Cymad Cyf

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I have prepared this report for presentation to the National Assembly for Wales under the Government of Wales Acts 1998 and 2006.

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**Report presented by the Auditor General for Wales to the
National Assembly for Wales on 18 May 2010**

**Cymad did not adequately control some of the public funding
that it received but there was no evidence of fraudulent
misuse, and the public bodies mostly managed their
funding effectively**

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Summary

- 1** Cymad Cyf (Cymad) was established in 1995 as a not-for-profit company, based in Porthmadog, Gwynedd. It became fully operational in 1996. During the first two years of its existence, Cymad's objectives were closely linked to those of the Leader II European Programme from which it received the bulk of its funding. The company's objectives focused largely on the promotion of sustainable development. It pursued them by promoting community and skills development, rural enterprises, agricultural diversification, environmental enhancement, rural tourism, new technology and culture.
- 2** However, during the late 1990s, and until 2005, the company experienced considerable growth. It diversified into other areas such as the promotion of the Welsh language, and sought to develop a more commercial arm to its activities. The company's income increased substantially, from £623,000 in 2002 to £1.6 million in 2005. Much of this income was from public sources, amounting to £3.6 million over the five years to 31 March 2008. This funding was provided by seven public bodies for specific projects or contracts ([Appendix 1](#)).
- 3** From May 2006, the Auditor General received complaints regarding the alleged misuse of public funds by Cymad. We investigated the complaints alongside the Welsh European Funding Office (WEFO) and found serious deficiencies in the handling of European money. As a result, in October 2006 WEFO suspended payments to the company.
- 4** WEFO completed its investigation of Cymad in March 2009. In August 2009, Cymad went into liquidation, owing the WEFO some £259,000 in European Union (EU) funding, in respect of which it had failed to retain the required supporting documents.
- 5** In response to the allegations made in 2006 and subsequently, this report seeks to answer two questions: Did Cymad misuse public funds? And, did the public bodies in Wales effectively manage public funds paid to Cymad, in the period after 1 April 2003? In relation to the second question, we examined whether:

 - a** criteria for funding and other requirements placed on Cymad by public bodies were sufficiently robust; and
 - b** the public bodies that provided funding complied with their own arrangements and managed public funding effectively.
- 6** In answer to the first question, we concluded that Cymad did not adequately control much of the public funding that it received and could not account for some of the public funding that it was awarded. In some cases, the company had also overcharged the funding bodies, but there was no evidence that it deliberately misused public funds. In our view, these problems arose mainly from poor understanding of the stringent rules governing EU funding and weak financial management within the company.

- 7** Cymad was ultimately asked to repay £259,000 of EU grant, representing 28 per cent of total European funding and seven per cent of the total public funding that it received in the five years to 31 March 2008. In contrast, there were few problems with the non-European funding that Cymad received. Cymad delivered most of its projects and contracts effectively, and an independent evaluation considered the Cyfrwng Welsh for Adults pilot project to have been successful. Cymad's demise has led to a reduction of jobs at the company and to two projects not being completed.
- 8** In answer to the second question, we concluded that the public bodies in general managed public funding in Cymad effectively, although there were administrative weaknesses in some public bodies which meant that they did not become aware of the problems in Cymad until the allegations were made in 2006. Funding criteria and contracts were generally robust but contract terms could have been stronger in some respects, especially to require the disclosure of suspected fraud by officials of the recipient body. We found that:
- a** The public bodies carried out appropriate financial appraisals for most of the projects. WEFO's appraisals brought to light risks to financial control and viability, but these did not trigger closer monitoring or more help for the company to establish appropriate systems.
 - b** WEFO funded Cymad by quarterly advances, but this created particular risks because of poor financial controls and liquidity risks at the company. Following a review which identified problems with the delivery of its contract, the Welsh Language Board (WLB) stopped funding Cymad in advance and this prevented financial loss for the Board.
 - c** Monitoring and audit arrangements for most of the bodies were effective, but those for WEFO and NCETW did not always highlight gaps in the documentation held by Cymad to support claimed expenditure. Cymad told WEFO that it had addressed weaknesses identified in a monitoring visit but did not in fact do so. The company's independent auditor certified grant claims which turned out to be seriously mis-stated.
 - d** WEFO acted promptly once the problems in Cymad's financial management became evident, and acted to reduce loss to the public purse by working with the company to bring together as much evidence for expenditure on EU funded projects as practicable.
 - e** Some public bodies in Wales did not share information effectively about the weaknesses they identified in Cymad's systems and controls, and there is no system to ensure that risk assessment and financial monitoring is coordinated between public bodies.
- 9** Every year, the public bodies in Wales distribute significant amounts of money to small organisations in Wales. In doing so, it is essential that they have mechanisms in place to manage effectively the risks of loss or misuse of public money by recipient bodies. We recommend that:
- a** All public bodies confirm the financial viability of grant recipients prior to approving significant amounts of grant aid, working together where possible to avoid duplication. Financial viability checks should be carried out by staff experienced in analysing company finances using the most recent financial information for the grant recipient and any group companies. As part of this review, public bodies should

- risk assess the financial management of the recipient.
- b** Public bodies conduct ongoing reviews of a company's financial position, in proportion to risk, to identify possible weaknesses in financial management and to take remedial action where necessary.
 - c** In drawing up contracts, public bodies should ensure that contract terms minimise the risk of additional costs to the public purse.
 - d** In order to minimise the risk of fraudulent use of public funds, public bodies should include a standard clause in grant offer letters which requires a recipient to inform them immediately in writing if any of its officers involved in public funding are suspected of involvement in fraudulent activity.
 - e** Whilst we recognise that private, not for profit organisations often work with significant cash flow constraints and usually need to be funded in advance, public bodies should assess and mitigate the risks for each recipient on a case by case basis. If officials identify risks to financial viability or weak systems and controls at an organisation, they should take steps to mitigate the risks by, for example, monitoring the project more closely and providing assistance to the organisation concerned.
 - f** The WEFO should consider extending the training currently offered to Assembly Government staff, to staff in other organisations in receipt of EU funding.
 - g** Public bodies should establish clear guidance regarding follow up action where weaknesses in financial management arrangements are identified.
 - h** The Assembly Government should require and enable its departments and sponsored bodies to share information on weaknesses identified in a grant recipient's financial management arrangements.

Part 1 – Cymad was unable to substantiate some of its claims for public funding, due mainly to poor financial management, but delivered most of its projects effectively

1.1 Cymad was a local enterprise agency established in July 1995 to assist the sustainable development of communities in Meirionydd and Dwyfor. It went into creditors' voluntary liquidation in August 2009 and is currently being wound up. This part of the report considers the allegations made against the company in 2006 and subsequently, the impact of those allegations and the underlying reasons for the company's demise.

Cymad was a significant provider of rural development services when allegations of financial mismanagement were made in 2006

1.2 Cymad is a not-for-profit company limited by guarantee and has no share capital. It describes its principal activity as the promotion of sustainable development, including economic, social, linguistic, cultural and environmental sustainability. The company pursued these objectives through projects that were financed from public sources through specific grants or contracts, time-limited and with restrictions on how funds could be used.

1.3 In the six years to 31 December 2005 Cymad reported income of £5.8 million, with a rising trend to £1.5 million in 2004 and £1.6 million in 2005. A large majority of this income arose from grants and contracts to deliver projects in the public interest. The company was a

significant player in the provision of business advice and various social and environmental projects in the Dwyfor and Meirionydd areas of Gwynedd where it was based.

1.4 From 2003, in order to strengthen its business, Cymad diversified into more commercial activities. These activities included a call centre (provided by a subsidiary company, Galw Cyf) and the rental of commercial property purchased with bank loans and secured with mortgages.

1.5 Up to 2006, Cymad was delivering projects and contracts for seven public bodies (Figure 1):

- a** the National Council for Education and Training in Wales (NCETW, now part of the Assembly Government);
- b** the Welsh European Funding Office (WEFO, part of the Assembly Government);
- c** Gwynedd Council;
- d** the Welsh Language Board (WLB);
- e** the Welsh Development Agency (WDA, now part of the of the Assembly Government);
- f** the Countryside Council for Wales (CCW); and
- g** the Wales Tourist Board (WTB, now part of the Assembly Government).

Figure 1 – Public bodies providing funding to Cymad

More detailed information on the projects is in Appendix 1

Public body and reason for funding	Payments ¹ (£000)
National Council for Education and Training in Wales (NCETW) Pilot project to develop more accessible Welsh language courses for learners.	973
Welsh European Funding Office (WEFO) Grants from the EU for six projects for environmental improvement, development of renewable energy and community development.	900
Gwynedd Council Funded Cymad to liaise with local farmers as part of an agricultural development project and provide drama workshops for a community development project.	614
Welsh Language Board (WLB) Welsh Language Initiative. Projects to support parents of children in Welsh language schools, help incomers integrate into the community and help small firms to make more use of the Welsh language.	466
Welsh Development Agency (WDA) Contracts to provide business advice to new businesses and farmers (continued by the Assembly Government from April 2006).	419
Countryside Council for Wales (CCW) Two environmental improvement projects.	124
Wales Tourist Board (WTB) Grants to install Welsh language signs in shops.	75
Welsh Assembly Government Environmental improvement project funded from the Aggregates Levy Fund.	30
Total funding	3,601

¹ Payments in the period 1 April 2003 to 31 March 2008

Source: Wales Audit Office

1.6 In May 2006, allegations about general financial mismanagement and possible fraud at Cymad became public following disclosures by the company's former finance officer. In relation to public funding, these allegations included:

- a** misuse of a subsidiary company's cheques;
- b** misuse of the company credit card;
- c** the creation of a false invoice by a supplier for one of the European projects, enabling the company to claim money from the Assembly Government that it had not actually spent;
- d** the company improperly accounting for value added tax (VAT), again enabling it to claim money from the Assembly Government that it had not spent;
- e** claims for the cost of staff time that was not spent on the relevant project;
- f** non-completion of work on one European project; and
- g** generally lax management and financial controls.

1.7 WEFO and the Wales Audit Office worked together to investigate the allegations insofar as they related to public funds and to assess the impact on the substantial amount of public money that had been awarded to Cymad to deliver projects in the public interest. North Wales Police also investigated certain allegations. WEFO worked with the company until the closure of the 2000-06 European Structural Funds programmes to confirm the eligibility of as much of the European funding as possible. We completed this report once these investigations had concluded in 2009.

Some of the public funding that Cymad received had to be recovered because it did not comply with funding conditions, but there was no evidence that it was fraudulently used

1.8 WEFO and the Wales Audit Office visited the company on several occasions to investigate the allegations and the use of public money by Cymad. These investigations comprised:

- a** a review of the company's management and financial systems;
- b** a review of the company's accounts and management information, including the minutes of its board of directors;
- c** a review of expenditure charged to the Managing Director's company credit card;
- d** sample testing of transactions relating to the contracts and grants provided to the company to check that they conformed with the conditions of the funding;
- e** a review of documents held by the funding bodies to support the funding they had provided to Cymad, including an external consultant's assessment of management systems commissioned by the WDA in 2006;
- f** interviews with the Managing Director, the former Finance Officer (who made the allegations against the company), the Finance Officer who succeeded him in 2006, and Cymad's external auditor; and
- g** liaison with the police on those allegations that it investigated.

1.9 Working with WEFO, we examined the claims for each main funding stream to ensure that they were properly supported by transaction records and complied with the conditions attached to the funding. We found that the results of this work fell into two broad categories, with non-European funding streams having a much lower level of error or discrepancy than EU funding.

Non-European funding was relatively straightforward with a low rate of error or discrepancy

- 1.10** Non-European funding sources were generally based on fixed sums (for example, a fixed payment for business advice visits) or reimbursement of specified expenses. They were relatively straightforward to administer and we did not find significant errors.
- 1.11** Claims for grant funding provided by the WDA, WLB, WTB and Gwynedd Council were adequately supported by project documentation and complied with the conditions governing them. There was one relatively minor exception: Cymad claimed £2,500 for management costs on a £25,000 contract with the WTB to administer a grant scheme for Welsh language signs in shops. This management charge was not provided for in the contract. The Cyfrwng contract was the largest source of funding for Cymad at the time the allegations were made and was correspondingly more complex. We found that Cymad was unable to fully support some of its claims due to a lack of appropriate documentation, although the overall costs appeared reasonable.

There were serious deficiencies in Cymad's management of EU-funded projects

- 1.12** WEFO awarded grants to Cymad for six projects with a total value of £2.13 million under the 2000-06 European Structural Funds programmes. These projects were governed by rules set by the EU and tended to be more complex and demanding than the funding conditions set by UK institutions. Cymad also had to comply with specific conditions on match funding (the EU covers only part of the cost of the project – the balance comes from other bodies), competitive procurement of goods and services, and publicity.
- 1.13** After exhaustive work, WEFO decided to disallow £259,000 of the £900,000 that it had paid to Cymad for EU projects. This represented an error rate of 28 per cent of the grant paid, but this was still a substantial reduction from the £459,000 that was initially disallowed based on the original documentation submitted by the company to WEFO. WEFO was able to reduce the figures by working with Cymad staff to confirm project expenditure after the initial assessment.
- 1.14** The principal discrepancies in the costs claimed were:
- a** Cymad could not demonstrate that its claims for overheads were calculated in line with the policy stipulated by WEFO (£67,975).
 - b** Claims for staff time were unsupported by timesheets in the format required by the rules (£46,297). Instead, staff costs had been apportioned to individual EU projects using estimated percentages of time spent.
 - c** Inclusion in claims of standard management fees totalling £37,145 for four projects. Only actual costs can be claimed for European projects.

- d For one project, the amount paid to a supplier substantially exceeded the amount awarded in the contract letter without a satisfactory explanation of the difference.
- e Payments relating to the Uwchgwyrfai project had been made via the bank accounts of Arian Byw, one of Cymad's wholly owned subsidiaries. Although this subsidiary was VAT registered and had therefore been able to reclaim the VAT relating to payments made, Cymad had also claimed the VAT from WEFO, resulting in the company benefiting from a potential overpayment of around £13,000 in EU funding.

1.15 Other important discrepancies were:

- a The largest grant offer, Mae'r Rhod yn Troi, was subject to a special condition that required all project funds (including advance payments) to be deposited in a separate bank account and used only for the project. Despite this condition Cymad used the advance for other purposes. They initially restored the funds into a separate bank account when instructed to do so by WEFO in 2007, but a subsequent WEFO inspection in late 2008 identified that the funds had again been used for other purposes, as Cymad used it to pay staff. On the second occasion Cymad did not have the money to restore the funds to the separate account, resulting in an error of £123,136.
- b No evidence of competitive tendering for £89,601 of project expenditure.
- c The company did not have enough evidence to support the project outputs that it reported to WEFO.

- d There is no reason to believe that the work claimed for each project was not done. However, there were problems in delivering the Uwchgwyrfai project to manage common land with fencing, cattle grids and interpretation boards. An external inspection in 2007 found that most of the work had been completed and work was in progress to finish the remaining work. However, a relatively small part of the project was never completed because an objection to the location of fencing and access points could not be overcome before the project finished.

1.16 In most cases, the errors appeared to be due to a lack of knowledge or understanding of EU funding regulations rather than a deliberate attempt to gain advantage. We found no prima-facie evidence of fraudulent use of public funding. The police decided to press charges in respect of one of the allegations that they investigated. In May 2007, the Managing Director was convicted of false accounting in respect of two cheques issued by Cymad's subsidiary, Galw, worth a total of £680, and was fined £500. This offence did not relate specifically to the public funding received by the company.

1.17 On the basis of the findings outlined above, we conclude in respect of each of the allegations:

- a Misuse of subsidiary company cheques: this allegation was proven through the conviction of the former Managing Director for false accounting. There was no impact on public funding received by the company.
- b Misuse of the company credit card: we found no evidence to support this allegation.

- c** The creation of a false invoice for one of the projects, enabling the company to claim money from the Assembly Government that it had not actually spent: WEFO identified one instance in which a supplier was paid more than the contract awarded without adequate explanation, but there was no proof that this was due to the creation of false invoices.
- d** The company improperly accounted for VAT, again enabling it to claim money from the Assembly Government that it had not spent: it was clear that VAT was poorly controlled during 2004 and 2005 and that there were discrepancies in inter-company balances, potentially allowing Cymad to claim the VAT element of expenses to which it was not entitled. However, the circumstances suggest that this was due to poor management rather than fraud.
- e** Claims for the cost of staff time that was not spent on the relevant project: WEFO found several instances in which staff time charged to projects could not be supported. This seemed to be due mainly to the lack of adequate timesheets.
- f** Non-completion of work on one project: we found no evidence that Cymad deliberately claimed for work that had not been done. Two projects were not completed: Mae'r Rhod yn Troi, because the construction stage had not been reached when payments were suspended; and Uwchgwyrfrai, where planning difficulties meant that some work was never completed.
- g** Generally lax management and financial controls: we agree that lax management and poor financial controls until 2006 were primarily responsible for the problems that Cymad faced in managing public funding.

Errors were due mainly to weak financial management in Cymad

- 1.18** Cymad did not appear to fully understand the strict rules governing the EU funds and were unable to apply them in practice. The rules on charging overheads to projects changed after the projects were approved, causing further difficulties.
- 1.19** Cymad had a tendency to over-claim on overheads and management expenses. This demonstrates a common problem in organisations that depend largely on public funding that is restricted to specific projects. If the funding conditions require the money to be spent only to meet costs that are directly attributable to the project, an organisation will find it difficult to cover all of its corporate overheads. This problem can be avoided if the company has other, less restrictive sources of funding (for example, from commercial activities or public core funding) or if it is allowed to make a profit on contracts, for example through competitive procurement rather than grant funding. The 2007-2013 EU programmes increasingly use competitive procurement rather than grant funding when distributing the Structural Funds to providers.
- 1.20** Cymad's financial systems and controls were weak. Project managers were primarily responsible for keeping essential records and preparing financial information for inclusion in grant claims for their projects. There was no single system used by all project officers to record this information and no detailed procedure for them to follow. WEFO found that the information kept to support claims was poorly organised and disjointed.

1.21 Financial management at the corporate level was also weak in several respects:

- a** As a small company, Cymad relied heavily on its finance officer to operate the financial systems. However, there were no management controls to ensure that the company had the financial skills, capacity and resources it needed, and to detect and put right any shortcomings in a timely way.
- b** Regular bank reconciliations were not done until 2006, so the company did not know whether its bank balances and accounting records matched each other. Bank reconciliations are an essential control in any business. They were particularly important in Cymad because the group had several bank accounts, and would pay invoices for one project or company from another account if sufficient funds were unavailable in the correct account.
- c** A new Finance Officer was appointed in 2006. She reported errors in VAT returns and inter-company balances, with resulting mis-statements in the accounts of Cymad and its subsidiary Galw in 2004. She also found some invoices that had been filed but not posted in the accounting system.
- d** Management accounts were not routinely prepared for the group as a whole. Management accounts enable the business to see how it is performing and to consider its financial position, and to take appropriate action, for example to address cash flow problems or variations from budget.
- e** The Board did not exercise adequate oversight of the business. As it did not receive regular management accounts, it was unaware of the overall financial health of a company that had liquidity

problems and was growing quickly, both key risks that needed to be managed carefully. The Finance Officer did not usually attend board meetings, and there were no board meetings at all between July and November 2005. The minutes of board meetings did not record important discussions or decisions in sufficient detail, so it is unclear whether financial weaknesses that were brought to the Board's attention (for example, in relation to the quality of accounting records) were properly addressed.

For the most part, Cymad delivered its projects effectively and an evaluation showed that the Cyfrwng project was a success

1.22 Cymad delivered the majority of its projects and contracts effectively. The funding bodies were generally satisfied with the progress and performance of the projects and contracts, although there were some delays in establishing projects or in providing monitoring information.

1.23 Cymad delivered the majority of the outputs predicted for its EU-funded projects, meeting or exceeding 10 of the 16 targets for five of the six projects that were being funded in 2006 (Figure 2). However, these figures need to be interpreted cautiously, as some of the outputs reported are not supported by documentary evidence. The main project, Mae'r Rhod yn Troi, did not deliver any of the forecast outputs because none of the capital works had taken place when payments to the company were suspended in October 2006. However, considerable work was done on feasibility studies for the hydro-electric energy projects that the project was designed to

Figure 2 – Outputs delivered by EU funded projects sponsored by Cymad

Output	Target	Actual	% achieved
Jobs created and safeguarded			
Number of gross new direct jobs	8	8	100%
Number of gross new indirect jobs	6.5	6.5	100%
Number of gross new jobs in community-led projects and community enterprises	1.5	1.5	100%
Number of gross jobs safeguarded	15.0	13.0	87%
Business support			
Number of new SMEs benefiting from support and advice	100	117	117%
Number of existing SMEs benefiting from support and advice	500	717	149%
Renewable energy			
£000 increase in turnover of supported companies	1,820	0	0%
Number of exemplar models developed for clean energy	1	0	0%
Supported projects rolled out into private sector supported production	10	0	0%
Community development			
Number of community groups assisted	228	146	64%
Number of inter-agency partnerships/regeneration initiatives supported	21	19	90%
Number of community environmental appraisals undertaken	5	5	100%
Number of community environmental enhancement projects supported	15	15	100%
Number of community led projects supported	30	33	110%
Environment and public access			
Number of access management projects	12	12	100%
Number of kilometres of managed access	36	24	68%
Number of land management projects	12	12	100%
Number of hectares brought under sustainable management	1,522	1,483	97%
Number of kilometres of traditional boundary created or renovated	0.2	0	0%

Source: WEFO

deliver. There is typically a long lead-in time before most construction work takes place on such capital projects. The other five projects spent 67 per cent of their budgets after deducting ineligible costs.

- 1.24** The NCETW evaluated the Cyfrwng Welsh for Adults contract in 2006 as part of a wider evaluation of its Learning Challenge Fund. The contract was a pilot project to increase the capacity of Welsh for Adults providers to deliver in a non-traditional way by providing new accessible courses, designed in a way that would lead to fluency. The evaluation concluded that the project had been a success and had delivered significant benefits in Welsh language tuition for adults. The project had exceeded four of its five targets, was well managed on a day to day basis and had demonstrated that the innovative methods piloted in the project could be successful in generating demand for Welsh for Adults learning. There had been some delays in setting up the project and a short hiatus due to a change in project manager, but these did not detract from the overall achievements of the project.

The demise of Cymad led to a reduction of jobs at the company and prevented the completion of some projects

- 1.25** WEFO suspended payments to Cymad in October 2006, and the company's income from publicly funded projects fell dramatically as it no longer benefited from public sector business. This funding was crucial to the company's existence and its withdrawal meant that it was no longer viable. The cost of employment litigation and losses on property investments added to the financial stress on the company. On 7 August 2009,

the company was placed into creditors' voluntary liquidation. The Statement of Affairs shows creditors of £556,000, £512,000 (92 per cent) of which is to public bodies (£201,000 for unpaid tax and National Insurance, and £311,000 to the Assembly Government for grant reclaimed by WEFO and rent on the company's premises). It is currently unclear how much money the creditors will receive from the liquidation. However, Cymad no longer provides publicly funded services in North Wales and the company no longer employs any permanent staff, although its subsidiary Galw employs about 25 people in its call centre business.

- 1.26** The suspension of payments meant that Cymad did not complete two of its EU funded projects: Mae'r Rhod yn Troi and Uwchgwyrfai. Mae'r Rhod yn Troi was undertaking feasibility studies for mini hydro-electric schemes when payments were suspended in 2006, and none of the schemes were ever delivered. WEFO was unable to replace Cymad as the project sponsor before the closure of the 2000-06 European programmes. There were also some problems in completing Uwchgwyrfai (paragraph 34), but again the bulk of the project was delivered as intended.
- 1.27** The impact on non-European projects is less significant. Cymad completed outstanding work and any continuing contracts were transferred to other providers.
- 1.28** WEFO was aware from mid 2006 that Cymad would probably be unable to complete some of its projects and that there was a risk that a significant amount of EU funding would be recovered from the company. As part of its normal risk management and financial planning procedures, WEFO adjusted its funding plans to reflect possible under-spends on projects run by Cymad (along with many

other project sponsors) and released the funds for alternative projects. As a result, WEFO does not believe that the under-spends at Cymad caused the loss of any EU funding to Wales, although any part of the £259,000 reclaimed from the company that is not returned by the liquidator does represent a loss to the taxpayer.

Part 2 – Funding contracts were generally robust and the public bodies acted promptly when problems became evident, but some administrative weaknesses meant that errors by Cymad went undetected until the allegations were made

2.1 During the period 1 April 2003 to 31 March 2008, Cymad received £3.6 million in public funds. Around £2.9 million of this amount was received prior to 31 March 2006, and before allegations of misuse of public money by the company had been raised with the Auditor General. This part of the report looks at how well the funding bodies managed the public money that they provided to Cymad, and whether they had sufficient safeguards to avoid loss or misuse.

The criteria and other requirements placed on Cymad by the public bodies in Wales were generally robust but could be strengthened in some respects

Cymad was eligible to receive funding under each of the public bodies' grant schemes

2.2 In order to qualify for grant funding from each of the public bodies, Cymad was required to submit applications for grant aid demonstrating that they met scheme eligibility criteria and agreed to comply with the terms and conditions of funding. From our review of documents provided to Cymad by the various public bodies, we are content that, at the time of approval, Cymad had met the eligibility criteria for all of the grant schemes or contracts under which it subsequently received funding. However, we identified

some areas where the funding criteria and contractual arrangements set out by the public bodies managing the various grant schemes could be strengthened.

None of the funding agreements required Cymad to disclose that a senior official of the company was under suspicion of fraudulent activity

2.3 None of the terms and conditions of the funders required a grant recipient or contractor to disclose the fact if a senior official, with access to public funds, was suspended or found guilty of a criminal offence. Cymad continued to receive funding from some of the public bodies after its Managing Director was charged with false accounting in 2006.

2.4 Whilst most of this funding represented small final payments on grant schemes which had been ongoing over a period of time, the Assembly Government's Department for Rural Affairs and Sustainability made a £30,000 grant payment in respect of a new project in December 2007. WEFO (also part of the Assembly Government) had suspended payments to the Company in October 2006 following an investigation into allegations regarding Cymad's misuse of public money.

2.5 The new project was originally approved by the Department for Rural Affairs and Sustainability in November 2005, before the allegations of misuse of public money. But, the terms and conditions of

funding did not require Cymad to inform the Department if there was any suspicion that senior officials of the company were involved in fraudulent activity. Although it was reported in the press, staff in the Department for Rural Affairs and Sustainability told us they had been unaware of the case involving the Company's Managing Director and had not, therefore, considered any additional safeguards in their funding arrangement with Cymad.

- 2.6** There is no evidence to suggest that any amounts paid to Cymad after May 2007 related to irregular expenditure. However, public bodies have a responsibility to minimise the risk of fraudulent use of public funds. In doing so they should seek disclosure, at grant application and on an ongoing basis, where there are suspicions or evidence that officials of recipient bodies are involved in fraudulent activity. Such disclosures should trigger a re-assessment of the risk posed to public money so that appropriate measures can be taken to mitigate the risk, for example through closer monitoring.
- 2.7** We note that WEFO has now inserted a standard clause in all grant approval letters for the 2007-2013 Structural Funds programmes which requires grant recipients to inform WEFO immediately, in writing, if there is any suspicion that any of its officers, with access to public funds, is involved in fraudulent activity. We recommend that other public bodies do similarly.

Criteria for WTB funding were unclear

- 2.8** The WTB grant terms and conditions were not clear on whether funding should have been paid in advance or in arrears. The terms indicate that £25,000 funding for the Welsh Signage Scheme should have been received in arrears, and following proof that work had been carried out, but in fact Cymad received £25,000 in advance each year. In addition, the company retained ten per cent of the total funds advanced by the WTB for administering the scheme, despite there being no reference to any such retention in the grant terms and conditions.

There were some minor weaknesses in the terms and conditions of the Cyfrwng contract

- 2.9** The Cyfrwng contract was generally robust and enabled NCETW to manage the project effectively. However, the terms and conditions did not refer to the funding arrangements relating to maternity leave by Cymad employees. Although the contract was silent on this issue, NCETW funded a replacement for the project officer when she went on maternity leave and reimbursed Cymad for the maternity pay. And the contract did not specify arrangements for replacing project staff who left the company, so that NCETW could not rely on the contract to ensure that a departing manager was replaced quickly with someone of similar skills and experience.
- 2.10** It is important that, in drawing up contract terms and conditions, public bodies are clear about the arrangements for replacing key staff who are absent for a prolonged period through maternity leave or sick leave. This is necessary both to ensure that suitable replacements are found quickly and to avoid additional costs such as maternity pay above the statutory amounts.

Weaknesses in administration meant that some public bodies did not detect errors by Cymad until the allegations were made, but they acted promptly to deal with the problems once they became evident

2.11 Public bodies are responsible for administering grant funding so that the risk of error or misuse by the recipient is kept as low as practically possible. As part of this audit, we considered whether the public bodies that provided funding for Cymad:

- a** assessed the financial viability of the company when it applied for funding;
- b** complied with their own procedures when making payments;
- c** had adequate arrangements to confirm that the amounts claimed were correct;
- d** acted appropriately when problems at the company became evident; and
- e** worked together and shared information to reduce risk and avoid duplication.

WEFO undertook financial appraisals that indicated weaknesses in financial controls

2.12 WEFO grant appraisal procedures include a requirement for project sponsors, such as Cymad, to submit their last three years' audited accounts in support of their application for grant assistance. WEFO should only approve grant aid when it has confirmed that a project sponsor is financially viable and that the risk of loss of public money is minimal. WEFO has a financial appraisal team to assess the project plans of grant applicants and the financial viability

of private companies that are applying for grants. During the 2000-06 programmes, it was usual for project officers in WEFO to refer business plans and grant applications for private and voluntary bodies to the financial appraisal team for advice.

2.13 Cymad was a small company that depended on grant funding from public bodies for its existence. At the beginning of the 2000-06 Structural Funds programmes, it was seeking to diversify into commercial ventures, including property acquisitions that were funded mainly by bank loans. However, the company did not have significant cash reserves to meet any unexpected expenditure or shortfalls in income, including delays in receiving grant income or repayment of grant if the conditions of funding were not met. Cash flow was tight, and a reduction in project income would have made it more difficult for the company to meet its overhead costs. These factors meant that the company was financially vulnerable and tight financial management was essential to maintain the company as a going concern. The viability of the company was at risk of changing over time depending on the fortunes of its various projects and commercial operations.

2.14 WEFO carried out financial appraisals for three of its six projects, starting in December 2003 for the Uwchgwyrfai project and again in August to December 2004 for the Mae'r Rhod yn Troi project. These appraisals rightly picked up risks to Cymad's viability and the appraisal for Mae'r Rhod yn Troi recommended appropriate conditions in the project's grant offer letter. It was also apparent from the appraisals that the company did not prepare management accounts and was unable to provide other requested financial information, including the company's annual accounts, on a timely basis. These shortcomings indicated weak

financial control and a greater risk to financial viability. In hindsight, such weaknesses should have triggered closer monitoring of the company's financial systems or help for the company to establish appropriate procedures, but this did not take place. Since the Cymad grants were approved, WEFO has introduced inception visits for all project sponsors. WEFO staff visit the project sponsors to review their systems in some detail and provide advice and assistance as required. Regular follow-up visits are undertaken, based on a risk assessment.

Advance funding provided by WEFO was especially at risk due to poor financial controls and liquidity problems at Cymad

2.15 The terms and conditions of funding by the WLB, the former WTB and WEFO permitted advance funding to Cymad. In the case of the WLB and the WTB this advance funding was for relatively small amounts of money annually. However, in April 2005, WEFO made an advance payment of £123,000 to Cymad in respect of the Mae'r Rhod yn Troi project. The conditions attached to the grant required the advance to be ring-fenced and separately identified in the company's annual accounts.

2.16 Advance funding to voluntary and private not for profit organisations fully complied with EU and WEFO terms and conditions of funding during the 2000-06 EU Structural Funds programmes. Following WEFO's review of the company in 2006, it became clear that Cymad had not complied with the requirement to separately identify the advance funding for the Mae'r Rhod yn Troi project in their accounts and that the funds had been used to finance other company expenditure. Although WEFO immediately suspended payments for this particular project, it was ultimately unable to fully recover the advance funding from Cymad.

2.17 Advance funding by public bodies may be appropriate for small voluntary or not for profit organisations which face cash flow difficulties and would otherwise rely on bank lending that would be expensive or difficult to obtain. However, there are increased risks arising from such funding relating to failure to deliver the project or misuse of public funds. Public bodies need to manage these risks carefully, ensuring on a case by case basis that monitoring of such funding is robust and reflects the risk posed by the recipient. In Cymad's case it is clear that they would have needed advance funding due to the absence of any cash reserve, but this funding was high risk due to the financial systems and cash flow difficulties in the company.

The funding bodies dealt properly with claims for payment, although there were some weaknesses in NCETW's financial monitoring

2.18 The terms and conditions of funding of each of the public bodies required Cymad to submit claims for payment at regular intervals during the life of the project. These claims were subject to internal checks by each public body, prior to being approved for payment. From our review of a sample of claims submitted by Cymad, we are content that funders only made payments once claims had been authorised internally.

2.19 During the period 1 April 2003 to 31 March 2008, Cymad received £973,000 from the former NCETW in respect of the Cyfrwng contract. The original contract stated that NCETW would pay the contractor a maximum of £989,000 of total approved expenditure of £1,448,000 or 75 per cent of the total project costs, whichever was the lower. The remaining expenditure would be made up of match funding from the colleges, who would fund half the salary cost of the tutor organisers.

2.20 From our review of expenditure claimed by Cymad under the Cyfrwng contract, we noted that there was close monitoring of project indicators, for example, the number of calls made to the Cymad-operated information line, and the progress of the project generally. However, project costs and match funding were not so closely monitored:

- a** Cymad did not provide details of match funding actually provided by the colleges when it invoiced NCETW (as required by the contract) because this information was not always available to Cymad when it prepared invoices. NCETW was therefore unable to confirm whether its contribution was less than 75 per cent of the total project costs as stipulated by the contract, and no final reconciliation was undertaken to confirm that this condition was met.
- b** NCETW did not check supporting evidence for all of the project expenditure to confirm that Cymad had actually incurred the amounts it was claiming. The contract required an external audit at the end of the project to confirm reported expenditure, but this was not undertaken.

2.21 As reported in **Part 1**, Cymad did not hold supporting documents for some of its expenditure on the Cyfrwng contract. Due to the lack of supporting documents, we were unable to quantify the precise amount by which payments made by NCETW during the contract period were inaccurate. NCETW did not detect the potential errors because it did not fully enforce the contractual provisions for supporting documents or a post-completion audit.

Monitoring and audit arrangements did not highlight gaps in the documentation held by Cymad to support claimed expenditure

2.22 It is important that public bodies have arrangements to ensure that public funds are used for the purposes intended. They can seek assurance in a number of ways. For low risk or low value grant schemes, a public body might place reliance on a certificate from a senior officer of the recipient body stating that funds were used for the purposes intended. In other cases, the public body will carry out monitoring visits to the recipient body or place reliance on an audit certificate from an independent accountant.

Audit certificates received by WEFO each year did not highlight weaknesses in the documents held by Cymad in support of EU project expenditure

2.23 With the exception of the European funding, the terms and conditions of the various grant schemes did not explicitly require monitoring visits to Cymad. In order to ensure that European Funds were used for the purposes intended, WEFO required annual audit certificates in respect of expenditure claimed by grant recipients. They also carried out monitoring visits to a sample of grant recipients in compliance with European regulations relevant to the 2000-06 EU Structural Funds programmes.

2.24 The requirement for external audit is a valuable control which has highlighted weaknesses in many other claims submitted to WEFO by grant recipients. However, although there were clearly deficiencies in the documents held in support of expenditure claimed by Cymad prior to WEFO's first visit to the company in November 2006, these deficiencies were not highlighted in the audit certificates WEFO received, and WEFO placed reliance on them in continuing to make

payments to the company. WEFO received unqualified audit certificates every year for each of the projects it was funding at Cymad, although much of this expenditure was subsequently found to be ineligible for EU support. This situation highlights a potential weakness in WEFO's system of controls over project expenditure, as the value of the audit certificates depends on the robustness of the audits. In Cymad's case it was clear that the audits fell short of what was required to prevent payments to which the company was not entitled.

WEFO should have carried out a follow-up visit to Cymad to ensure that weaknesses identified during an earlier monitoring visit had been addressed

2.25 The July 2004 monitoring visit to Cymad for the Cadw'r Lliw yn Llŷn project had highlighted weaknesses in the company's systems and controls which subsequently gave rise to much of the ineligible expenditure identified in 2006. At the time of the initial visit the company had spent very little on the EU project. However, the report highlighted, for example, a lack of information regarding Cymad's tendering procedures, and a need to establish systems for the collation of documents to support project spend. WEFO have told us that these issues were not untypical of weaknesses identified at other organisations that were setting up systems and processes for managing EU funds.

2.26 Following the monitoring visit, Cymad provided written assurances to WEFO that they had addressed issues arising from the visit. However, despite these assurances, the Company had not done so. A follow-up visit to the company soon after the initial visit would have enabled WEFO to ascertain if the systems were operating as Cymad had claimed, and to take remedial action where

this was not the case. Such a visit would have been particularly appropriate as the weaknesses identified were systemic and likely to apply to the other projects run by the company, which amounted to a significant value.

2.27 Ongoing review of Cymad's financial viability by the WEFO, including annual review of their financial statements, may have alerted WEFO to possible weaknesses in the company's financial management and enabled them to take remedial action at the company prior to allegations being made about the misuse of public money. This review is particularly important for grant recipients such as Cymad which receive public funding over a number of years, during which their financial stability may change.

2.28 WEFO believes that it was reasonable to rely on the company's repeated assurances in the absence (at that time) of other evidence of poor financial control, and that it was not cost-effective to undertake follow-up visits routinely in all such circumstances particularly when they had received unqualified audit certificates in respect of project spend. WEFO has since introduced inception visits and regular project reviews for all projects under the 2007-2013 programmes.

2.29 Subsequent investigations by WEFO and the WAO revealed major weaknesses in the documentation available to support grant claims and that financial control at Cymad was poor. This information did not come to light until 2006. A separate review commissioned by the WDA, to confirm funding for its own payments to the company, also concluded that management and financial capacity was weak. However, this work addressed the WDA's concerns only and the other funding bodies were unaware of it until it had been completed.

There is a general lack of understanding of the documentary requirements of EU funding

- 2.30** From our review we are unable to determine whether the company's failure to comply with the requirements of EU funding was deliberate or whether it was the result of a lack of understanding of those requirements by Cymad staff. It is clear however that the company lacked robust financial management arrangements and the financial expertise to manage EU funding appropriately.
- 2.31** The documentary requirements of European Funding are complex. Although guidance is available from WEFO, for example in the grant offer letter issued in respect of each project and on their website, our work auditing EU projects managed by the public sector bodies in Wales suggests that this guidance was not always understood. As with Cymad, common problem areas include procurement, failure to retain timesheets and the use of an incorrect methodology for the apportionment of overheads. Although WEFO had issued guidance on these issues to the company following their monitoring visit in July 2004, Cymad do not appear to have followed this advice.
- 2.32** For the current (2007-2013) round of EU Structural Funds programmes, WEFO have issued more comprehensive guidance to project sponsors. In addition, staff in the Wales Audit Office are working with staff from WEFO to provide training in respect of the documentary requirements of EU funding for staff managing EU projects within the Assembly Government. However, WEFO should consider whether there is a need to extend this training to other grant recipients, particularly small companies like Cymad, in order to minimise the risk of clawback of EU funding by the European Commission.

WEFO acted promptly once the problems in Cymad's financial management became evident

- 2.33** In October 2006, when WEFO suspended payments to Cymad, Cymad had approval for an additional £1.23 million EU grant. Following the issue of WEFO's report in March 2007, Cymad gave assurances to WEFO that they would address the deficiencies in their financial systems and procedures which had given rise to the initial estimate of £459,000 grant recovery. They agreed to continue to submit expenditure claims to WEFO. Although these claims would not be reimbursed by WEFO until such time as WEFO had audited the documents supporting them, they could be used to reduce the outstanding debt if the company were able to demonstrate that it had addressed the weaknesses identified.
- 2.34** Over the next 18 months, Cymad submitted additional claims to WEFO totalling £155,000. However, despite Cymad's commitments to address weaknesses in their financial systems, a WEFO follow-up visit to the company in December 2008 found that standards of audit trail and record keeping at the company remained poor.
- 2.35** In June 2009, WEFO concluded that the company was either unwilling, or unable, to substantiate claimed expenditure, and resolved to pursue recovery of £259,000 grant funding from Cymad. This estimate included £101,000 in respect of the Mae'r Rhod yn Troi project.
- 2.36** From our review we are content that the work carried out by WEFO to identify the level of ineligible expenditure claimed by Cymad was robust. In addition, although we have some concerns about the length of time Cymad was given to address the weaknesses identified in their financial systems, we accept WEFO's view that an earlier demand for repayment

may have resulted in the company going into administration earlier, curtailing the benefits of the projects that the company was undertaking at that time. The work undertaken by WEFO staff to advise and support the company significantly reduced the potential repayment due and the amount of expenditure that will ultimately have to be reported to the European Commission as ineligible expenditure, and thereby saved around £200,000 of public money.

- 2.37** The liquidation of the company should further reduce the remaining £259,000 loss. As an unsecured creditor, the Assembly Government is entitled to a proportion of the proceeds from the liquidation. The liquidation is yet to be completed so the final dividend payable to unsecured creditors is not yet known.

Public bodies in Wales failed to share information effectively about the weaknesses they identified in Cymad's systems and controls

- 2.38** Prior to allegations about the possible misuse of public funds being made to the Auditor General, both the WLB and the former WDA had carried out monitoring visits to the company in response to their own concerns about possible misuse of public money. The WLB also carried out a risk assessment.
- 2.39** In 2005, in response to general concerns about project delivery, the WLB had ceased funding Cymad in advance, requiring them instead to produce invoices/claims for expenditure claimed. Staff in the WLB told us that they discussed their concerns and the results of their visit with officials in the Assembly Government. However, these concerns were not shared with other public

bodies, mainly because there was no system in place for this to happen, and these other bodies continued to fund Cymad as previously.

- 2.40** Similarly, an independent report commissioned by the WDA and issued in February 2006, which highlighted serious deficiencies in the company's financial management arrangements, was not made available to all of the other public bodies funding Cymad, although it was shared with WEFO.
- 2.41** Previous reports by the Auditor General have raised concerns about a lack of communication between public sector bodies in Wales. We note, in particular, the similarities between the findings of this review and the conclusions set out in the Auditor General's report published after the collapse of the North Wales based enterprise agency, Antur Dwyryd Llŷn Ltd, in June 2005. As with Cymad, Antur Dwyryd Llŷn was largely dependent on contracts and grants from the public sector, including funding administered by the former NCETW, and WEFO. Like Cymad, it was subject to poor internal controls and financial mismanagement, and eventually went into liquidation, leaving creditors of some £500,000 and owing the Inland Revenue a further £600,000.
- 2.42** The Antur Dwyryd Llŷn report highlighted that, prior to the collapse of the company, concerns identified by the Assembly Government during a financial eligibility assessment of the company were not shared with its sponsored bodies or the WEFO. It also noted the poor communication between various departments within the Assembly Government which had given rise to delays in a decision about whether to award match funding to the company.

2.43 Following their consideration of the Auditor General's report on Antur Dwyryd Llŷn in July 2005, the National Assembly's Audit Committee recommended in their report that standing arrangements be put in place for each body whereby information received by one part of the public sector is communicated in a timely way to all public sector funders. This recommendation was accepted with qualifications by the Assembly Government in their response to the Audit Committee's report. The Assembly Government's view at that time was that it should not be answerable for the practices of public bodies outside its control and that the provisions of data protection legislation might hinder information sharing. It was also concerned that data sharing beyond the Assembly Government could require complex new systems and considerable extra cost. The Chair of the Audit Committee responded by asking the Assembly Government to confirm that it would take a pragmatic and proportionate approach towards collective risk management and information sharing.

2.44 In their response to the Audit Committee's report, the Assembly Government also stated that the ongoing development of a shared database within the Assembly Government would enable their Departments to share information regarding grant recipients. It is disappointing to note that, more than four years after the Antur Dwyryd Llŷn report was issued, this database is not in place, and that the Assembly Government has failed to implement the Audit Committee's recommendations regarding improved communications to ensure that public funds are adequately protected.

2.45 However, we note that the Assembly Government is currently undertaking a project to look at the development of an effective and sustainable framework for the future management of grants. This work will seek to address some of the concerns identified previously. The project seeks to deliver better corporate processes, procedures and tools to support the appropriate award, monitoring and management of grants, identifying a consistent governance and regulatory framework for controlling resources to help safeguard against the misuse of funds.

2.46 The outline business case recommends the establishment of a corporate unified grants management IT solution that will facilitate the sharing of information between Assembly Government departments. A grants 'Centre of Excellence' has been established to promote high standards of grant management, by providing advice and support to grants managers throughout the Assembly Government. We welcome these developments. However we recommend that, in taking the project forward, the Assembly Government consider how the information generated by the proposed corporate system might be shared with other public funders in a timely way, to ensure that public funds are adequately safeguarded.

Appendix 1 – Publicly funded projects at Cymad

National Council for Education and Training in Wales (NCETW)

Cyfrwng Welsh for Adults contract: increase the capacity of learning providers to deliver in a non-traditional way by providing new accessible courses, designed in a way that would lead to fluency. Aimed at parents of Welsh medium nursery school children, non-Welsh speakers in Welsh speaking areas and people learning Welsh in the workplace.

Welsh European Funding Office (WEFO)

WEFO funded six projects from the 2000-06 European Structural Funding programmes:

Prosiect Uwchgwyrfai: environmental project to instal fencing, cattle grids and interpretation boards on common land.

Cadw'r Lliw yn Llŷn: environmental project to protect important wildlife on the Llŷn Peninsula, raise awareness and provide recreational opportunities.

Croeso Cymraeg Mewn Busnes: encourage businesses to add value to their services by using and giving prominence to the Welsh language.

Cwlwm Iaith-Ymlaen â'r Gymraeg yn y Gymuned: development of community-led projects to expand the use of Welsh in disadvantaged communities.

Amgylchedd Gwynedd: staff support and grants to encourage community groups to develop voluntary projects to improve the local environment.

Mae'r Rhod yn Troi: a development fund to help landowners develop hydro-electric power schemes in Gwynedd in a way that is sustainable and consistent with the natural environment. Assistance to research the concept, conduct feasibility studies and grants for capital funding.

Gwynedd Council

Menterra: Cymad liaised with local farmers as part of this £2.3 million pilot project to encourage farmers to develop new crops and link them with processing and marketing opportunities.

Llwyddo'n Lleol: Cymad provided drama workshops as part of this rural community development project, led by Gwynedd Council and funded by the WDA.

Welsh Language Board (WLB)

Welsh Language Initiative (Menter Iaith): local organisations which offer support to communities to increase and develop their use of the Welsh language, supported by grant funding.

Homework helpline to offer support to parents of children in Welsh medium or bilingual schools.

Inward migration project aims to raise awareness among incomers to the Llŷn Peninsula about the Welsh language as a community language.

Business Grant contract to provide financial support for small firms to make more use of the Welsh language, by paying for short translations, signage, leaflets or other visual materials.

Welsh Development Agency (WDA)

New business starts: Cymad provided business advice to start-ups under contract to the WDA.

Farming Connect: Cymad provided agricultural and food development advice to farmers under contract.

Countryside Council for Wales (CCW)

Lliw yn Llŷn: match funding for EU-funded project covering ground clearance, new footpath signage and improvements to habitat.

Uwchgwyrfai Common: two reports (Common Baseline Study and management study).

Wales Tourist Board (WTB)

Sense of Place grant: Cymad paid grants under contract to WTB to small business for Welsh signage.

Adfwyio: small amount of funding to upgrade footpaths and trails.