

Audit Committee AC-06-02(p3)

Draft Text of letter for the Permanent Secretary to send to:

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Audit Committee Evidence Session: Thursday 16 May 2002 "Continuing the Regeneration of Cardiff Bay"

Further to the Committee's session on 16 May, I undertook to write with further information on a number of matters.

Auditor General for Wales/National Audit Office direct access to information held by Cardiff Council.

I attach, as promised, a copy of the exchange of correspondence between Assembly officials and officers of Cardiff County Council. I have commissioned advice from the Counsel General on "reasonable access" as set out in the Section 165 agreements and have had an initial discussion of the matter with Sir John Bourn.

Funding or Financial Memoranda – Cardiff County Council/Harbour Authority.

The two section 165 Agreements set out the basis of, and for, payments to the Council for Harbour Authority and other functions and liabilities. The purpose of the funding or financial memoranda – which have no legal standing – is to define and set out the detailed arrangements under which grant payments will be made to the Council. I share the Committee's concern about the delay in finalising the financial memorandum, but it has been necessary for the Council and the Assembly Government to resolve two issues. The first, relating to the drawing down by the Council of its fixed or quantified costs entitlement, has now been resolved in principle. The other issue is VAT treatment.

The principles relating to VAT were set out in two key documents – the Memorandum of Understanding between the then First Secretary and the Lord Mayor in October 1999 which said:

"The Council will retain VAT otherwise payable in respect of Harbour Authority income and expenditure as far as is possible within the law, and will apply such sums to the functions, duties and area of the Harbour Authority, subject to consultation with the Assembly on the proposed spending.

The Assembly will facilitate, as far as is possible within current statutory provisions, the maximisation of the recoverable VAT payable to the Council in these circumstances. Overall funding levels will take account of the VAT recovered by the Council to an extent to be determined when the level of VAT recoverable can be quantified."

The latter sentence is a key point.

The 'Harbour Authority' s165 Agreement contains various provisions for the payment of grant, including

- in respect of 'actual costs' which may include a sum for VAT in circumstances where it may not be recoverable by the Council;
- for the Council, annually, to notify the Assembly Government of the amount of VAT recovered; and
- for the identification of the amount of VAT savings accruing in consequence of the Council carrying out the functions that would have been undertaken pursuant to an invitation to tender.

The amount identified in relation to the last point is shared equally between the Council and the Assembly Government. The Council's share is reduced by the amount of the VAT actually recovered, and any balance is due to the Council by way of a grant payment. That amount, together with the amount of VAT recovered, is retained by the Council but must be spent in relation to the functions, duties and area of the Harbour Authority.

This is complex and has proved difficult to define in terms of the draft financial or funding memorandum for the Harbour Authority. Both the Council and the Assembly Government agreed that a clear understanding of how it works in practice was needed. In 2001 the Council, in conjunction with the Assembly Government, began a detailed analysis of the VAT situation – for 2000-01 this involves considering over 2000 invoices. Each transaction incorporating VAT has had to be identified, along with the VAT status in terms of the Council's position, and linked to the provisions of the s165 Agreement.

Considerable progress has been made, and we hope to conclude the process shortly. In the meantime, the Council has not made any claims for VAT incurred and, as a consequence, no grant has been paid by the Assembly Government in relation to VAT.

Review of the Arrangement in the s165 Agreements

In responding to a question from Mr Cairns [93] I believe I said that 'all the section 165 Agreements had provision for them to be reviewed within the initial 5 year period'. I now understand that that is not the case as it is only the s165 Agreement with Cardiff Council in relation to the Harbour Authority responsibilities that has such a provision.

All the s165 Agreements, have a clause to the effect that they will continue to apply as long as any terms, conditions or covenants contained in the Agreement remain to be performed. They all also have provisions to amend or vary (but not terminate) the Agreement.

The 'Harbour Authority' s165 Agreement is exceptional and contains a provision that the arrangements in the Agreement shall be reviewed after the initial period (5 years from 27 March 2000). The review has to be completed within one year or a longer period if both parties agree. Subject to the outcome of the review, both parties (acting reasonably) can agree to amend the arrangements in the Agreement (or any of them); or either party (acting reasonably and not vexatiously) can call for the Agreement to be terminated on the basis of 12 months notice.

Dredging Costs

I would like to take this opportunity to clarify the answers I gave to questions [141] and [142] from Val Lloyd about the increase in dredging costs. I suggested that, in addition to market conditions, there was also some enhancement or enlargement of the contract specification to meet fuller requirements (including some necessity to redesign the saline sump), that contributed to the additional cost. I now understand that the basic tender specifications which were in two parts (the first to dredge to a sufficient depth to enable the statutory water quality standards to be met and the second to dredge deeper to facilitate greater water useage), these were planned by the former CBDC and issued by the Harbour Authority and were broadly similar. During dredging, some problems (unforeseen rock) were encountered in the saline sump area which required a different type of dredging operation to resolve. A dredging contract variation order was made and the Assembly approved an additional budget allocation. In the event, due to savings secured elsewhere in the contract, the additional budget allocation was not required. The increased dredging cost was principally the result of buoyancy in the dredging market at that time.

Bute Avenue PFI – completion of Compulsory Purchase Orders and Triggering of Overage Clauses

The Compulsory Purchase Orders (CPOs) were all made in 1996 and opened to claims in 1998 i.e. those affected by the CPOs were able to lodge claims for compensation arising from the CPO. There are 11 possible claims remaining unsettled, which represent about 5 per cent of all claims. Of these, 8 are under negotiation, with some of these being substantial and currently above original estimates. There have not yet been any claims on the remaining 3 CPOs. The current best estimate of total cost is £2.25 million but this largely depends on the outcome of Land Tribunal decisions, which are anticipated in three or four of the cases. The Welsh Development Agency envisages that the programme should be complete in two years.

The overage on Residential Development is calculated against Base Figures set out in the PFI Agreement i.e. £13.683m for Beazer, and £11.493m for Wimpey, (the aggregate anticipated sale prices at June 1999). These will be adjusted in line with the General Building Cost Index.

The Residential Overage relates to the amount by which the Gross Sale Proceeds exceed the adjusted Base Figure. 60 per cent of that will be due to the WDA (formerly CBDC). No overage is payable on Affordable Housing.

The overage provisions for the Commercial developments are more complex with different Base Figures for each of the main plots. The total Base Figure is £4,529m. The method of calculation is set out in the PFI agreement, which states that the overage due to CBDC (now WDA) varies between 60 per cent and 100 per cent.

To monitor the overage position for the residential development, the Agency has an appointed Project Professional to keep all records and terms of sales and advise the Agency accordingly. They provide monthly reports on the expenditure and progress of the commercial developments.

WDA consent is required before the disposal of any development sites by Citylink. There is a detailed procedure set out in the agreement regarding determining open-market value. Payment of overage will not be due until sites are sold, offices let etc.

Reporting Lines and Relationships between Assembly Government and Environment Agency

The Environment Agency is under a broad duty to provide the Assembly Government with all such information as it may reasonably require.

The Environment Agency has a range of responsibilities and statutory functions in relation to Cardiff Bay covering amongst other matters water quality, groundwater control, fisheries, and flood defence and protection. While in many cases there are no specific requirements for the Agency to report to the Assembly on the exercise of these individual functions and responsibilities, against the background of its general duty and the Assembly's wider policy and sponsorship responsibilities, there is frequent contact and reporting by the Agency to the Assembly Government and this includes matters relating to Cardiff Bay.

There are periodic meetings between officials of the Welsh Assembly Government and the Agency specifically related to Cardiff Bay. Welsh Assembly Government officials and those of the Agency also attend meetings of the 'Environmental Communications Forum' which are arranged by the Harbour Authority. Other contacts occur as and when specific matters arise.

More broadly, the Agency reports quarterly on progress across all its functions to the Assembly Government; quarterly meetings are held with officials and Ministers; and the Agency reports annually

on its performance and plans to EPT Committee. The Agency also produces annual reports and corporate plans relating to its activities in Wales and, more widely, in relation to England and Wales as a whole.

On the basis of these contacts, the Agency is reporting no major or specific issues relating to Cardiff Bay which are of significant current concern. The Committee was advised of matters relating to the operation of the automatic sluice gates in which the Agency has interests and responsibilities. The Agency also advises the Assembly Government on water quality, and specifically on eutrophication aspects, in relation to the requirements of European Directives.

Plymouth Park – increase in Running Costs

Janet Davies [159] questioned the discrepancy between the figures of £163,000 quoted in paragraph 4.23 of the AGW Report and £169,000 quoted in the reply to a Written Assembly Question given on 16 May. Paragraph 4.23 of the Report gives the figure as "in the region of £163,000". This figure has now been refined to £169,000. At transfer, when the estimates of cost were made, the Park was to some extent an unquantified liability because of the environmental problems involved with the landfill and the work that would be required to contain and control it. The increase to site management costs arises from the original estimate being conservative and the need to undertake additional work to ensure that the site and the surrounding areas are properly vented for methane. The increase to landscaping costs is also due to a conservative original estimate, but the latest figure also includes the additional cost of putting in place an on-site leachate treatment plant. While these works will initially increase cost they will in subsequent years secure long term savings.

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