

The City of Edinburgh Council

10.00am, Thursday 30 June 2016

Council Companies

Item number 8.2

Report number

Executive/routine

Wards

Executive Summary

This report outlines internal audit findings and recommendations alongside corresponding management actions, following a review of Council companies. Approval is sought for an amendment to the Committee Terms of Reference and Delegated Functions to implement one of the proposed management actions. Details are also provided of the new Council companies' hub and how this aims to improve the officer scrutiny of Council companies.

Council Companies

1. Recommendations

- 1.1 To agree that Governance, Risk and Best Value Committee scrutinises Council companies and remits are adjusted appropriately within Committee Terms of Reference and Delegated Functions;
- 1.2 To note the management action taken in regard to the Internal Audit recommendations on Annual Assurance in paragraph 3.23;
- 1.3 To note the management action taken in regard to the Internal Audit recommendations on the Council observer role outlined in paragraphs 3.27 to 3.30;
- 1.4 To agree that elected members who are directors of Council companies undertake mandatory training on their duties under the Companies Act;
- 1.5 To agree to create a Council Companies Hub, chaired by the Chief Executive, as outlined in paragraphs 3.31 to 3.34; and
- 1.6 To note that an annual report on the work of the Council Companies Hub would be submitted to the Council.

2. Background

- 2.1 The City of Edinburgh Council operates a number of companies to deliver designated services. Whilst the company takes on responsibility for the delivery of the service, the Council retains responsibility for ensuring the proper use of public funds and achieving best value. Council companies are often seen as an extension of the Council and reputational risks for service failure remain with the Council.
- 2.2 Due to these risks, the financial pressures facing the Council and the need to ensure improved service delivery, it is critical that effective and robust governance arrangements are in place for all Council companies.
- 2.3 [A review of Council companies was carried out in 2012](#), with an elected member working group established to consider officer recommendations on governance and the Council's arrangements for its companies. Council agreed a range of proposals for the governance of its companies such as:
 - 2.3.1 elected members remaining directly involved in decision making as directors of Council companies;

- 2.3.2 Council directors having responsibility for companies in their area of operation; and
- 2.3.3 executive committees having responsibility for scrutiny of Council companies operating within their remit.
- 2.4 As part of the Internal Audit Plan for 2015/16, it was agreed that a review assessing the design and operating effectiveness of governance and controls in relation to 'Council Controlled Companies' be undertaken.

3. Main report

- 3.1 The review by Internal Audit identified four areas of concern:
 - 3.1.1 the independence of elected members as directors of companies;
 - 3.1.2 governance reporting to Council committees;
 - 3.1.3 the Council observer role; and
 - 3.1.4 the annual assurance process for Council companies.
- 3.2 This report considers the Review's findings and recommendations. Proposals for management action to address these are also outlined along with strengthening the overall governance of Council companies.

Elected Members as directors and Governance Reporting to Council committees

- 3.3 Internal Audit highlighted the potential for a conflict of interest for elected members who sit on the boards of Council companies. Elected Members who are appointed to these director roles may also routinely sit on the executive committees with the remit to scrutinise the same companies.
- 3.4 These circumstances could be perceived as a conflict of interest and that elected members' decisions taken at committee were being influenced by their role as directors. This is not best practice and was highlighted as an area of concern in [Audit Scotland's report into Arms Length External Organisations](#) in 2011.
- 3.5 Internal Audit considers this a high risk that could pose significant reputational risk to the Council. The Review recommends that elected members should not sit on boards of companies that are scrutinised by a committee they also sit on.
- 3.6 The Internal Audit Review also highlighted a medium risk on governance reporting to Council committees. The manner in which Council companies have been scrutinised by executive committees was examined for Edinburgh Leisure, EICC, EDI and Lothian Buses. In the period January 2013 to August 2015, Edinburgh Leisure was scrutinised five times with Lothian Buses, EDI and EICC only scrutinised once.
- 3.7 The Review highlighted that this inconsistent approach to scrutiny could result in significant reputational risk to the Council due to a lack of transparency in the

relationship between the Council and its companies and that risks to both parties may not be brought to the attention of elected members.

- 3.8 Internal Audit recommends that executive committees review their arrangements for the scrutiny and performance monitoring of each company ensuring effective annual scrutiny at committee.

Actions – elected members as directors and governance reporting to Council committees

- 3.9 The independence of elected members as directors and how companies are reported to committee are interlinked. There is an inherent conflict of interest for elected members who sit on company boards. As directors of companies they have duties under the Companies Act 2006 and must act in the best interests of the company. The Councillors' Code of Conduct is clear that it is the responsibility of the elected member to declare an interest and judge whether this should prevent them from taking part in any consideration of the item.
- 3.10 The Code of Conduct does contain a specific exclusion for those Council companies that are established wholly or mainly to provide services to the Council, and that have entered into a contractual agreement with the Council for the delivery of those services or goods ([paragraph 5.18 \(2\) \(d\)](#)). This means that for some companies the elected member may be able to take part in decisions at committee without breaching the Councillors' Code of Conduct. However, it is not considered to be best practice for scrutiny to be undertaken by elected members who are also directors of the company in question, even if the Code of Conduct permits it.
- 3.11 These considerations must be weighed up against the fact that a critical element of good governance is to ensure that the directors of Council companies have the skills, expertise and qualifications to carry out their role effectively. In many cases the members, and in particular the convener and vice convener of the relevant executive committee, will have more experience and knowledge of the work undertaken by the company than an elected member who has had no involvement in that area of work. For example a member of the Economy Committee or Culture and Sport Committee will have greater knowledge and experience to bring to the boards of companies such as EDI and Edinburgh Leisure than an elected member who has not served on these committees.
- 3.12 It is clear from Internal Audit's findings that scrutiny of a Council company should not be solely undertaken by a Council committee that includes the board directors of that company. Elected members simply withdrawing when their company is being considered would not be as effective as a different committee providing an overview and independent scrutiny.
- 3.13 However, there are benefits in executive committees scrutinising Council companies as otherwise there is the possibility of there being a disconnect between the company's plans for the future and the policy direction of the aligned Council services. It is therefore recommended that the scrutiny of Council companies is separated to allow for executive committees to scrutinise the future plans of the

relevant company and the Governance, Risk and Best Value Committee to scrutinise past performance and the accounts.

- 3.14 There are examples of effective scrutiny from the Economy Committee and the Culture and Sport Committee, whereupon future business plans from companies such as EDI have been considered. The scrutiny process at committee will seek to build on this best practice and ensure that the reporting process is not too onerous and inefficient for either party; and it is envisaged that the same report would be submitted to both committees.
- 3.15 The Governance, Risk and Best Value Committee have had a critical role in the Council's improvement in governance over the last few years. This was reflected in Audit Scotland's Best Value Report.
- 3.16 This change in remit will allow the Council's audit and scrutiny committee to regularly monitor, scrutinise, build experience and establish a consistent approach to monitoring and oversight across all Council companies. It would allow those councillors with specific subject expertise to continue as directors of Council companies as scrutiny would no longer be solely carried out by executive committees, mitigating any conflict of interest and perceived bias or influence in decision making. Any directors of Council companies who were also members of Governance, Risk and Best Value Committee would be recommended to declare an interest and consider whether they should withdraw from consideration of that item.
- 3.17 It is also recommended that the Pensions Audit Sub-Committee be delegated the authority to scrutinise those Council companies that are associated with the pension fund or the management of the fund. The specialist nature of pensions and the expertise of the members of the sub-committee mean it is more appropriate for this committee to scrutinise than Governance, Risk and Best Value Committee. This separate governance and regulation is to ensure the pension fund continues to exercise its duties in a separate and distinct capacity from for example the Council in its capacity as an employer in the pension funds.
- 3.18 The Council's Committee Terms of Reference and Delegated Functions will require to be amended to take into account the new role of the Governance, Risk and Best Value Committee, the Pensions Audit Sub-Committee and the adjusted role of the executive committees.
- 3.19 Although this report concerns itself with Council scrutiny of its companies it does not reflect on the scrutiny within the companies itself. Many Council companies have non-executive directors on their Boards who are not elected members. This scrutiny together with the use of audit committees means that Council monitoring would be undertaken in addition to companies' internal governance arrangements.
- 3.20 It is recommended that all elected members who act as directors of Council companies undertake training on their duties under the Companies Act, including conflicts of interest. To ensure full completion and to mitigate risks regarding any

misunderstanding of conflict of interests, it would be beneficial if Council determined that this training be mandatory.

Annual Assurance

- 3.21 The Review also considered the effectiveness of the Council's annual assurance questionnaire, the aim of which is to provide the Chief Executive and the Council with a level of assurance on the adequacy of the governance arrangements in place in Council companies.
- 3.22 Internal Audit found the quality of responses received to be inadequate and recommended that an assurance questionnaire tailored to Council companies be revised and utilised, that the checklist should have guidance notes attached to promote a greater understanding of the process and that Council observers and relevant service directors should be required to formally confirm that the responses from each questionnaire reflects their view of the governance of the Council's companies.

Actions - Annual Assurance

- 3.23 The specific assurance questionnaire recommended by Internal Audit already exists and is currently being utilised as part of the Annual Assurance Process for the year to 31 March 2016. The questionnaire will be adjusted to better reflect the specific requirements relating to companies following consideration of responses by officers. The revised questionnaire will be finalised by 31 December 2016 in good time for issue for the year to 31 March 2017. The accompanying guidance will be improved and along with formal directors' assurance, will be introduced as part of the process for next year.

Council Observer Roles

- 3.24 The Council nominates Council officers as observers to its companies' boards. Internal Audit have identified minimum requirements for the observers as follows:
 - 3.24.1 Attendance as an observer at all Board and Audit Committee meetings;
 - 3.24.2 Regular receipt and scrutiny of risk registers;
 - 3.24.3 Regular receipt and scrutiny of management accounts and accompanying management information; and
 - 3.24.4 Regular access to management.
- 3.25 Internal Audit raised concern that these minimum requirements are not being met and that there is no process documentation for any of the roles. The implication of this is that the scrutiny of the operation and performance of companies is not carried out to the required level, and financial or reputational risks may not be identified.
- 3.26 The Review recommended a series of actions for each executive director as follows:

- 3.26.1 Executive Director of Resources - to review their approach to how they scrutinise Arms Length Companies that they are responsible for. We would expect the Observer (or a deputy) to attend all Board and Audit Committee meetings.
- 3.26.2 All executive directors - Process documentation covering as a minimum the following points, should be prepared and maintained for each of the Arms Length Companies.
- 3.26.2.1 Key management contacts;
 - 3.26.2.2 Basic structure of the entity;
 - 3.26.2.3 Key risks to the Council arising from the entity;
 - 3.26.2.4 Nature/timing of meetings attended;
 - 3.26.2.5 Key management information/reports received, their frequency and source;
 - 3.26.2.6 Use made of/procedures undertaken on management information received including any early warning thresholds/KPI's; and
 - 3.26.2.7 Reporting requirements for the relevant scrutinising Council Committee.

Actions – Council Observers

- 3.27 The Executive Director of Resources has agreed that observers should attend all Board meetings and that when this is not possible comments on the papers are submitted to the Board. The observer would also attend audit committees where possible. Although the recommendation of Internal Audit was for Resources the requirement extends to all directorates.
- 3.28 The Council's executive directors agreed that the recommendations proposed by Internal Audit outlined in paragraph 3.26.2 of this report be taken forward. The Executive Director of Communities and Families also noted that, due to changes in senior staff, a handover would be necessary.
- 3.29 The Corporate Leadership Team has instructed a review of the role of the observer to ensure that the role is still relevant, achieves the aims of the Council and has the appropriate officers filling the role. The Review will also examine how the observer feeds back to the Council and how this process could be improved.
- 3.30 Guidance and guidelines will be prepared for Council observers, to assist them in carrying out their duties and to ensure a consistent approach is maintained across all the Council's companies. The Council Companies Hub outlined below will also monitor observers and ensure that the role is being properly fulfilled.

Council Companies Hub

- 3.31 There is a corresponding need to improve the internal management scrutiny of Council companies and ensure that this structure both aligns with and supports the committee scrutiny role.
- 3.32 It is recommended that a Council officer management group or hub is established to provide Council oversight of its companies. This group will scrutinise the management of Council companies, seek assurance over the delivery of services and ensure the Council is aware of any risks. The group would meet quarterly with the aim of each Council company or when appropriate group of companies, outlined in the appendix, coming before the group annually or more frequent if appropriate. It is recognised that there are a considerable number of Council companies of differing significance and that scrutiny will have to be undertaken on a phased approach and one that recognises the specific responsibilities and activities of each company. In the first instance the Hub would focus on Council companies but this could be expanded in future to look at those organisations where the Council holds a significant interest. The report, accompanied by the relevant company representative, would be considered by the Hub and any findings or concerns from the Hub would then be submitted to the Governance, Risk and Best Value Committee and relevant executive committee to inform elected member scrutiny. It is envisaged that the same report would be utilised by the Hub and the committees to ensure a streamlined arrangement and avoid an onerous and inefficient process.
- 3.33 It is proposed that the core membership of the Hub is the Corporate Leadership Team with other appropriate officers added when required. The Hub would be chaired by the Chief Executive. All executive directors should be members to ensure a co-ordinated cross-service approach. The Chief Executive, Section 95 Officer (Executive Director of Resources) and Monitoring Officer (Head of Legal and Risk) should be members in view of their statutory responsibilities for Council services as it is likely that Council services provided by Council companies are included in this remit.
- 3.34 As part of the improvements to the internal management scrutiny of Council companies, a team within the Strategy and Insight division will provide guidance, monitoring and will manage the Council companies hub and its connection to the Council's committees. A critical objective of this team is to ensure that the Council takes a consistent approach to its companies.

4. Measures of success

- 4.1 To address the concerns raised in the review by Internal Audit and improve the governance arrangements of the Council in regard to its companies.

5. Financial impact

- 5.1 The costs of establishing and administering the hub will be contained within existing revenue budgets.

6. Risk, policy, compliance and governance impact

- 6.1 There is a risk that issues and concerns relating to Council companies are not identified to elected members or senior management and may impact on service delivery, or pose a financial or reputational risk to the Council. The creation of the Council Companies Hub and the added support to observers aims to mitigate this risk.
- 6.2 If the scrutiny arrangements of Council companies are not changed there is a reputational risk to the Council. This is due to a possible perception that there is a conflict of interest for those elected members who are directors of Council companies and who sit on committees that scrutinise those companies.

7. Equalities impact

- 7.1 There are no direct equalities impacts as a result of this report.

8. Sustainability impact

- 8.1 There is no direct sustainability impact as a result of this report.

9. Consultation and engagement

- 9.1 Consultation took place with the Acting Executive Director of Resources and the Acting Head of Legal and Risk.

10. Background reading/external references

- 10.1 [Council Companies](#) – City of Edinburgh Council 13 December 2012

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11. Links

Coalition Pledges

Council Priorities

**Single Outcome
Agreement**

Appendices

Appendix one: list of active companies

List of Active Council Companies considered in the audit

Company Name	Subsidiary 1	Subsidiary 2	Subsidiary 3
CEC Holdings Limited			
	The EDI Group Limited		
		EDI (Industrial Limited)	
		EDI Central Limited	
		Edinburgh Retail Investments Limited	
		North Ayrshire Ventures Limited	
		New Larieston (Glasgow) Limited	
		EDI Market Street Limited	
		Buredi Limited	
			Bell's Mills Limited
		Waterfront Edinburgh limited	

Company Name	Subsidiary 1	Subsidiary 2	Subsidiary 3
			Caledonian Waterfront (Harbour Road) Limited
			Waterfront Edinburgh (Management) Limited
		Shawfair land limited	
		Edinburgh Park (Management) Limited	
	Parc Craigmillar Limited		
		Parc Craigmillar Development Limited	
Transport for Edinburgh	Trams for Edinburgh Limited		
	Lothian Buses Limited		
		Edinburgh Bus and Coach limited	
		Lothian Region Transport Limited	
		Majestic Tours Edinburgh Limited	

Company Name	Subsidiary 1	Subsidiary 2	Subsidiary 3
		Edinburgh City Transport Limited	
		City Sightseeing Edinburgh Limited	
		The Overground Limited	
		Lothian Country Buses Limited	
		Edinburgh Bus Tours Limited	
		Leith Walk Property Limited	
		Mactours Limited	
		Lothian Trams Limited	
		Lothian Transport Limited	
	Transport Edinburgh Limited		
	CEC 2013 Limited		

Company Name	Subsidiary 1	Subsidiary 2	Subsidiary 3
Festival City Theatres Trust			
	Festival City Theatres Trading Limited		
CEC Recovery Limited			
East of Scotland Investment Fund Limited			
Essential Edinburgh			
Lothian Investment Fund for Enterprise Limited			
Edinburgh international Conference Centre Limited			

Note: Dissolved companies have not been included.

