

**Report of the Statutory
Inquiry into the Novas
Scarman Group (including
response to
representations)**

Private & Confidential

15 December 2008

Executive Summary

1 FINANCIAL VIABILITY OF NOVAS

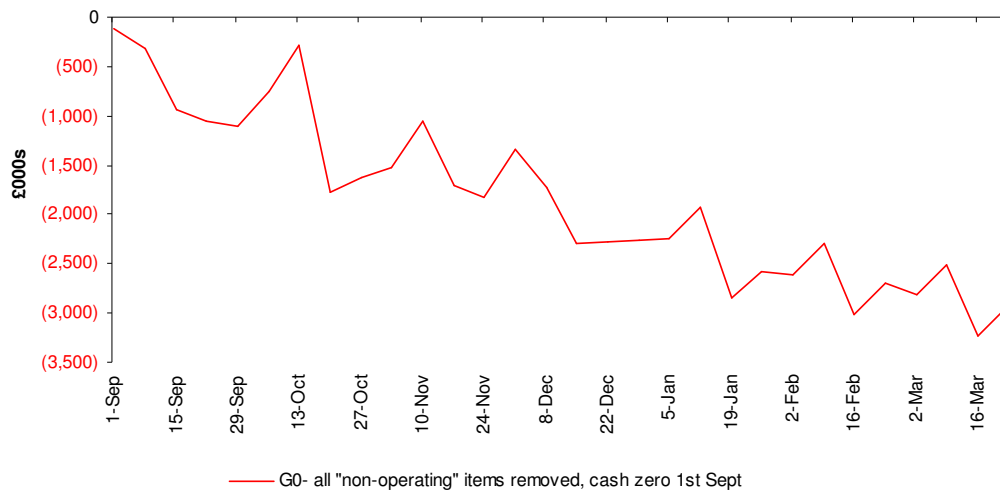
Please read the following in conjunction with timeline at the back of this Executive Summary.

1.1 *Sensitivity Analysis*

1.1.1 As part of the work undertaken on the financial viability of Novas, we have performed a number of illustrative sensitivities, adjusting a number of assumptions in the business model provided by Novas to assess their impact.

1.1.2 The sensitivity analysis shown in the graph below attempts to strip out all one-off inflows and outflows, such as property disposals, non-recurring grant income, and expenditure on Dean Street etc. It sets cash to zero at 1 September. This is in order to examine the underlying business.

Modelled bank balance, Sep 2008-Mar 2009

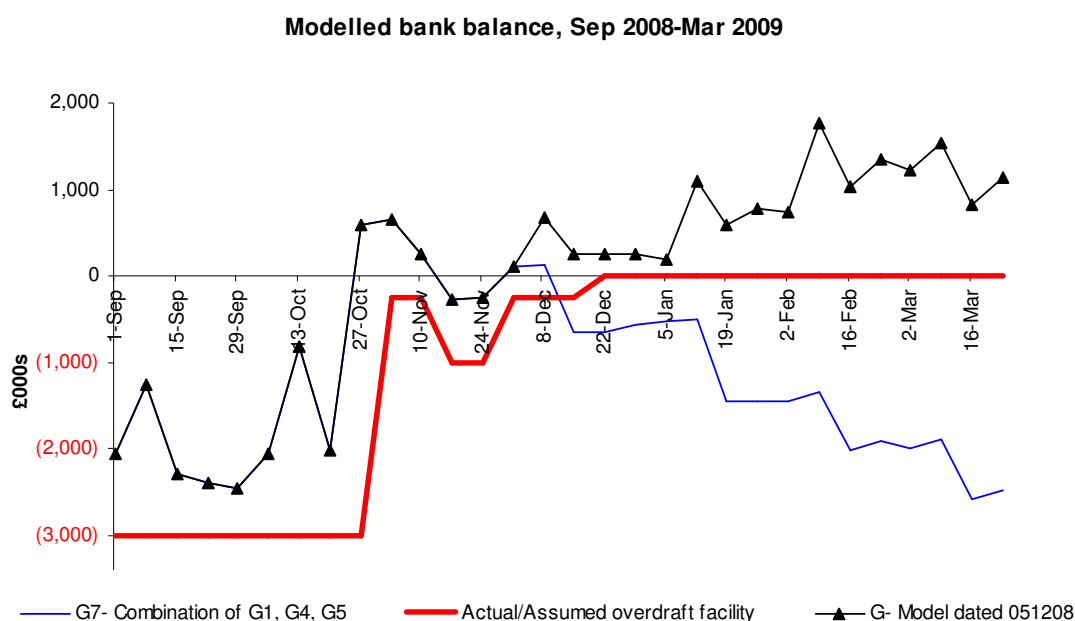


1.1.3 As can be seen, based on managements' own forecasts, the underlying business appears to be consuming more cash than it generates, leading to a net cash outflow of around £2.9 million in the forecast period to week commencing 23 March 2009. Unless the costs and income can be better aligned, it suggests that property disposals and/or bank loans will provide only temporary relief to Novas.

1.1.4 A second sensitivity analysis shown in the graph below reflects the impact of:

- (a) Increased December creditor payments to clear backlog and subsequent payments to historical levels;
- (b) No further inflows from property disposals during the financial year ending 31 March 2009, and
- (c) No inflow from the NWDA in respect of the remainder of the grant in respect of the Contemporary Urban Centre in Liverpool.

1.1.5 As can be seen, these adjustments result in an outcome for Novas with its bank overdraft peaking at a £2.6 million during the week commencing 16 March 2009 indicating how reliant Novas is on one-off cash inflows and creditor management in order to maintain a cash-positive position.



1.1.6 A breach of Novas’ current overdraft facilities could arise from the week commencing 15 December 2008 if the creditor backlog is cleared and if no new one-off funds are received.

1.2 *Short Term viability*

1.2.1 Novas runs the imminent risk of being insolvent. Under the terms of the Insolvency Act 1986, Section 123, the inability to pay debts is defined as follows:

“A company is deemed unable to pay its debts—(a) if a creditor (by assignment or otherwise) to whom the company is indebted in a sum exceeding £750 then due has served on the company, by leaving it at the company's registered office, a written demand (in the prescribed form) requiring the company to pay the sum so due and the company has for 3 weeks thereafter neglected to pay the sum or to secure or compound for it to the reasonable satisfaction of the creditor.”

1.2.2 At present, Novas is unable to pay creditors as they fall due, with a number of creditors have threatened/begun legal action against Novas. Short term viability is dependent on a number of one-off inflows from property sales, on not paying standard creditors as they fall due, and on either not paying Durkan Construction (“Durkan”) in full prior to reimbursement from Camden Council, or on having an overdraft facility in place to allow Durkan to be paid shortly before Camden reimburses Novas. As at 2 December 2008, Camden are still to pay the £850,000 owed to Novas, although AIB have indicated that a temporary facility is being made available until this payment is received. It has also been indicated to us that Camden are now prepared to pay Durkan directly rather than through Novas.

1.2.3 Provided that all of these factors are managed carefully, and that proceedings to wind up any of Novas’ companies have not commenced, it is possible that Novas can continue in the short term.

1.3 *Medium and Long Term viability of Novas*

- 1.3.1 We have assessed the medium and long term viability of Novas on the basis of the Business Plan forecast model produced by Matthew Brown, Interim Financial Controller. These forecasts do not appear to be complete, with the reduction of rental units not currently being reflected. Several drafts of these forecasts have been provided, and have contained several significant errors.
- 1.3.2 Three scenarios are now being considered; one in which Arlington House is retained, one in which it is disposed of, and a third in which both Arlington House and Dean Street are disposed of.
- 1.3.3 In the latter two scenarios, the model shows a business that is cash generative in the base case in most years.
- 1.3.4 On the assumption that Arlington House is retained, and that the business is obliged to fund several million pounds of unfunded capital spend on the property, the latest version of the model we have seen assumes a loan of £10 million is required.
- 1.3.5 The correct interest and capital repayments on this loan, which were initially wrongly calculated, would result in significant cash outflows in all but the current year.
- 1.3.6 It is difficult to understand how these outflows could be funded without further property disposals, such as the Liverpool CUC, or refinancing, something which is not modelled.

1.4 *Key issues identified during our review of going concern are as follows:*

- 1.4.1 **Cash:** The total aggregated cash balance as at close of business on 9 December 2008 was £144,517. Novas also has access to a £250,000 overdraft facility, which expires on 19 December 2008.
- 1.4.2 **Overdraft:** Novas's previous £3 million overdraft facility expired on 31 October 2008, on which day a VAT rebate of £2.5 million was received, without which Novas would have been significantly overdrawn without an authorised overdraft. Furthermore, on Friday 7 November 2008, Novas considered attempting to pay Durkan without having sufficient funds available to do so.
- 1.4.3 **Audit:** The audit of the Novas' financial statements for the year ended 31 March 2008 has not yet been completed, due in part to the fact that the accounting records of The Scarman Trust, which merged into Novas Overtures to form the Novas Scarman Group Ltd, were not complete when the merger took place. The Scarman Trust finance staff responsible were made redundant prior to effective handover taking place. The accounts should have been submitted to the Housing Corporation by the end of September 2008.
- 1.4.4 **Finance department:** Novas' finance function has undergone significant reorganisation over the past two years with a significant reduction in staff headcount. A further reorganisation is underway with several staff having been advised that they are at risk of redundancy. A consultation process has commenced, and at risk staff are due to be informed of their status by 15 December 2008. If a significant number of the existing finance team are not retained following this process, it is likely that a considerable amount of systems and 'in house' knowledge will be lost.
- 1.4.5 **Weekly Cash Flow Model:** Numerous versions of the weekly cash flow forecast have been produced. Previous versions have projected several overdraft breaches. The current version does not.

2 ARLINGTON HOUSE

2.1 *Introduction*

2.1.1 It is clear that Novas no longer have the cash flow to finish the Arlington House Project. The Novas SMT would argue that this is a moot point because:

- i). they have already decided to move away from the provision of beds, and
- ii). they have agreed with another RSL (One Housing Group) to take over the completion of Arlington House.

2.1.2 From evidence obtained during the inquiry and from interviews with Michael Wake and Maria Donoghue-Mills, Co-Chief Executives, it would appear that discussions commenced with One Housing Group during April 2008 yet it was not until 17 September 2008 that CLG were informed of Novas' cashflow difficulties by Michael Wake.

2.1.3 One possible rationale for Novas seeking to retain Arlington House until the last possible minute was in order to utilise its grant/rental stream to complete the renovation of the Liverpool CUC.

2.1.4 In order to refurbish Arlington House funding of c.£27m was initially required with cash being raised by the sale of eleven properties to St Mungo's for £14.26m. The remaining £12.77m was provided by way of a grant from CLG.

2.2 *Funding streams – disposal of hostels by Novas to St. Mungo's*

- 2.2.1 CLG had no objection to the disposal of the stock provided there was certainty that the proceeds from the sales would be fully reinvested in order to ensure that other schemes in the improvement programme were 'properly addressed'.
- 2.2.2 St Mungo's did eventually receive funding from both the Housing Corporation (c.£5.2m) and CLG (£7.4m) with St Mungo's contributing c.£1.6m giving a total of c.£14.2m.
- 2.2.3 Michael Wake writes to Maff Potts, specialist advisor with the Homelessness and Housing Support Directorate, CLG on 4 May 2005 to confirm that there will be further disposals 'in line with Novas' current strategies' and that Ennersdale House in Lewisham and Mare Street in Hackney will be included in the disposals programme. Mr Wake indicates that the disposals already agreed would raise approximately £7m which would enable the first stage of the remodelling of Arlington House.
- 2.2.4 However, Michael also states that there is a further £7m to £8m to find and if this money were not available then the remodelled Arlington would have large areas un-refurbished until the additional funding was found. Michael identifies the disposals of Ennersdale House and Mare Street as being able to provide these additional funds.

2.3 *The actual spend on the Arlington House project*

2.3.1 According to a spreadsheet prepared by Gerry Glover interim head of renewals finance at Camden, the total paid to Novas by Camden was £5,212,049 up to 13 October 2008. In addition to this, Novas have incurred further costs of £1,893,154 in respect of construction work undertaken by Durkan Limited and £99,613 mostly in respect of professional fees. Therefore it would appear that the total spend on the Arlington House project to date is £7,204,817.

Novas Architects

2.3.2 Novas Architects are mentioned at this juncture as they have charged costs in relation to the Arlington House of £811,245. It appears that they should have only received £630,000 based on 4½% of the construction costs of £14,000,000. There is a lack of clarity over an additional £180,000 of architects' fees received by Novas Architects. We have also noted that a benchmark of 4.5% was used for Arlington House whereas costs on the Liverpool CUC were only 2.6% although the same in-house architects were utilised on both schemes.

2.4 *The obligations incumbent on Novas relating to the project*

2.4.1 Novas told the Housing Corporation on the section 9 disposals forms that the hostels were being sold in order:

“To raise capital for Arlington House scheme & new social enterprises as agreed by ODPM, Housing Corporation & relevant local authorities.”

2.4.2 The social enterprise schemes were criticised by Maff Potts as he did not see any evidence that consideration had been given to their content, their business case or sustainability.

2.4.3 In an e-mail of 31 May 2007 Michael Wake recognises the need to have the budget confirmed but he also notes:

“Will nee [sic] to open up the fact that we do not have £14m as we have had other costs eg loan etc to pay off.”

2.4.4 Mr Wake asks his Finance Director, Will Melia, in his e-mail of 12 December 2007:

“Silly question-so we do not have the £14m set aside for AH development?”

2.4.5 Will Melia responded on the same day, stating:

“Michael, although we have a reserve to cover AH/Lpool-CUC/Soho-CUC it is not fully backed by cash. So I guess a long winded answer is, no we have not got the £14m cash set aside for Arlington.”

2.4.6 On 9 March 2008, Michael Wake drafts an upbeat letter to Maff Potts. It is not known if the letter was eventually sent. The salient parts of that letter are as follows:

“I write to inform you that the Group will honour its commitment to refurbish Arlington.....the Novas Group will fund the project up to £Xm matching (and exceeding the funds obtained from the CLG”

- 2.4.7 It would therefore seem that Michael Wake, having being told that the £14m was not set aside for the Arlington House Project by Will Melia, then proceeded to draft a letter to the CLG in upbeat terms saying that the capital raised from the sale of the hostels would go towards Arlington and Dean Street refurbishments. We also suspect that when he asked Will Melia if the monies were present he was feigning ignorance because he knew in May 2007 that they were not.
- 2.4.8 It seems that Novas held on to Arlington House as long as possible before seriously looking at its disposal. This may be because Arlington House generated income in the form of rental income which Novas would not want to forego until the last possible moment.

2.5 *The potential recipients of the £14m raised from the sale of the hostels*

2.5.1 As noted above, it appears that the funding provided by CLG via Camden has been used so far for the redevelopment of Arlington House. However, the use of the funding received from the sale of the hostels to St Mungo's is not as clear.

2.5.2 Of particular interest is that there is no mention is made in correspondence we have seen with CLG of the spending by Novas on the Liverpool CUC. We have established that the total spending on the CUC was £16,789,270. The building includes areas for restaurants, coffee shops, art galleries, office space and conference facilities.

2.5.3 Further, the explanation of Matthew Pike in relation to the spending of the £14.5m of cash generated from the sale of the hostels to St Mungo's appears now to be incorrect as it is clear that it is impossible for £13.8m to be spent on the CUC in Liverpool when also taking into account the £14.5m spend which was set out by Matthew Pike. Taking the two together would give a total spend of £28.3m (£13.8m + £14.5m). Novas do not appear have this level of cash reserves between 2005 and 2008. The monthly cashflow prepared by BDO shows that the maximum level of cash held was £22.3m as at 1 February 2006 leaving a shortfall of £6m (£28.3m - £22.3m).

Conclusion

2.5.4 Monies were received from funders after Novas SMT made verbal, written and e-mail assurances as to the use of the proceeds of the disposals of the St Mungo's properties. These monies are now not available and the end use has deliberately been hidden from central and local Government and Novas' regulator.

3 ALLEGATIONS OF FINANCIAL MISMANAGEMENT

Please read the following in conjunction with timeline attached at back of this report.

3.1 *Due Diligence report prepared by Beever & Struthers*

3.1.1 Beever & Struthers (“B&S”) were commissioned by Novas to prepare a due diligence report in respect of the proposed acquisition of The Scarman Trust under their letter of engagement dated 8 October 2007.

3.1.2 The resultant report makes it clear that it was not all encompassing.

3.1.3 The due diligence report sets out further areas of concern and recommendations.

3.1.4 It is clear that the report raises a number of serious concerns that B&S suggested should be dealt with prior to the transfer taking place.

E-mail documentation identified regarding the due diligence report

3.1.5 Michael Wake accepts at this point, prior to undertaking any external due diligence, that The Scarman Trust has numerous issues in respect of the financial management (e.g. weak cash flow position, weak finance team and Trustee Board). He also highlights the various positives of the merger (e.g. improved image, more political and government links, potential for further partnerships of similar nature).

3.1.6 Michael Wake emails Gnosoulla Tsiouppra-Lewis in this matter, stating:

“...Our auditors have undertaken a due diligence and did not raise any significant concerns (although not too in depth due to time scales)...”

3.1.7 It is important to note that this e-mail, dated 7 November 2008, is providing feedback on the due diligence review carried out by B&S prior to the B&S report being received by Novas. Further, Michael Wake claims that the due diligence review did not raise any significant concerns. As can be seen above,

the due diligence report outlines numerous areas of concern. Some of these areas of concern were considered of such importance that B&S suggested further work be undertaken to resolve or gain a greater understanding of them prior to the transfer being finalised.

- 3.1.8 These concerns were raised despite the limitation on the scope of the work. There is obviously the probability that if their scope had been widened, they would have uncovered more concerns.
- 3.1.9 An e-mail from Michael Wake to Will Melia and Maria Donoghue-Mills relating to the due diligence report and its findings, dated 29 November 2007, states that they needed to be proactive with the auditors in what they present.
- 3.1.10 We have also identified an e-mail dated 1 October 2008 from Paul Byrne, Management Accountant at Novas, to Michael Wake, Maria Donoghue-Mills, Matthew Pike and the senior members of the finance team (Matthew Brown, Liza Ryan and Lindsey McCormick), asking whether Novas requested a full due diligence report.
- 3.1.11 Maria Donoghue Mills immediately responds to this e-mail solely to Michael Wake stating:
- “Paul needs to go!!!”*
- 3.1.12 It would appear that it was portrayed to the Board that the issues with the Scarman Trust would be easily managed and rectified once the transfer was complete.
- 3.1.13 The extent to which the actual due diligence report in respect of The Scarman Trust was distributed to the Board members is not clear. However, following meetings that we organised, we understand that that at least two of the Board members present at this meeting do not remember receiving or reviewing the due diligence report.

- 3.1.14 Gnosoulla Tsioupra-Lewis stated that the due diligence report may have been distributed but stated that she was likely to only have read the Executive Summary.

3.2 *Allegations concerning misuse of a company credit card and abuse of senior management perks*

3.2.1 Since our inquiry began Michael Wake has reviewed the expenses that have been claimed on the company credit card and he has identified over £1,600 of personal expenses that should not have been claimed for. It is not clear whether Michael Wake would have taken this measure had the inquiry not been announced.

3.2.2 In respect of the hotel accommodation at the Pangkor Laut Resort, both Michael Wake and Erwina A-Ghafar have claimed that Erwina stayed with friends/relatives on the weekend of 15 - 17 August 2008. However, we have obtained an e-mail confirmation sent to Erwina A-Ghafar dated 12 August 2008 for a sea villa which indicated that it was for double/twin occupancy and that the reservation was in the name of Erwina A-Ghafar. Erwina has told us that she booked the accommodation in her name because she would obtain a better rate for Michael but she states she did not stay there.

3.3 Purchase of artwork by staff

- 3.3.1 We understand, based on discussions with Gnosoulla Tsioupra-Lewis, Chair of the Board of Novas, that the art scheme was introduced because Novas had previously bought too much art and as a result, an art director had been sacked
- 3.3.2 It appears that an employee of Novas can get 10% discount for each year that they lend the purchased piece of art back to the gallery. The art would be used in exhibitions staged by Novas at any of the CUC buildings. All the proceeds will go back into the gallery and the artwork will be insured by Novas.

Art purchases made by Michael Wake

- 3.3.3 It has been noted that Michael Wake was the only employee who took part in the scheme purchasing art for approximately £6,300.
- 3.3.4 Although it was the original intention that the art scheme was to be used to reduce the amount of art held by the organisation in the permanent collection it was on at least one occasion used to increase the amount of art.
- 3.3.5 On 23 October 2008, the day after our inquiry commenced, Michael Wake sent an e-mail stating:

“... for the sake of clarity and transparency that all art work that I purchased under this policy will remain with NSG and all purchases will be null and void.....”

- 3.3.6 It is clear that there are also VAT issues surrounding this scheme and Matthew Pike suggested to us that a specialist art VAT query may have delayed the November VAT re-payment that was crucial to Novas' cash flow.

3.4 *Cronyism*

- 3.4.1 After being made redundant from Novas, Tara Muthoora was employed as a consultant earlier this year and it would appear that the correct procedures were not adhered to. It is possible that the previous relationship between Tara and Michael Wake may have had an unfair influence on the decision to re-employ her.
- 3.4.2 Erwina A-Ghafar has had various promotions from architectural employee to director in the last few years. However, there is no clear audit trail in respect of these promotions.
- 3.4.3 As with Tara Muthoora above, a relationship between Erwina A-Ghafar and Michael Wake may have had an unfair influence on the decision to promote her and casts doubt on whether there was a sound business case for her to go on business trips to Malaysia with Michael.

3.5 *Nepotism and Manyee UK Ltd*

3.5.1 We have been able to confirm the following connections with Manyee UK Ltd (“Manyee”):

- i). Within Terry Lau’s personnel file, we have noted that his emergency contact is stated as being William Chung, his father-in-law. This matches the name printed on a Manyee business card.
- ii). Terry Lau was previously a director and 50% shareholder of Creative Design Projects Ltd. Alex Wan was also a director and 50% shareholder at the same time as Terry Lau. While in operation, the registered address for this company was 262 Oldham Road, Manchester – the same registered address as Manyee;
- iii). Terry Lau was previously a director of Oriental Buffet House Ltd and resigned in August 2005. However, he remains a shareholder of this company and his wife, Lisa Lau, is currently company secretary. The previous registered address for this company was also 262 Oldham Road, Manchester. Catherine Cheung was previously a director of this company. It is worth noting that Catherine Cheung is named as a director of Manyee on the D&B reports and at Companies House. She is also a 72.4% shareholder in Manyee UK Limited; and
- iv). We note that Alex Wan is a director of Oriental Buffet House Limited. As can be seen above, we have already established links between Terry Lau, and Mr Wan and Oriental Buffet House Ltd.

Payments made to Manyee

3.5.2 We understand that £414,000 has been paid to Manyee since March 2005 by Novas and a further £37,000 is still to be paid.

3.5.3 It has also been noted that Manyee have previously requested payment for work that had not been fully completed due to Manyee suffering cash flow problems. Novas’ finance team refused this payment.

3.6 *Payment of unused annual leave to Terry Lau*

- 3.6.1 We have obtained a copy of a payslip dated 29 February 2008 which shows that Terry Lau received £13,039.39 in relation to Annual Leave entitlement.

On 28 January 2008 Michael Wake sends an e-mail to Will Melia, Mary Connolly, Terry Lau and Maria Donoghue-Mills, stating:

“Please note the unusual request fo [sic] such a high payment to be made for TL (payment of 50 days accrued AL). This request is approved and should be paid by payroll in the next salary payment. It can be capitalised against AH as TL has had to lead [sic] this eg 3000 drawings in 2 months was just one of the hurdles he had to overcome this year.....”

- 3.6.2 We have obtained a copy of the policy in respect of “Annual Leave and Extended Leave – Version 4 (Review date: 25 June 2004)”
- 3.6.3 Paragraph 1.5 states that *“In highly exceptional cases only, up to 5 days annual leave can be carried over to the next period but needs to be taken within two months of the new period”*.

3.7 Funds payable to The Elspeth Kyle Trust

3.7.1 We have obtained a report and report summary dated 24 September 2003 prepared by Michael Wake in respect of the Elspeth Kyle Trust Fund. The purpose of the report is stated as being:

“To propose the establishment of a separate Trust to commemorate the work and life of Elspeth Kyle and her commitment to the voluntary sector.”

3.7.2 There is also a separate letter from Gill Saunders, then the Director of New Initiatives, dated 26 April 2004 stating that the Trust will be established with funds of £120,000. This was due to be funded by £35,000 from Elspeth Kyle’s legacy and £85,000 from Novas.

3.7.3 It is worth noting that no accounts or returns have been filed at the Charity Commission for this organisation since it was incorporated.

Amount of funds to be transferred to Elspeth Trust

3.7.4 Will Melia confirmed that he refused to sanction a payment of €160,000 requested by Michael Wake which was to be used for the set up of a joint venture company in Ireland (to attempt to draw down funds from the Irish government in relation to international development work), saying that Board approval was required in order to transfer funds to a separate legal entity outside of Novas.

3.8 *Tendering process*

3.8.1 We have obtained a copy of the “Novas Ouvertures Tender Book” which provides a pro forma “tender opening and recording form”. We have undertaken an initial review of the tender book and we have noted the following points:

- i). There are numerous instances when details of only one or two tenders are noted on the tender form in respect of tenders in excess of £10,000 – whereas the policies and procedures state that three quotations should be received in these circumstances;
- ii). There are a few occasions when the staff noted as being present at the opening of the tender documents have not actually signed the relevant box within the form – the reason for this is unclear; and
- iii). Out of eleven of tenders where George Jones & Sons were involved, they withdrew from providing a tender on five occasions.

3.8.2 It is also clear that on page 41 of the tender book a blank copy of the page has been glued on top of the original page. The original page had writing on it relating to a quotation relating to some additional work for the CUC and the parties involved were Manyee and John Fox. Terry Lau stated that the quotes were too expensive and so they were asked to quote again.

3.8.3 Terry Lau claimed that the page was stuck on top due to the fact that the work should have cost c.£5,000 (where only 2 written quotes are required) whereas the quotes were in excess of £12,000.

3.8.4 We also understand that on one occasion Samuel Prem Ananth was asked by Terry Lau to sign the tender book to state that he had witnessed the opening the documents relating to a respective tender when Samuel had not actually been present.

3.8.5 We understand that Liam Bedson, Senior Purchasing Officer at Novas, had expressed concerns about the tender process and procedures not being followed and as a result, Will Melia asked him to compile a report in this regard.

- 3.8.6 The report proceeds to outline various areas where the procedures were not followed according to the documentation within the tender report.
- 3.8.7 Michael Wake responded to this report stating “*When did LB undertake this report, who authorised it and was I notified it was to be done?*” No mention or concern is shown about the issues raised within the report by Liam Bedson. Michael seems interested only in the authorisation under which Liam carried out this work.
- 3.8.8 It may be worth noting that Liam Bedson has now left the organisation and Will Melia also handed in his notice on 9 September 2008, less than two weeks after the above exchange.
- 3.8.9 Terry Lau advised that there is some leeway of up to 25% above the agreed figure which he is able to approve. From our experience, we understand that this is high – typical Registered Social Landlords would seek re-approval above 5% to 10%.

3.9 *Non-compliance with purchasing policies and procedures*

3.9.1 Michael Wake sent an e-mail to various members of the Finance and Senior Management team, stating that the finance team were instructed to make payments in respect of the CUC as and when they were requested by certain specified individuals (these would appear to be Stuart Ball, Erwina A-Ghafar, Madhu Gajjar, Tony Graham and Terry Lau).

3.9.2 Therefore, the finance team were effectively instructed to pay creditors in respect of the CUC in preference to other creditors that may have been outstanding for a longer period. Due to their cash flow position, Novas were unable to make the payments to all creditors as they fell due.

3.10 *Payment of costs in respect of Joe McGarry's move to Australia*

- 3.10.1 Joe McGarry was employed in the role of Director of Operations CUC and was previously a member of the Novas Group Board. We understand that in April 2008, Joe McGarry resigned from Novas (effective from 31 December 2008) due to high levels of stress and planned to emigrate to Australia where his wife was born and raised.
- 3.10.2 We have obtained a letter dated 7 May 2008 from Mary Connolly to Joe McGarry in response to his letter dated 16 April 2008 giving his resignation with effect from 31 December 2008. The letter from Mary Connolly states that Joe McGarry will remain as Director of Operations CUC until 31 May 2008. Following a period of annual leave that he was entitled to, Joe McGarry was to be employed in the new role as International Development Director in Australia until 31 December 2008. His new salary was to be £34,000 per annum and the letter states that he was entitled to relocation allowance of £4,200 to cover removal and other expenses
- 3.10.3 It is not clear whether Joe McGarry applied for his new position of International Development Director. An e-mail dated 25 April 2008 from Michael Wake to Mary Connolly and Maria Donoghue-Mills states that Joe McGarry wants to *“leave to live in Australia and the Group would like to take this opportunity to try and progress our international work”*. This suggests that Novas or a representative of Novas proposed this idea rather than Joe McGarry.

3.11 Governance of a dominant Chief Executive

3.11.1 A number of present and former staff have told us that, in their opinion, Michael Wake was a bully. Matthew Pike told us that he brought the issue of Michael's bullying of Maria Donoghue-Mills to the Chair's attention. According to Matthew Pike, Gnosoulla's response was that she was aware of this and was waiting for the opportunity to deal with it. When we interviewed Soulla, she denied this exchange had taken place. Gnosoulla said that Michael was not a bully but proceeded to caveat this by saying that although he did not shout at people, he could probably do with a mentor. When we interviewed Maria she was fairly open in responding to most questions but refused to satisfactorily answer the question on whether she was bullied by Michael. An examination of e-mails shows that Maria Donoghue-Mills tells Michael that she "*feels threatened*" and Will Melia states "*I feel bullied*".

Lack of financial expertise on the Board

3.11.2 It appears that the Board itself recognised that they are lacking in experience in certain areas. Specifically, they recognised the need to have a Board member who possesses financial expertise.

3.11.3 Despite first being raised as an action point and a potential area of weakness in March 2007, it can be seen that this issue has not been addressed.

3.11.4 It is clear that there are a number of areas where the Board should have been more robust on certain decisions, for example:

- i). The decision/speed to acquire Scarman;
- ii). Resisting the sale of Arlington House in March 2008 but acquiescing in its disposal one month later without reviewing adequate financial information;
- iii). Michael Wake's allowance re living in Liverpool; and
- iv). The art scheme that only benefited Michael.

4 CONCLUSIONS

4.1 *Financial Viability of Novas*

Short term viability

- 4.1.1 Novas runs the imminent risk of being insolvent. It has a number of creditors who have threatened/started legal action and it appears that Novas cannot pay its debts as they fall due. Novas had a £3 million overdraft facility that expired on 31 October 2008. There was no 'Plan B' if a large VAT refund, which was credited to the Novas' bank account on 31 October 2008, had not arrived. Novas is still producing inadequate and optimistic cash flow projections. Although Novas' bankers have made some encouraging noises, there are still serious concerns about how they can meet their ongoing obligations.
- 4.1.2 It may be the case that if Novas manage to sell properties in the next quarter then they may remain viable through this period. However, these properties will have to be sold at severely discount prices. For example the acquisition and refurbishment costs of the Alima Centre were over £2.6 million and, we believe they will struggle to sell this asset for more than £500,000. It had a reserve price of £750,000 at an auction held on 4 December 2008 but it did not attract any bids. The auction appeared to be for the sale of repossessed and sub-standard housing and the prices for other lots were far below the reserve price set for the Alima Centre. We would question whether this was the best way in which to attempt a sale of this property.
- 4.1.3 The reason for the loss in value in assets cannot be purely blamed on the current economic conditions. Property prices have fallen dramatically but as in the case of the Alima Centre they have not fallen by 71%. One of the reasons the Alima Centre has fallen in price, is that it was a speculative decision to build an arts centre at the edge of the Baltic Triangle regeneration area in Liverpool. This regeneration has now halted. The attractiveness of this property has also been affected by the decision to remove the car parking facilities and replace these with a Chinese theatre which has had limited, if any, use.

- 4.1.4 Indeed the Liverpool CUC which has cost £17 million has the same car parking issues. Novas is to be congratulated on building a facility for disadvantaged groups in deprived areas. They must however, be aware of the requirement to provide secure parking facilities if they are going to attract the cross subsidisation effect they require from more affluent visitors to their centre.

Medium term viability

- 4.1.5 It is apparent that Novas will only survive in the medium term by disposing of unencumbered properties. No-one can predict how long the present recession will last, and it is unclear whether Novas will be able to generate significant funds from these disposals, unless it makes a decision to dispose of the Liverpool CUC.

Long term viability

- 4.1.6 It would appear that even if Novas disposed of their unencumbered properties, it is unlikely that the revenue from their Social Enterprise activities can cover their costs and, under the current business model, the present direction of Novas does not look viable.

4.2 *Arlington House*

- 4.2.1 It would appear that there was no legal contract between CLG, Camden and Novas that committed Novas to completing Arlington House using the funds provided from the sale of hostels to St. Mungo's and the CLG grant. However, there are correspondence, e-mails and representations made by Novas' SMT, that, until very recently, committed them to completing Arlington House.
- 4.2.2 It is extremely unlikely that the Housing Corporation would have agreed to the hostel sales to St Mungo's if the proceeds were not for Arlington House. The Section 9 Notices signed by a Novas employee state that the proceeds were for Arlington House and Social Enterprise.
- 4.2.3 It is now accepted that Arlington House cannot be completed by Novas because even if they were to raise loans on their unencumbered properties they do not have the cash flow to cover the interest on those loans. Novas' remaining hope is that One Housing Group will complete this project. Negotiations with One Housing appear to have stalled and we believe that One Housing Group are asking for a further £3m and/or the transfer of the Dean Street hostel. It must now be questionable whether the One Housing transaction will take place.
- 4.2.4 Maria Donoghue-Mills now accepts that £10 million is needed to complete Arlington House and that Novas will not be able to raise this amount from their bankers who, in her view, will probably only sanction a loan of £2 million to £3 million. What is of great concern is that neither Matthew Brown, Michael Wake, Maria Donoghue-Mills nor Gnosoulla Tsioupra-Lewis have, at their finger tips, the cost to complete Arlington House. What we do know is that over the time period of the Arlington House project Novas have built the North West CUC in Liverpool at a cost of approximately £17 million.
- 4.2.5 Although the proceeds of the hostel property sales to St Mungo's did not directly go straight from St Mungo's to the Liverpool CUC, it is accepted by Maria and Gnosoulla that the funds went to the central Novas pot and funds were paid out of that pot in respect of Liverpool CUC. At this time the reserves of Novas were approximately £8 million. Therefore, even if the total reserves

went into Liverpool CUC and, taking into account the North West development grant of £3 million, it is still clear that approximately £6 million of the proceeds of the hostel sales to St Mungo's went into the CUC in Liverpool. £2.3 million of VAT has been refunded but Novas would have had to pay these funds out in the first place from some source before they could be reclaimed.

- 4.2.6 Although social enterprise is to be commended, it is not clear whether the funders of Arlington House (CLG) and the funders of the hostels disposal (predominately the CLG and the Housing Corporation) would have agreed to funds, previously identified to improve the provision for homeless people in London, ending up in a Social Enterprise Centre in Liverpool. Unlike Arlington House and Dean Street, CUC Liverpool does not have any bed provision but has a Malaysian restaurant, a theatre, a number of art galleries, a further separate restaurant, a coffee shop and conference facilities such as meeting rooms.
- 4.2.7 It is clear that Novas would argue that these facilities generate revenue (although we understand that no profit or surplus has been generated by Liverpool CUC) and that revenue can go back into Novas to benefit tenants and disadvantaged groups. However, we would argue that as Novas moves away from bed provision for the homeless, and into social enterprise Novas should have made this clear to funding providers. They should not have used funds that were earmarked for the homeless in London.
- 4.2.8 With some justification Novas could argue that they owned the hostels sold to St Mungo's and therefore they could do with those proceeds as they wished. However, it is clear that without the representations they made to ODPM/CLG the funders would not have agreed to put £12 million of tax payer's money into an unfinished project, i.e. Arlington House. Further to that, in order to get Arlington House finished, it is clear that either (a) the project will be diluted or (b) that an acquiring RSL will require/request an input of a further substantial grant from funding providers.

- 4.2.9 The reason why Novas can no longer fulfil their obligations is because they have not managed their finances correctly. Novas would argue that this is due to the recent fall in the property market and, also that it is the fault of inadequate staff in their finance department. It is true that economic events over the recent three or four months make it very difficult for Novas to dispose of some of their unencumbered properties. However, from the ‘Away Day’ in March 2008 (if not before) and the Board meeting in April 2008, it was clear that Arlington House had to be disposed of, or substantial loans obtained, in order for Novas to survive.
- 4.2.10 Even at that late stage there are still things that could have been done i.e. for example, loans secured on the Liverpool CUC that could have led to Arlington House being completed. Unfortunately that window appears to have passed.
- 4.2.11 With regards to blaming present and former finance employees we find this disingenuous. There were many basic fundamental errors, for example not having a satisfactory business plan for a £17 million project such as the Liverpool CUC. The responsibility of this must lie at the co-Chief Executive level and cannot be blamed on individuals that process payments and provide financial reports to senior management. This is the case even if the individuals appear to get a bit ‘uppity’ when their jobs are at risk.
- 4.2.12 There appears to be a culture that whenever anybody in the finance team raised difficult and challenging questions about the financial circumstances of Novas, those raising the issues were portrayed as being difficult, not “seeing the bigger picture” or even racist. Some of the staff that have raised issues about expenditure, cash flow etc are now being faced with redundancy. We are still not clear whether these redundancies are warranted, or whether these are vindictive actions by Senior Management at Novas. For example, it was very damning that when one of the management accountants (Paul Byrne) raises an concern over the extremely poor due diligence report produced prior to the acquisition of the Scarman Trust, the Co-Chief Executive’s immediate response was “*Paul needs to go!!!*”.

- 4.2.13 There are a number of decisions that we, as inquirers, fail to see how they benefit the homeless. For example, the decision to charge Novas' architects out at a market rate rather than at cost half way through the Arlington House project, has meant that there is less money available for beds or social enterprise activities at Arlington House. Novas would argue that these funds are still in Novas and are supporting social enterprise activities in Liverpool. From what we are seeing these activities support a small group of people and not a cross section of the homelessness/deprived communities. For example in Liverpool we would expect to see the Liverpool CUC catering for the needs of large Cantonese, West Indian or refugee communities, however, a lot of time has been spent on the Malaysian community.
- 4.2.14 Our information is that the Malaysian community of Liverpool is small compared to other ethnic communities e.g. the Afro Caribbean population in Liverpool. A lot of decisions seem to have been made according to the whims or ethnicity of Novas employees, rather than the requirements of their local constituents.

Group Structure

- 4.2.15 Novas SMT would argue that they have arrived at their present circumstances because:
- i). There was a fall in the property market;
 - ii). Their regulator that does not understand their business;
 - iii). There were poor quality previous finance employees and mutinous present finance staff, and
 - iv). Some elements of institutionalised racism.
- 4.2.16 We would argue that the reasons are much simpler than that. The structure of Novas is unsound, it did not have enough financial acumen at a senior level and it was inadequately supervised by its Board. Novas' two Chief Executive officers are Maria Donoghue-Mills and Michael Wake. Although this is

unusual, this arrangement could probably still work if there was clear delineation of duties i.e. all aspects of Novas were properly managed by a Chief Executive who had the right skills to manage that part of Novas.

- 4.2.17 What appears to have happened is that Maria Donoghue-Mills was responsible for operational and financial issues. Michael Wake was responsible for visionary, social enterprise and cultural activities. So something like the Liverpool CUC which cost £17 million, was classified as social enterprise and was managed by Michael who did not possess the required financial management skills. Further, the situation has arisen where Michael has set up his own parallel finance function within the Liverpool CUC. For example, he has a finance officer who reports into Tara Muthoora, with Tara then reporting directly to Michael.

4.3 *Allegations of financial mismanagement*

- 4.3.1 Tara Muthoora was recently brought into the organisation as a consultant and there are a number of issues surrounding this. For example, she was made redundant from her position of Director of Regeneration receiving a redundancy package of c£30,000 and was re-recruited as a consultant with the same title of Director of Regeneration. There are also issues about Michael having a relationship with Tara in the past and the lack of clarity about the way she came back into the organisation.
- 4.3.2 It is inappropriate that an organisation can have a capital project like Liverpool CUC, which is outside the normal finance function without an effective business plan. Michael Wake says Tara was re-recruited to, amongst other things, to produce an effective business plan. We find it unusual that an effective business plan is produced after a £17 million building has been completed.
- 4.3.3 Erwina A-Ghafar was recruited for the architects' department and later became a director of the organisation with responsibility for art. Erwina spent considerable time travelling to Malaysia (three times in eighteen months) to purchase Asian art. During interview we asked Erwina why Novas could not purchase ethnic art e.g. Malaysian art from Malaysians within the UK. We were told, that their art had been adulterated.
- 4.3.4 When we asked for details of Erwina's qualifications/experiences she said she had studied art as part of her baccalaureate i.e. during her secondary education. On one of her trips to Malaysia Erwina said she went to buy Thai, Filipino, Indonesian and Malaysian art. It was telling that she could not give us the name of any Thai, Filipino or Indonesian artists during our interview with her.
- 4.3.5 During interview, Erwina denied having an affair with Michael Wake (who accompanied her on trips to Malaysia) and, Michael Wake initially denied this too until eventually he admitted it.

- 4.3.6 Also, Michael said that this relationship, and the potential conflict of interest it caused, was signed off by John Humble, a Vice Chair on the Novas Board. John Humble is a previous tenant of Arlington House. John is adamant that Michael never divulged this relationship to him and stated in the interview that until our interview he did not know that Michael was having a relationship with Erwina.
- 4.3.7 John Humble describes Michael as his mentor for over 20 years, it is quite obvious that his relationship with Michael is not one of equals. Therefore, it is clearly inappropriate that he was the Board member Michael asked to sign off his expenses (including the Malaysian trip). John has stated to us that he did not check Michael's expenses. We are also aware, from speaking to the Chair that she became aware that John signed Michael's expenses. In our view as a Chair she should have been questioning who was approving Michael's expenses much earlier.
- 4.3.8 In terms of greater issues of Board supervision, as stated earlier the Chair did not know the exact costs to complete Arlington House. She also had a complaint from Matthew Pike who said he was going to make a Public Interest Disclosure. Part of this complaint was that there were management issues in that Michael Wake systematically bullied Maria Donoghue-Mills. Matthew alleges that when he told the Gnosoulla this, she responded by stating that she was waiting for the opportunity to deal with it. Gnosoulla denies this. When we asked Maria Donoghue-Mills directly whether or not she was bullied by Michael, she refused to clearly answer that question although she was quite open on other issues.
- 4.3.9 As Inquirers, we would not normally be interested in who has had relationships with whom. However, we also discovered that Michael has had a relationship with Maria in the past. There is obviously the possibility that as well as a fundamental structural weakness (the areas of social enterprise that did not get sufficient oversight), the dynamics between Michael and Maria have led to her not being able to challenge him sufficiently. The Chair tells us that Maria

would often confide in her but that she could stand her corner. We have not seen much evidence of this.

- 4.3.10 It is also a concern that an agreement was made by the Chair and others on the Remuneration Committee, to give Michael an allowance so that he could purchase a property in Liverpool. In the current economic climate, that property has probably fallen in value but over the last twenty years that decision would normally have led to an increase in property value for the individual rather than the organisation. At one point we know that it was raised that Novas would buy the property and that subsequently it was decided that Michael be given an allowance so that he could buy a property. Soulla stated that the reason for this was that they thought they might have problems disposing of the property without sign off by the Regulator.
- 4.3.11 It is also a concern that Manyee a Chinese building supplier to the Liverpool CUC, the Alima Centre and the Dragon Theatre had family connections to the Novas' architect Terry Lau who was in charge of that project.
- 4.3.12 In conclusion we believe Novas is poorly managed. It was poorly governed by a Board that did not have enough financial expertise and also did not sufficiently challenge a dominant individual like Michael Wake. In our opinion Novas is an 'at risk' organisation.
- 4.3.13 In our opinion the senior management team of Michael Wake, Maria Donoghue-Mills, Terry Lau, Matthew Brown, Matthew Pike, Mary Connolly and Erwina A-Ghafar have collectively mismanaged the business.
- 4.3.14 The actions of Michael Wake, Maria Donoghue-Mills and Terry Lau may additionally, in our opinion, be regarded as misconduct.