

EXECUTIVE OF THE COUNCIL – 20 DECEMBER 2005

Minute Item No 5

5 Review of Local Authority Company Governance and Monitoring (Agenda item number 7)

The Council had established a number of arms length companies to provide Council services and/or deliver policy objectives. Proposals for future arrangements for all Council related companies work which took into account the issues highlighted through Audit Scotland's recent review of the Council arms length companies were detailed.

Decision

- 1) To implement specific improvements to corporate governance arrangements to ensure best practice in line with the recommendations of Audit Scotland as detailed in the joint report by the Directors of City Development, Finance and Corporate Services.
- 2) To redefine the focus of the Company's Unit within the City Development Department and of CEC Holdings to reflect revised responsibilities.
- 3) To review the composition of the CEC Holdings Board in the light of this expanded role and to consider recharging more of the Council's cost to the company in order to achieve taxation benefits as noted in paragraph 4.6 of the joint report by the Director of City Development, Finance and Corporate Services.

(Reference – joint report no E/342/05-06/CS&CD by the Directors of City Development, Finance and Corporate Services, submitted.)

Review of Local Authority Company Governance and Monitoring

Executive of the Council

20 December 2005

1 Purpose of report

- 1.1 To consider future arrangements for all Council related companies work, taking account of the issues highlighted through Audit Scotland's recent review of the Council Arms Length Companies.
- 1.2 To review the remit and workings of the Companies Unit in the City Development Department.

2 Summary

- 2.1 The Council has established a number of arms length companies to provide Council services and / or deliver policy objectives. It has demonstrated a commitment to the principles of good governance through its arrangements for the successful operation of these companies. However, to ensure public funds remain protected, and risks managed, a number of operational changes are recommended.
- 2.2 Since its establishment in 2001 the Companies Unit has performed an important liaison and strategic development role in relation to the major shareholding companies. The Unit's role has continued to evolve and some modifications to organisational arrangements are now required to ensure that Corporate Governance best practice is achieved consistently across the Council.
- 2.3 Between February and November 2005 Audit Scotland completed a review of four of the major arms length companies. The review highlighted a number of good practices in the Council's corporate governance arrangements but also specified areas where improvements can be made.

3 Main Report

Background

- 3.1 The Council has adopted an innovative and pioneering approach to delivering strategic objectives and major developments through the use of shareholding arms length companies, joint ventures and companies limited by guarantee.

- 3.2 It has an interest in more than 100 companies ranging from large trading companies with shareholdings, to companies limited by guarantee, trusts and voluntary organisations. In most cases the Council provides funding to such companies through third-party funding agreements or Service Level Contracts. However, the Council is also the sole or major shareholder in a small number of companies.
- 3.3 These major shareholding companies, owned partly or wholly by the Council have net assets of circa £100 million, with a total project value of £2 billion and an annual turnover of circa £100 million; (the companies are listed in Appendix One).
- 3.4 Over the next fifteen years the property companies from within this portfolio will deliver over 15,000 residential units, including around 1,000 affordable homes. In addition, these companies have directly built over 1.5 million square feet of commercial office accommodation. These major developments will transform large brown-field sites and regenerate communities with the provision of new schools, leisure and employment opportunities.
- 3.5 Major new public realm works with capital value in excess of £17 million have also been driven by the City Centre Management Company, and ongoing feasibility studies are investigating the possibility of a major redevelopment of the city centre, which could result in a regeneration project of around £1 billion.
- 3.6 Provision of equity loans to small and medium size enterprises has resulted in around thirty investments, totalling over £2.5 million, with project values in excess of £32 million. This has helped create or secure over 1,300 jobs across the city.
- 3.7 To provide assistance to those Council companies for which City Development is the lead department, a Companies Unit was established within the Economic Development Division of the department in March 2001.
- 3.8 When the Unit was formed the Executive noted that, in due course, there would be a further report on the role and performance of the Unit and that this would be linked to a review of all the Council's work with companies.
- 3.9 Between February and November 2005 Audit Scotland completed a review of four of the major arms length companies, namely: Transport Initiatives Edinburgh ("TIE"), Waterfront Edinburgh Limited ("WEL"), New Edinburgh Limited ("NEL") and CEC Holdings ("CECH"). The review focused on ensuring that a robust decision making process was being used to determine the appropriateness of providing services in this way, that effective strategic planning, financial control and monitoring and accountability arrangements were in place and that the principles of sound corporate governance were being adhered to.

Effective Corporate Governance – the current issues

- 3.10 Corporate Governance is the system by which companies are directed and controlled. It ensures that a wide range of principles and codes of operation for companies are clearly articulated.
- 3.11 Recognising the need for such a system, the Executive of the Council approved a 'Code of Guidance and Conduct' governing the relationship between the Council and its Companies in 2001. This provides a structure for assessing the need to establish a company and for monitoring its operation in order to protect the Council's interests and to ensure that the company's objectives are being met.
- 3.12 It is now recognised that if Corporate Governance best practice is to be fully achieved, a number of additional issues remain to be addressed. These are outlined below.

Board composition and chair

- 3.13 Corporate Governance principles dictate that an effective board should head every listed company. To be effective a board should have a balance of professional expertise and shareholder interest, with Directors having sufficient seniority, experience and expertise to add value to the board. The board should also reflect the political composition of the Council wherever possible.
- 3.14 Elected members currently act as non-executive directors on the boards of Council companies. Corporate Governance recommends a formal selection process with non-executive directors selected with the same impartiality and care as senior executives to demonstrate that they have been appointed on merit and not through any form of patronage. In turn candidates need to consider if they have the right set of skills to perform the duties effectively.
- 3.15 All directors appointed by the Council should be given appropriate training, across a full range of issues, at the time of their appointment, and / or subsequently as appropriate. This is especially important in the context of insolvency, where directors face personal liability if acting improperly.
- 3.16 In some companies senior Council staff act as non-executive directors, ensuring a certain level of expertise at board level. Officers may also be required to take on the role of alternate directors to ensure that meetings are quorate; (this is the current situation for officers from the Companies Unit within the City Development Department.)
- 3.17 Whilst the involvement of officers at board level can help ensure the effective operation of Council companies, this can raise potential conflicts of interest for both staff and councillors. The current arrangements within the City Development Department also have the potential to undermine the Company Unit's ability to fulfil an objective, independent monitoring role, an issue detailed later in this report.

- 3.18 Protocols are needed to advise board members on how to deal with such conflict situations, along with questions of declaration of interest.
- 3.19 Corporate Governance also highlights the need for proper recognition of the role of finance, at the highest management level, by making the finance function the designated responsibility of a board director. However, this does not absolve the other directors of responsibility for financial issues and it is, therefore, recommended that the larger shareholding companies should have an Audit Committee.
- 3.20 With these issues in mind, for the larger, more high profile Council companies the appointment of additional independent board members should be considered. There is currently a dearth of independent non-executive directors with the range of experience and expertise required by the major Council companies.
- 3.21 The use of fixed term appointments is also recommended and, when possible, these terms should correspond to the cycle of local government elections.
- 3.22 The chair has primary responsibility for the working of the board and for ensuring that all directors are enabled and encouraged to contribute effectively to the board's activities. He or she must ensure that members are properly briefed on the issues arising and that they make an effective contribution as board members. The Department of the Environment and Trade Good Practice Guide recommends the appointment of an independent chair, who is seen to be free of links to any of the partners.
- 3.23 There will be an optimum combination of chair, board and officer involvement for each company. The same arrangements will not fit all companies and cognisance must be taken of the particular business area within which each company is operating. Boards do, however, need to be drawn from as wide a pool as possible including, where appropriate, elected members with proven skills and competencies, officers and members of the commercial community.
- 3.24 The Council has a very diverse portfolio of companies and arrangements need to be considered on an individual company basis supported by robust, rigorously applied rationale.

Monitoring

- 3.25 The Code of Conduct governing the relationship between the Council and its companies requires that all companies in which the Council has an interest should be monitored. There is a need for a formal monitoring regime with a standard procedure applied to all Council companies. Frequent reporting is required to ensure company objectives and targets are met.
- 3.26 Under current arrangements only annual reports are generally placed before the Council's Executive. These are essentially high level documents that do not always include key performance information, such as progress made against the business plan, or details on financial or non-financial performance.

By contrast, the Council receives two monthly reports on the performance of Council departments.

- 3.27 Performance monitoring of the Council's shareholding companies has however, been greatly enhanced through the recent establishment of a Companies Strategy Group, chaired by the Chief Executive and attended by the Directors of City Development, Corporate Services and Finance.
- 3.28 Despite this, there remains a need to clarify the levels of risk exposure that the Council is willing to accept in relation to companies' activities. The Audit Scotland report recommends that these levels of risk should be reported to Council on a regular basis, along with other key performance data.
- 3.29 The Council's Code of Conduct refers to the appointment of a Monitoring Officer to ensure that the Company is carrying out its agreed objectives, has taken on board the policies and objectives of the Council and that it is adhering to best practice in relation to corporate governance. However, the Code does not currently cover the extent to which Monitoring Officers should be involved with companies.
- 3.30 Existing arrangements for supporting and monitoring company activity in departments vary. In the Department of Culture and Leisure, client officers work with companies to establish objectives and provide advice and comment on behalf of the Council. A different nominated reporting officer analyses company accounts and attends at least one board meeting per year, to check that the company is conducting its business in accordance with the principles of sound corporate governance.
- 3.31 This arrangement follows the guidelines in the 'Code of Guidance on Funding External Bodies and Following the Public Pound' produced by the Accounts Commission and CoSLA. There is a clear separation of roles and responsibilities between officers who liaise with companies on behalf of the Council and those with responsibility to monitor performance.
- 3.32 However, as already highlighted, ongoing monitoring of the major City Development companies is conducted through the Companies Unit by officers who can also have involvement at board level and regularly provide advice to board members. This is not in line with the guidelines and can undermine attempts to secure objective monitoring, an issue also highlighted by Audit Scotland.
- 3.33 The concept of officers who undertake a dual role of support and challenge is not, however, unusual within the Council with examples being found in Financial Services, Corporate Services and Children and Families departments amongst others.

Other governance issues

- 3.34 The Council currently has no requirement within its operating agreements to ensure that subsidiary companies established by arms length companies comply with the control agreements in place for the parent companies. There

is therefore a risk that the parent companies could make use of the subsidiary companies to circumvent Council controls.

- 3.35 In addition, to ensure maximum transparency and openness in all Council company operations, Audit Scotland has recommended that a consistent approach to other governance issues be adopted by the Council. These include Registers of Interest, Procurement, Asset Management, Fraud and Irregularity, Whistleblowing and formal Recruitment and Selection policies.

The Companies Unit

- 3.36 The present Companies Unit was established in March 2001. It provides liaison between and support to arms length companies, partners and Council departments.
- 3.37 The original structure included a Companies Manager supported by an Economic Development Officer and Administrator. Subsequently, a Senior Economic Development Officer and two Economic Development Officers were also transferred into the team, although they continue to be involved in a range of other Economic Development related activities.
- 3.38 The Unit's role is one of maintaining a strategic involvement in the companies listed in Appendix One. It provides a link to related Council work and attempts to ensure overall efficiency, achievement of the Council's objectives and, where appropriate, a commercial return for the shareholders. As already highlighted, officers act as non-executive directors on boards, provide advice to company directors and liase with other shareholders.
- 3.39 Performance monitoring of these companies is also undertaken by the Unit, with officers co-ordinating the annual reporting to the Council Executive and the Development of the City Scrutiny Panel.
- 3.40 In addition, the Unit has worked on initiatives such as new shareholding companies and company start-ups within other Council departments. It has also been involved in work relating to the aftermath of the Cowgate fire, the Usher Hall Business Plan and the viability of Blindcraft.
- 3.41 Substantial advice and support is also provided to companies by other staff within the Economic Development Division, by the Legal Services Division of Corporate Services and the Finance Department, with other departments being involved in inter-departmental working groups where appropriate.

The performance of the Companies Unit

- 3.42 The Companies Unit has developed an in-depth knowledge of each of the shareholding companies and has played a key role in ensuring high standards of corporate governance. It has been represented on companies' operational, strategic and executive groups, allowing it to provide the requisite expertise to protect the Council's interest as a shareholder and provide a key link to Council services which are delivered in partnership with companies.

- 3.43 The Unit also has a significant knowledge base in relation to Corporate Governance and it contributed to the production of the Council's "Code of Guidance and Conduct" for companies. It has subsequently ensured that each of the Companies has adopted the Code and is adhering to its requirements. Assisted by the Legal Services Division of Corporate Services and the Finance Department, it has also ensured that a Shareholder or Operating Agreement is in place between the Council and the companies.
- 3.44 In addition, at the request of the Chief Executive, a database which details information about the major shareholding companies in which the Council has an interest has now been compiled by the Companies Unit.
- 3.45 Under current arrangements, staff from the Companies Unit, Legal Services and Finance Department work together to provide regular advice and guidance to the elected members who act as Directors of City Development-related companies. On-going support has also been provided to some of the companies in relation to company secretary activities, in the form of administrative assistance provided by the Companies Unit, and legal input from the Council Solicitor's Division.
- 3.46 However, only limited attempts are made to recover support costs from the companies (see Appendix Two). Efforts are made to charge for services when acting on behalf of the company, although these currently only go part way towards recovering costs. Where the primary objective is regarded as one of protecting the Council's interest in the venture, charges are not normally made.

4 Conclusions

- 4.1 The Council is leading the way in pursuing innovative methods of delivering services. It has demonstrated a commitment to the principles of good corporate governance in the operational arrangements for its major companies but some improvements to these arrangements, and associated organisational framework, are now recommended to ensure that best practice is achieved.
- 4.2 The recommended improvements include:

Board composition

- The competencies required by non-executive directors, whether members or non-members, must be identified; directors are to be recruited against these criteria and appropriate training provided where necessary. Party Groups and the Council must take account of the competencies in approving nominations.
- Directors will be provided with a general induction, specific training appropriate to their individual competencies, written advice on how to fulfil the role and ongoing training as necessary.

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- Protocols should be produced for all Council company directors on the handling of potential conflicts of interest and questions of declaration of interest.
 - Board appointments should be for a specified term.
 - The finance function should be identified as the designated responsibility of one board member and an Audit Committee established for each of the major shareholding companies.
 - Independent non-executive directors should be considered for appointment to the Council company boards. Where appropriate, this practice should be extended to the appointment of independent (paid) board chairs, who can bring the expertise required to this role.

Monitoring

- Business Plan approval should be assessed in terms of compliance with an agreed framework, to include a structured approach to risk management and clear measurable targets.
- Six monthly reports on the performance of the major arms length companies should be presented to the Executive/Council, detailing key performance information against Business Plan targets and risk assessments as appropriate.
- A process of annual company self-assessments against a Corporate Governance Code for Companies should be implemented, with follow-up actions implemented in the light of these assessments. The results of the assessment process to be reported annually, through Internal Audit.
- There should be as clear a separation of roles and responsibilities as possible between officers who liaise with companies on behalf of the Council and whose function is to monitor performance.
- Council companies should feature in the Audit Plan, which is determined on a risk-assessed basis, to ensure regular independent monitoring.

Other governance issues

- A consistent approach and, where appropriate, specific guidelines are needed to all governance issues including Registers of Interest, Fraud and Irregularity, Whistleblowing, Recruitment and Selection, Procurement, Asset Management planning, directors' review of internal controls and reviews of internal audit coverage.
- Operating agreements with parent companies should be extended to cover all subsidiary company operations.

- Contingency arrangements should be strengthened and a policy agreed on how to respond to companies that breach financial regulations or encounter significant operational problems.
- 4.3 The “Code of Guidance and Conduct” governing the relationship between the Council and its companies should be updated to reflect these proposed changes.

Review of portfolio

- 4.4 There are around twenty Council arms length companies that have been established to deliver identified Council objectives and/or significant projects. Whilst these companies are subject to ongoing review, Audit Scotland has recommended that the Council undertake regular review of its company portfolio to ensure that the companies remain fit for purpose and continue to represent the best method of service delivery.

Changes to key responsibilities

Role of CEC Holdings

- 4.5 In order to overcome concerns around potential conflicts of interest and the need for independent monitoring it is recommended that CEC Holdings take on an extended role. This would include undertaking regular reviews of the Council company portfolio, Business Plan approval, monitoring of performance, overseeing Corporate Governance and Risk Management issues, along with considering reports from Monitoring Officers prior to summarised submissions to the Council Executive / Council.
- 4.6 The composition of the CEC Holdings Board should be reviewed in the light of this expanded role. Consideration should also be given to recharging more of the Council’s costs to the company in order to achieve taxation benefits.
- 4.7 The focus will initially be the major shareholding companies for which the City Development Department has responsibility, but it is recommended that these arrangements be extended to cover other companies in which the Council has a significant investment, following consultation with the relevant monitoring department.

The Companies Unit

- 4.8 It is proposed that the focus of the Companies Unit within City Development be redefined to relate specifically to company liaison and strategic development. Key roles for its staff will be:
- strategic overview of City-Development related Company activity;
 - leading on a multi-disciplinary approach to advising CEC Holdings on Business Plan approvals, (ensuring that staff acting as Board members / alternate members for the company involved do not sign off the approval);

- providing commentary on monitoring reports, assisted by Financial Services / other Council officers, (again ensuring that staff acting as Board members / alternate members for the company involved do not sign off the reports);
- as a nominee of the Director of City Development, acting as Director on Company Boards;
- sitting on Company Board of Directors as Alternate or with Observer Status;
- advice and Guidance to the Chair, Company Directors and Councillors;
- liaison with Company Executives;
- liaison with Council departments;
- liaison with other shareholders;
- establishment of new companies, where appropriate;
- management of legal relationship between Council and companies;
- company secretarial support, where appropriate, with Company Secretary activities being reviewed at the earliest opportunity;
- representation on inter-departmental groups;
- providing general advice on corporate governance/commercial issues, company formations and other strategic considerations, with Finance input where appropriate;
- related business development activities.

Internal Audit

4.9 The role of the Internal Audit team, within the Finance Department, will be as follows:

- to administer and review a process of annual company self-assessments against a Corporate Governance Code for companies, with follow-up actions being implemented as appropriate in the light of returns by the companies. The results of these assessments would be reported annually;
- to ensure that Council companies feature in the Audit Plan / to conduct four yearly independent reviews of each of the major Council companies and report to the Executive/Council.

4.10 Consideration should be given to transferring staff costs and budgets from the Companies Unit to CEC Holdings in order to achieve taxation benefits. This will be reported on in more detail at a later stage, but advice is now being sought on the principle of adopting this approach as a model of good practice.

5 Financial Implications

5.1 Assuming staff costs of approximately £250,000, a potential tax saving in the region of £75,000 can be achieved.

6 Recommendations

6.1 The Council Executive is requested to approve the following recommendations:

- a) the implementation of specific improvements to corporate governance arrangements to ensure that best practice is achieved, in line with the recommendations of Audit Scotland and as detailed above;
- b) the focus of the Companies Unit within the City Development Department and of CEC Holdings should be re-defined to reflect revised responsibilities.
- c) the composition of the CEC Holdings Board should be reviewed in the light of this expanded role and consideration given to recharging more of the Council's costs to the company in order to achieve taxation benefits as noted in paragraph 4.6 above.


Andrew Holmes
 Director of City Development

13.12.05


Donald McGougan
 Director of Finance

13/12/2005


Jim Inch
 Director of Corporate Services

13/12/05

Appendices Appendix 1 – Company Details
 Appendix 2 – Charges for Company Support

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Wards affected

Background Papers "Code of Guidance on Funding External Bodies and Following the Public Pound" – Accounts Commission and CoSLA 1996
 Local Authorities Involvement in Companies: Good Practice Guide DETR 1997
 Code of Guidance and Conduct governing the Relationship between the City of Edinburgh Council and its Companies 2001
 "Guidance for Reporting Officers" – Report by the Director of Corporate Services to the Policy and Resources Committee 25 February 1999
 "City of Edinburgh Council - Council Arms Length Companies" 2004/2005 report by Audit Scotland

COMPANY DETAILS – COMPANY UNIT

Shareholding Companies

CEC Holdings Limited

Craigmillar Joint Venture Limited (PARC)

The EDI Group Limited

The Edinburgh International Conference Centre Limited

Projects Edinburgh Limited

Lothian Buses Limited

Lothian Investment Fund for Enterprise Limited

New Edinburgh Limited

Pacific Shelf Limited

Shawfair Developments Limited

Transport Edinburgh Limited

TIE Limited

Waterfront Edinburgh Limited

Companies receiving significant financial support

Edinburgh City Centre Management Company Limited

Edinburgh International Science Festival

Edinburgh Science Centre Limited

Screen Industries Limited

Edinburgh Convention Bureau Limited (to be established in 2005)

APPENDIX TWO

CHARGES FOR COMPANY SUPPORT (2004/05)

<u>Company</u>	<u>Department</u>	<u>Charges (£s)</u>
CEC Holdings Ltd	City Development (Companies Unit)	5,000
	Finance	20,000
	Legal	15,000