LOCAL GOVERNMENT BILL :

COUNCIL-CONTROLLED ORGANISATIONS

A report prepared for Local Government New Zealand

Contents

INTRODUCTION

The purpose of this report is to provide Local Government New Zealand ("LGNZ") with a critique of Part 4 and schedules 6 and 7 of the Local Government Bill focusing specifically on:

- The workability of these provisions.
- Any unreasonable costs and/or risks associated with the changes that may be of concern.
- Any changes considered necessary or desirable to resolve those concerns.

BACKGROUND

The stated purpose of Part 4 and the associated schedules is to *"provide a code for the governance of council-controlled organisations and for the monitoring and reporting of their performance".* The explanatory note to the Bill includes the judgement (in the Statement of Net Benefit) that *"Better processes for establishing and monitoring council-controlled organisations should ensure better consistency with the long term council community plan and a higher level of benefit to the community and the economy".*

PRINCIPAL CHANGES FROM PREVIOUS LEGISLATION : THEIR EFFECTS AND RECOMMENDATIONS

The remainder of the report deals with the Bill in three main sections: Coverage, Establishment and Governance. Each section (or sub section within governance) first outlines the principal changes, then discusses the effects, and finally makes recommendations. A final section, Drafting, deals with definitional matters that may merit clarification.

Coverage

Principal Changes

Part 4 and the associated schedules replace Part 34A of the Local Government Act 1974. Part 34A provides the statutory framework for the establishment of Local Authority Trading Enterprises (LATEs). Broadly, LATEs are defined to include:

- A company in which equity securities carrying 50% or more of the voting rights at a shareholders' meeting, are held or controlled, directly or indirectly, by one or more local authorities; or
- An organisation (that is, an entity or arrangement other than a company) which (1) operates a trading undertaking with the intention or purpose of making a profit and (2) is subject to significant control directly or indirectly by one or more local authorities (significant control is defined as control of 50% or more of the votes at a meeting of the organisation or the right to appoint half or more of the trustees, directors or managers).

The definition explicitly excludes port and energy companies, the New Zealand Local Government Association Limited, and any company or organisation controlled by it.

As well as excluding port and energy companies, the way in which the definition in Part 34A is drafted also excludes council-controlled trusts and any other council-controlled organisation unless it operates a trading undertaking with the intention or purpose of making a profit.

The definition in the Bill substantially widens coverage in two ways:

- It includes ***ALL*** council-controlled organisations (other than port companies, the New Zealand Local Government Association and any entity controlled by either). This is the case regardless of their structure and regardless of whether or not they are established for the purpose of operating a trading undertaking.
- Energy companies are no longer exempted and will therefore become council-controlled organisations subject to the new legislation once it is passed.

Currently, including a council-owned or controlled organisation within the definition of LATEs has two main consequences:

- Its establishment, operation and accountability are subject to the requirements of Part 34A of the Local Government Act 1974 (and certain other parts of the Act, principally ones dealing with planning, reporting and accountability).
- The income of the LATE itself is taxable. As well, any amount derived by a local authority from a LATE other than an amount received in trust, or rates, is also taxable.

Effects

With the two exceptions noted, all council-controlled organisations, whatever their structural or organisational form, will be subject to the requirements of Part 4 and associated schedules. The implications of this wider coverage are discussed in the separate parts of this report dealing with establishment and governance (other than boundary issues which are covered in this part).

The Income Tax Act will require a consequential amendment to deal with the change from Local Authority Trading Enterprise to council-controlled organisation. Logically that amendment should confine tax coverage to council-controlled profit organisations. The alternative of including all council-controlled organisations would be to make a substantial change in the tax liability of many local authorities. An obvious example would be those authorities which have leased facilities to (say) trusts established to manage museums, art galleries or other recreational/cultural or community facilities.

A principal effect of the Bill is to create a common legislative framework for council-controlled organisations regardless of their structure or whether or not they are intended to be profit making. In practical terms, the main impact of extending the coverage will be on council-established trusts.

Trusts are now quite widely used within local government for a range of different activities including, for example:

- Economic development agencies, tourism promotion, information centres etc.
- Art and cultural facilities such as art galleries, museums, libraries and theatres.
- Recreational facilities such as sports grounds, stadiums etc.

The use of trusts is likely to increase. Other areas where there is potential include such activities as housing and various forms of infrastructure. Under current legislation, the establishment process for trusts is normally quite straightforward with relatively low compliance costs. Commonly (but not necessarily) there will be a measure of public consultation by foreshadowing the intention to establish a trust in the council's annual plan. This will seldom be more than a paragraph or two spelling out the intention, the broad objectives of the proposed trust, and the funding which the council intends to make available.

The far more intensive regime now proposed will act as an incentive for councils to seek means for achieving the objectives currently served by council-controlled trusts through other arrangements which fall outside the definition of council-controlled organisation.

This should not be seen as a means of seeking to avoid public accountability so much as a means of reducing excessive compliance costs. In practice, virtually all trusts which councils have established continue to depend on the parent council for a substantial part, usually the majority, of their funding. The reason is simple. Typically the trust has been set up to take over a council function, where the activity is already in place, or to be the vehicle for delivering a new function, the nature of which is primarily the delivery of local public goods and thus dependent on continuing ratepayer funding.

Ongoing accountability to the public for the activity is assured because of the council's obligation to report prospectively and retrospectively on the allocation of funding and the outputs/outcomes that achieves. This is also reflected in the relationship between the council and the trust. Current best practice is a well-defined performance (or purchase) agreement specifying outputs, performance measurement, reporting etc.

Not all councils understand the different options available and have the skills needed to design structures that will fall outside the council-controlled organisation framework but still provide proper accountability and control of those matters of importance to the council's community. LGNZ may wish to consider developing best practice guidelines to assist councils understand the options.

Boundary Issues

There are three boundary issues which need to be dealt with. They are:

- Special purpose bodies.
- Energy companies.
- Small entities.

Special Purpose Bodies

There are a number of special purpose bodies, controlled by local authorities, which could be caught up within the expanded definition of council-controlled organisation. A number are established under statute with their own specific governance and accountability arrangements. Examples include the Canterbury Museum Trust Board, the Auckland Museum Trust Board, and the Otago Museum Trust Board. They are certainly controlled by local authorities in the sense that their governing boards are local authority appointed. What is unclear is whether they come within the definition of organisation in Section 42(2) of the Bill. If it is intended that organisations of this type be included, the legislation should be specific and any necessary modifications made to their current legislation. If it is not intended to include them, then the Bill should list them in the exemption provision in Section 42(4).

Energy Companies

Council-controlled energy companies will become subject to the requirements of Part 4. There does not appear to be any policy rationale for this change. If the concern is that publicly owned energy companies should be subject to greater accountability than is provided for under the Energy Companies Act (essentially the same as currently applies to LATEs), that would seem to apply equally to trust owned companies.

The compliance costs faced by energy companies will increase and so may the obstacles they face in carrying out their business activities (both the Christchurch and Dunedin city owned lines companies have been active in diversification). The more intrusive provisions of the proposed Bill could make dealing with companies subject to it less attractive for third parties. Further analysis of this issue is needed before deciding whether there should be a specific recommendation.

Removal of the exemptions for energy companies means that local authority-controlled energy companies will be subject to two separate pieces of legislation, the Local Government Act and the Energy Companies Act. These contain different provisions, for example regulating the preparation of a statement of corporate intent. The Energy Companies Act should be amended to avoid any possibility of conflict.

Small Entities

A number of local authorities are concerned that the expanded definition of council-controlled organisation will capture a number of relatively small and insignificant entities and thus make them subject to the full weight of the extensive compliance provisions in the Bill. Examples cited included:

- A Christmas parade trust.
- Management boards for local public halls where these have some form of corporate structure - perhaps as a trust, perhaps as an incorporated society.

It would almost certainly be an impossible task to rewrite the definition of council-controlled organisation to exclude small and insignificant entities. The scheme of the Bill suggests an alternative approach: rewriting Section 42(1)(b) so that it commenced *"A significant organisation ...."* and applying the equivalent of the process under Section 71 (Assessment of whether decision is significant) so that local authorities were required to consider, in respect of any council-controlled organisation other than a company, whether or not it was significant with the consequence that only significant organisations would be caught within the definition.

Recommendations

1. That the Bill be amended to make it clear whether or not special purpose bodies, such as the Auckland, Canterbury and Otago Museums, are intended to be covered by the council-controlled organisation provisions.
2. That the Energy Companies Act be amended in respect of local authority-controlled energy companies, to ensure that there is no conflict between the provisions of that Act and the new Local Government Act.
3. That the Bill provide a mechanism, equivalent to Section 71, by which local authorities can resolve whether a council-controlled non-profit organisation is significant and therefore subject to the proposed new provisions.

Establishment

Principal Changes

The current Part 34A deals explicitly with the establishment of LATEs. It includes an obligation to constitute and adequately fund an establishment unit, the role and function of the establishment unit, the preparation of an establishment plan, and a requirement to go to public consultation to the extent that the local authority wishes to depart from any recommendation of the establishment unit.

Under the Bill, there will no longer be statutory provisions regulating an establishment unit and its processes. Instead, the local authority will be free to devise its own processes relying on its general powers.

There is a new provision, in Section 43 of the Bill, that *"A proposal to establish a council-controlled organisation must be adopted in accordance with the special consultative procedure before a local authority may establish or become a shareholder in the council-controlled organisation".* [Note: The Bill uses terms such as 'shareholders' and 'directors' to apply to all council-controlled organisations, but with a provision in Section 42(3) to cover differing positions, arrangements etc.] Sections 66-72, dealing with consultation, require local authorities to use the special consultative procedure for any significant proposal and include the requirement that a transfer or divestment of significant assets (including a strategic asset owned or partly owned by the local authority) is a significant proposal.

Section 43 is explicit that consultation on establishment may be undertaken as part of another proposal or as part of an annual plan or a long-term council community plan. There is no similar requirement dealing with consultation on significant proposals.

Generally, Schedule 7 carries forward the procedural protections included in the present Part 34A from Sections 594ZE onwards, except for:

- Section 594ZO which excludes certain companies (principally port and energy companies) from the authority in Part 34A to transfer an undertaking to a local authority trading enterprise.
- Sections 594ZP, prohibiting local authorities from giving guarantees for LATEs, and 594ZPA prohibiting them from lending money to or providing other financial accommodation for a LATE on terms and conditions more favourable than would apply if the local authority itself were borrowing the money or obtaining the financial accommodation without charging rates.

Neither of these omissions is of any significance.

Effects

Dropping the specific provisions in respect of an establishment unit and establishment plan will allow local authorities to streamline processes and choose the most cost effective means of considering options for establishment. However, this is likely to be more than offset by the enhanced provisions for consultation. Even if it is to combine consultation on establishment with consultation on transfer of any significant assets, the compliance burden may be considerable. This is not a feature of Part 4 on its own, but rather of the enhanced emphasis in the legislation on public consultation and decision-with Sections 66-72 being much more detailed and prescriptive than the present Section 716A. This includes Section 68(1)(g) with its quite detailed requirements that any proposal to establish a council-controlled organisation set out reasons, proposed objectives, nature and scope of the activities, and the expected impact on the community, on the local authority's overall operations, and on the social, economic, environment and cultural wellbeing of the community.

Recommendations

1. It would be desirable for LGNZ to prepare, possibly in conjunction with the Controller and Auditor General, guidelines for local authorities to follow in the establishment of council-controlled organisations on matters such as:
   - What constitutes significant assets and/or strategic assets.
   - Compliance with the requirements of Section 68(1)(g) - for example, if a local authority decided to transfer an in-house design function to a council-controlled organisation, would it be sufficient compliance to report that the expected impact of the proposal on the local authority's overall operations was *"increased efficiency and flexibility in meeting council's design requirements"* and, for the impact on social, economic, environmental and cultural wellbeing of the community, to state simply *"none except to the extent that reduced cost will free up funding either for greater expenditure on other council activities or to hold/reduce rates".*
2. Section 43, dealing with the consultation required before a council-controlled organisation is established, and Section 72, requiring that the special consultative procedure be used before making a decision on a significant proposal, should be aligned so that a council establishing a council-controlled organisation in order to transfer significant and/or strategic assets to it, could use the one special consultation - whether it chose to do so through the annual plan or long term council community plan, or as a separate consultation. (That change could well apply to other significant proposals also, permitting them to be consulted on through either of those plans.)

Governance

There are four principal areas of change which affect governance and accountability. They are:

- Bringing all council-controlled organisations within a specific legislative framework for governance and accountability.
- Appointment of directors (or trustees, managers, etc).
- Statement of corporate intent / performance agreement - both content and process.
- The council / board relationship.

Each of these four areas is dealt with through the process of:

- Describing the change.
- Assessing the effects of the change.
- Providing recommendations.

All Inclusive Framework

Principal Changes

All council-controlled organisations will be subject to a detailed statutory framework covering governance and accountability rather than, as at present, just LATEs.

Effects

Under current legislation, a local authority faces two boundary issues it needs to consider when establishing a separate organisation. The issues are:

- In respect of any entity, will it come within one or other of the control tests set out in Section 594B?
- For an entity other than a company, will it be operating a undertaking with the intention or purpose of making a profit?

In practice, applying the current tests is normally straightforward. If the purpose is to carry on a trading undertaking with a profit objective or an activity which requires a strong commercial framework, the company structure has been used so that the entity is automatically a LATE. If the activity is a non-trading activity, it has been common to use trusts. As a result, the question of whether or not an entity is a LATE and therefore subject to the Act has been quite straightforward. Where there have been difficulties is in the area sometimes referred to as "accidental LATES", usually multi-party arrangements established either prior to the legislation or for purposes which seem distant from the legislation itself but, because of the potential for local authority control and the nature of their activities, may come within the definition.

The Bill preserves the control test which now becomes the sole test for whether an entity or arrangement comes within the legislative framework. The question of whether an entity is operating a trading activity with the intention or purpose of making a profit shifts from being a boundary test for application of the legislative framework to becoming a test for what type of entity - is it a council-controlled profit organisation or a council-controlled non-profit organisation?

Under the Bill, the main significance of the distinction is in how to comply with Schedule 6. A council-controlled profit organisation is required to complete a statement of corporate intent and a non-profit organisation a performance agreement.

The more significant distinction (as noted above at page 2) is likely to be the income tax implications. There is potential for these to be significant. The options available for amending Section CD3(b)(ii)(A) would logically seem to include:

- Applying it solely to council-controlled profit organisations.
- Applying it to all council-controlled organisations - with the consequences cited above.
- Applying it to council-controlled profit organisations plus any council-controlled non-profit organisations formed as companies.

This latter point is significant as the situation of Metrowater Limited, the Auckland City Council owned charitable LATE responsible for water distribution and collection of wastewater within Auckland City, demonstrates. At the time it was established, it and any payments it made to Auckland City Council, were non-taxable. The law was amended to make these amounts taxable.

In establishing Metrowater - and negotiating subsequent statements corporate intent - the Auckland City Council deliberately took the view that it should not seek to earn a profit, by way of dividend payment, from the company. The statement of corporate intent sets a minimal target for return on capital with the explicit requirement that this return is to be held for reinvestment. Both the company and the Council recognise that Metrowater will be required to invest in system expansion and upgrade amounts over and above what will be available solely from depreciation. Making some provision for funding from internal cash flow is accordingly seen as both appropriate and equitable (as between different generations of users).

Theoretically, Metrowater could have been established as an incorporated charitable trust rather than as a company. In practice, there is a widespread view that complex and large scale undertakings such as water and wastewater management require a company structure with its quite detailed and well understood legislative and governance frameworks (the provisions of the Companies Act and of common law; the provisions of the Financial Reporting Act) rather than the much less robust regime which applies to trusts.

There is good reason to believe that other local authorities will want to use corporate structures to manage water and wastewater undertakings so long as those can be properly controlled in the interests of ratepayers and users. Taking a view that these are service organisations and that their overriding objective should be to supply a least cost service to current and future users in a manner consistent with the community's objectives (including environmental and social objectives), there is a case for companies of this type being run as non-profit organisations. That is, they may generate a surplus to provide for future investment, but the shareholder itself receives no return.

Under an approach of this kind, management would be incentivised not in relation to optimising shareholder wealth, but on delivering a least cost service so long as they also meet related environmental and social objectives.

There is clearly scope for contention over this matter. The government's economic advisers are likely to argue that, unless companies of this type target earning at least a market rate of return on capital, then there may be significant distortions (in areas such as productive, dynamic and allocative efficiency). Those arguments lose some of their force in dealing with monopolies. As the electricity industry in particular shows, market regulation of monopolies is not always effective.

Such an approach might also be seen as creating a bias in favour of public rather than private provision. That, however, appears to be a government objective, at least in respect of water and wastewater in any event (see the provisions of Section 129 of the Bill).

The principal effect of the more comprehensive framework will be to shift the nature of boundary decisions when establishing council-controlled organisations. Councils will need to focus on:

- Whether the activity needs to be council-controlled or whether there are other mechanisms for protecting ratepayer and community interests (which there are)?
- Is it intended that the organisation operate a trading activity with the intent or purpose of making a profit?

Under the current regime, this latter issue has not always been at the centre of council decision making - except where there are issues over grouping different council activities for tax purposes.

The more explicit focus on the distinction between profit and non-profit organisations will require councils to have a clearer understanding of what they are seeking to achieve.

A further matter raised by this discussion is whether there would be merit in seeking to define the term "profit" as it applies to a council-controlled profit organisation, especially if the term is to have significance for income tax purposes. In private sector practice, the implications of undertaking a trading activity with the intent or purpose of making a profit are quite clear - the owner seeks a return on investment.

This does not translate across easily into the public sector, especially in the situation outlined above in which a local authority (and its community) might legitimately want an organisation to be run along commercial principles but with the expectation that there should be no return to the owner, at least in the form of a distribution akin to a dividend or other payment of surplus to the owner. If an organisation is generating a surplus purely for the purposes of reinvestment, and the undertaking concerned is one which is expected to remain in public ownership for the foreseeable future and for the purpose of delivering a public service, then applying the term "profit" to that surplus, with a consequence that the "profit" is taxable, seems less easy to justify.

This is a matter which Local Government New Zealand may wish to raise with its members and, if there is sufficient concern, with government in the context of the changes needed to the Income Tax Act as a consequence of the passage of the Local Government Bill.

1. It is critically important that the tax regime for council-controlled organisations be clear. Of the three scenarios for amending Section CB3(b)(ii)(A), the best appears to be substituting the expression *"council-controlled profit organisation"* for the expression *"local authority trading enterprise"*. The Inland Revenue Department and LGNZ may wish to agree criteria for resolving any boundary problems. This may include local authorities being quite explicit in their decisions to establish council-controlled organisations on the question of profitability and rationale.
2. Councils, perhaps with the assistance of LGNZ best practice guidance, should establish an explicit process for assessing the different organisational options available including questions

such as:
  - Does the organisation need to be council-controlled or are there other ways of achieving ratepayer and community objectives?
  - Is it intended to be a profit organisation or not?
  - What are the performance characteristics required and thus what kind of organisational structure? This question will become important for councils seeking to balance a non-profit objective (but with provision for generating a reinvestable surplus) against the robustness of different legislative and governance arrangements, especially for companies versus incorporated charitable trusts.

3. Local Government New Zealand should consider whether there is a case for clarifying the meaning of the term "profit" in respect of council-controlled organisations which generate a surplus but for reinvestment rather than distribution to the owner.

Appointment of Directors

Principal Changes

Current legislation provides that:

- At least two members of the directorate shall be persons who are neither members nor employees of any local authority.
- The directors of a LATE shall be persons who, in the opinion of those appointing them, will assist the LATE to achieve its principal objective (to operate as a successful business).

Section 44 of the Bill contains two separate requirements:

- The local authority must adopt a policy that sets out an objective and transparent process for (1) the identification and consideration of the skills required of directors of the council-controlled organisation and (2) the appointment of directors to a council-controlled organisation.
- The local authority may appoint any person who, in the opinion of those appointing the person, has the skills, knowledge and experience to (1) guide the organisation given the nature and scope of its activities and (2) contribute to the achievement of the objectives of the organisation.

Effects

The current legislation has been seen as inadequate to provide reasonable assurance that the boards of LATEs will be people appointed because of relevant skills and experience rather than for some other reason (such as being a councillor or employee, or having "friends at court").

Local government practice in appointing directors has been the subject of two significant reports by the Controller and Auditor General (a 1994 report *"Governance of Local Authority Trading Activities"* and a 2001 report *"Local Authority Governance of Subsidiary Entities"*.)

Both reports express concerns at the practice of appointing councillor directors. Both support the view that one reason for this was lack of confidence that non-councillor directors would be sufficiently responsive to the expectations of the local authority owner.

The second report expressed similar reservations in respect of trusts. In that report, the Controller and Auditor General noted that the majority of local authorities now had documented processes for selecting directors for company boards but this was not so much the case with non-profit entities. The report recommended that a governing body (whether of a trading enterprise or a non-profit entity) should have members with a mix of skills and experience appropriate to the entity's activities and that local authorities should follow similar processes for appointing members of the boards both of trading enterprises and of non-profit entities.

Recent legislative practice has taken a similar approach. As an example, that part of the current Local Government Act regulating Infrastructure Auckland provides that the electoral college, in selecting members for appointment, must use an objective process and that must involve:

- The preparation and publication of a job description.
- An advertised recruitment process.

The Act also provides that the Deed for Infrastructure Auckland must require that those appointed as members be appointed for their relevant knowledge and experience.

The wording of the Bill differs from the wording currently used for Infrastructure Auckland. That wording (Section 707ZZU) bundles together establishing the process and selecting the members. The wording of Section 44 separates the process of establishing the policy from the process of selection. The intention appears to be that the policy is put in place independently and not developed at the time when a council is considering establishment, or appointment of members to an existing board.

This separation (whether or not it is deliberate) should have some merit. Specifically, it should ensure that the policy is developed with a minimal risk that it could be influenced by a wish to see particular persons appointed to a particular entity.

As the Controller and Auditor General's 2001 report recognises, practice varies amongst local authorities. Complying with the new legislation will be comparatively onerous - or at least will require of councils a high level of familiarity with the principles and practice of corporate governance. There may be merit in LGNZ developing best practice guidelines for appointment to assist those local authorities which might otherwise have difficulty in meeting the standards the legislation will require. Given the emphasis on transparency, one benefit of this approach could be to minimise the risk of public criticism of whatever processes may be adopted.

One matter that has occasionally been controversial within local government is the question of director's fees. Specifically, if
are appointed as directors, should they be paid fees in addition to the

remuneration they receive as councillors?

The focus of the new legislation (and for that matter the requirements of company law, trustee law etc) is on directors being persons qualified by relevant skills and experience for performing the role and expected to contribute, actively, to the governance of the organisation. This carries two implications with it for any councillors (or mayors, or chairs) who may be appointed as directors:

- First, the councillor will presumably have been appointed not because he or she was a councillor but because he or she met the requirements for appointment, including appropriate experience, skills etc.
- The work of a director is additional to any other work a councillor might undertake for his or her council.

These considerations suggest that councillors should be remunerated on the same basis as other directors. Despite the force of these arguments, it is almost certain that any councillor director, remunerated for directorial services, will face a measure of public criticism. To minimise this and ensure that appropriately qualified councillors can be appointed, Section 44 (1) could usefully include a new provision along the following lines:

"(c) Approving the remuneration payable to directors and the basis for reimbursement of any expenses."

Recommendations

1. That LGNZ consider preparing best practice guidelines for the development of the policy required by Section 44.
2. That the scope of Section 44 be extended to include remuneration and the basis for reimbursement of expenses.

Statement of Corporate Intent / Performance Agreement

Principal Changes

The basic framework under the Bill is essentially unchanged from the current Act in that decisions relating to the operation of the LATE or council-controlled organisation are to be made in accordance with the statement of corporate intent (or performance agreement). The principal difference is coverage in that all council-controlled organisations are now within the framework.

Schedule 6 of the Bill deals with statements of corporate intent (for profit organisations) and performance agreements (for non-profit organisations) - referred to collectively as performance statements. There appear to be a number of drafting errors in the schedule which will need to be rectified and which, to some extent, cause problems in describing the intended changes.

First, in contrast to the current Act, Clause 2 sets out the purpose of performance statements - there are three:

- State publicly the activities and intentions of a council-controlled non-profit organisation for the year, and the objectives to which those activities will contribute (including the expression *"non-profit"* appears to be an error - both because performance statements relate to profit and non-profit organisations and because there seems no reason to exempt profit organisations from stating those matters).
- Provide an opportunity for shareholders to influence the direction of the organisation.
- Provide a basis for the accountability of the directors to their shareholders for the performance of the organisation.

The substance of performance statements is set out in Clauses 9 (Statements of Corporate Intent) and 10 (Performance Agreements) respectively. Clause 9 is basically similar to Section 594T of the current Act, with the following exceptions:

- The term *"the group"* is used more extensively in Clause 9 than in Section 594T. As both provisions start with the wording *"The group comprising the Local Authority Trading Enterprise and its subsidiaries (if any) …"* this change may be of no significance. If it has no significance, consistency would suggest staying with the current wording. If it is considered to have significance, it would be useful to know what that is.
- The requirement that the SCI specify the kind of information to be provided to shareholders includes a new requirement *"… and, in particular, what prospective financial information is required and how it is to be presented".*
- The provision for *"any other matters that are agreed …"* includes, in the new Bill, any required by resolution of shareholders requiring directors to modify the SCI. That provision is new but the provision that shareholders may require modification of the SCI is not. It is carried forward in essentially similar terms.

Clause 10 dealing with performance agreements is very similar to Clause 9 except that:

- Sub clause 10(b) omits the expression *"the group".* This seems to be a drafting error.
- Sub clause 10(c) uses the expression *"the ration"* rather than *"the ratio".*

There is a new sub clause 10(e) requiring performance indicators against which the group may be held accountable for the use of ratepayer funds or assets.

The new Bill carries forward, in Clause 8 of Schedule 6, an equivalent of Section 594Y of the present Act, providing for *"savings of certain transactions"*. As worded, Clause 8 applies solely to a council-controlled profit organisation. There seems to be no reason why the savings provision should not also apply to non-profit organisations.

Effects

The provisions regulating the contents of statements of corporate intent are fundamentally unchanged from the present provisions and so should have little impact on current practice. (This comment goes to content not process, which is discussed below.) The requirement for prospective information is an extension , the significance of which is not entirely clear. There is already provision in Clauses 9 and 10 of Schedule 6 for statements of corporate intent and performance agreements respectively to include *"the performance targets and other measures by which the performance of the group may be judged in relation to its objectives"*. In practice, with statements of corporate intent, this has normally included matters such as profitability, rate of return on shareholders' funds, gearing, capital investment, etc. There is an implication that this new provision will, in effect, require council-controlled organisations to publish their full financial forecasts - except to the extent, which will vary from organisation to organisation, that they can rely on the provision in Section 55 of the Bill allowing them to withhold any information that *"may be properly withheld if a request for that information were made under the Local Government Official Information and Meetings Act 1987".*

The performance targets provision already gives local authorities considerable scope to seek additional information (scope which will be increased both by the changed timing for SCIs and performance agreements and, if adopted, by the suggestion in this report that local authorities have in place a reporting cycle equivalent to that which the government uses for SOEs). Unless there is a compelling case that the new provision is required, it should be omitted.

Clause 10 is an attempt to bring within the accountability framework what is, in practice, quite a wide range of organisations - any non-profit organisation controlled by a council. The proposed mechanism is a performance agreement rather than a statement of corporate intent, but the schedule still expects that it is the directors (or trustees or other governing members) who prepare the agreement rather than the council.

In practice most council-controlled non-profit organisations have been or will be established to provide services which will be wholly or partly funded by the council. This is a significant difference from the typical council-controlled profit organisation. The distinction is that:

- Normally, a council-controlled profit organisation will operate in the market, drawing revenue from a range of services as the result of the sale of goods or services. Examples are LATEs established to operate contracting businesses, professional services, forestry operations etc.
- Council non-profit organisations will typically draw the bulk of their revenue from their council for the provision of what, in essence, are ratepayer funded public goods. Examples include economic development agencies, trusts operating various council facilities, tourism promotion etc.

A council-controlled profit organisation may hold quite substantial assets. It is common for the business assets associated with a trading undertaking to be transferred to the ownership of the entity concerned. This is less so with non-profit organisations. The council establishing (say) a library, art gallery, museum or zoo trust may retain ownership of at least the fixed assets, leasing them to the trust which may have relatively little capital of its own.

This gives the council a very different interest in performance of the two different kinds of entities. Where significant assets are held by a council-controlled profit organisation, there is a natural emphasis on profitability, maintaining shareholder value and so on. In contrast, where the main relationship is a purchase one, the council focus will be much more on the nature and quality of the services it is purchasing and the capability of the organisation to deliver to council requirements.

There could be merit in revisiting Clause 10 so that it reflects, more closely, the typical relationship between a council and a non-profit organisation. This should include considering how appropriate it is to use terms such as "consolidated shareholders' funds" and to provide for an estimate of the commercial value of the shareholders' investment in the group (which, with a trust, may be zero simply because the net worth is held in trust for other purposes).

Recommendations

1. The wording of Clauses 9 and 10 should be tidied up to remove drafting errors and to maintain consistency, as far as possible, with Section 594T of the current Act.
2. Clause 10 should be revisited, recognising that the typical council/non-profit organisation relationship will be a purchase relationship rather than an ownership one.
3. Clause 8 of Schedule 6 should be amended so that it applies to all council-controlled organisations

The Council/Board Relationship

Principal Changes

The Bill introduces changes in the process regulating the relationship between councils and council-controlled organisations in two main ways:

- Different timing for the preparation and completion of performance statements (statements of corporate intent and performance agreements).
- New provisions for performance monitoring.
- A new statement of the role of directors.

Timing of Performance Statements

Principal Changes

The current Act requires the directorate of a LATE to deliver a draft statement of corporate intent to its shareholder not later than one month after the commencement of the financial year to which it relates. It is required to consider any comments delivered to it within two months of the commencement of the financial year and deliver completed statement to shareholders within three months.

The new Bill substantially changes this. Clause 3 of Schedule 6 requires the directorate to deliver a draft performance statement on or before 1 March in each year, to consider any comments made to it within two months of 1 March, and deliver the completed performance statement before 1 July.

Effects

The changed timing for preparation and delivery of the performance statement means that local authorities will have information from organisations they control at least two months prior to the commencement of the financial year to which it relates and thus:

- Have rather more scope to influence activities for the forthcoming year.
- Have a better opportunity to integrate information about the organisations they control in their own planning processes (annual plan, in years where it is to be prepared long term council community plan).

The effect of the change will vary from local authority to local authority depending on the practice which individual councils currently follow. It is noteworthy that the provisions in the current Act follow, broadly, those for state owned enterprises. Central government, in its dealings with state owned enterprises, has put in place an annual cycle, not provided for in the Act, under which shareholding ministers review and discuss with the directorate the development of the SOE's business plan, the government's objectives, and the government's expectations of the directorate for the forthcoming year.

Such a practice would have value within the local government sector as well. Indeed a number of local authorities already have a similar process in place. Again, it would be useful for LGNZ to provide its members with guidance on best practice in this area. In doing so, it would be sensible to build on what central government has in place with SOEs (and other crown owned companies) if only as a means of establishing consistency in the governance of public sector companies and other organisations.

Recommendation

That LGNZ consider publishing best practice guidelines for local authorities in managing the annual reporting and accountability cycle with council-controlled organisations, following the practice employed by government in respect of SOEs and other crown owned organisations as a means of building consistency in the governance of public sector owned organisations.

Performance Monitoring

Principal Changes

Under the current Act the process for managing the relationship between local authorities and entities which they control is regulated largely by the Companies Act, trustee law, or other legislation and case law (depending on the nature of the organisation concerned).

The requirements of Part 34A have been relatively limited. Apart from the statement of corporate intent provisions, local authorities have generally exercised their control relying on the powers which they have under the Companies Act or, for other organisations, provisions which they themselves may have designed in purchase agreements or in the constitution of other entities.

LATEs have been outside the coverage of the Local Government Official Information and Meetings Act and the Ombudsmen Act (with a specific provision that nothing in the Act shall be construed as requiring the inclusion in any statement of corporate intent or other document of accountability of information that could be properly withheld if the Local Government Official Information and Meetings Act applied to LATEs and a request for that information had been made under the Act).

As a result of public concerns about the performance of some LATEs, and the claimed inability of their local authority shareholders to influence that performance , government has introduced legislation (the Local Government (Elected Member Remuneration and Trading Enterprises) Amendment Bill) which was passed at the end of 2001. That legislation adds to the successful business objective of Section 594Q, a provision that *"Operating as a successful business includes (a) achieving the objectives of its shareholders, both commercial and non-commercial, as specified in the statement of corporate intent; (b) being a good employer; and (c) exhibiting a sense of social and environmental responsibility by having regard to the interests of the community in which it operates and by endeavouring to accommodate or encourage these when able to do so".*

The Bill does not carry forward an equivalent of Section 594Q. Instead it defines a council-controlled profit organisation as "a council-controlled organisation that operates a trading undertaking for the purpose of making a profit". More importantly, it includes the following provision in respect of performance monitoring:

49 Performance monitoring

A local authority that is a shareholder in a council-controlled organisation must-

- have in place a process for approval or endorsement by that local authority of the directions and strategies, planning outcomes and activities, financial and non-financial targets, and income measures of that organisation; and
- regularly undertake performance monitoring of that organisation to evaluate its contribution to the achievements of -
  - the local authority's objectives for the organisation; and
  - the desired results, as set out in the organisation's statement of corporate intent or performance agreement; and
  - the overall aims and outcomes of the local authority.

Effects

The extended Section 594Q itself raised very real concerns for its potential impact on governance. Concern focused on the requirement that operating as a successful business includes *"achieving the objectives of its shareholders, both commercial and non-commercial, as specified in the* *statement of corporate intent".*

At the heart of the concern was that making directors responsible for both commercial and non-commercial objectives risked confusing their role and accountability. Section 49, as proposed, significantly increases the risks identified with the proposed amendments to Section 594Q. As worded, the section has the potential to take away from the Board of a council-controlled organisation (whether it is a company, an incorporated charitable trust, or some other organisational structure) its fundamental legal responsibility for the guidance of the organisation including determining the strategies and policies which the organisation should follow.

As worded, the new section would not force a local authority to take over the role of a board of directors. It could simply adopt a policy of endorsement which provided, in effect, for the introduction of a consultation cycle equivalent to that used for SOEs. The real concern with the section is the potential it offers for interference in governance, either because an individual council seeks to do so (perhaps because of a lack of understanding) or because it is responding to political pressure - with the community saying to the local authority *"You have the power to approve policies - exercise it.".*

In tandem with this is the question of uncertainty for potential directors or trustees. It is a legitimate assumption for them to make that if the power is there, it will be used - a matter of particular concern given the relatively short term electoral cycle under which local government operates.

There is a further complication the proposed new section raises. This is the question of whether a council (or individual councillors) exercising the powers proposed in the new section, would be caught by the *"deemed director"* provisions of the Companies Act.

The term *"director"* encompasses more than just individuals who have been formally appointed as directors of the company. The full definition is found in Section 126. Subsection 1 of that section reads as follows:

126 Meaning of "director"

1. *In this Act, director, in relation to a company, includes-*
2. *A person occupying the position of director of the company by whatever name called; and*
    - *A person in accordance with whose directions or instructions a person referred to in paragraph (a) of this subsection may be required or is accustomed to act; and*
    - *A person in accordance with whose directions or instructions board of the company may be required or is accustomed to act; and*
    - *A person who exercises or who is entitled to exercise or who controls or who is entitled to control the exercise of powers which, apart from the constitution of the company, would fall to be exercised by the board; and*
3. *For the purposes of sections 131 to 149, 298, 299, [301, 383, and 385], a person to whom a power or duty of the board has been directly delegated by the board with that person's consent or*

acquiescence, or who exercises the power or duty with the consent or acquiescence of the board; and

4. *For the purposes of sections 145 to 149 of this Act, a person in accordance with whose directions or instructions a person referred to in paragraphs (a) to (c) of this subsection may be required or is accustomed to act in respect of his or her duties and powers as a director.*

There is a distinct probability that councils acting under Section 49 would find that they or individual councillors or both were caught by the definition and thus subject to the responsibilities and liabilities of directors. It is doubtful that this outcome is intended.

A review of local and international commentaries on the role of the board, and legal obligations of directors, highlights the problem posed with Section 49, especially with its emphasis on a process for approval.

New Zealand

The Controller and Auditor General's report *"Local Authority Governance of Subsidiary Entities"* states in paragraph 262 that:

"A local authority should ensure that a subsidiary entity's board is responsive to its expectations as a public owner, ***without compromising the board's responsibility as the governing body to direct and control the conduct of the entity's business".***

The report goes on to state that, in consultation with the board, the local authority should establish a number of matters including a director selection and appointment process and:

- *"A clear statement outlining the council's expectations of the board, including a commitment to "no surprises" on matters likely to cause community concern or have political implications.*
- *Periodic forums for discussion between the board and councillors on strategic business issues and ownership objectives.*
- *Ongoing communication between the council and board chairperson and between entity executives and local authority officers, on matters of common interest."*

In other words, the board is to have the discretion to manage but the local authority, as owner, is entitled to be kept informed and have its views respected.

The Companies Act 1993 sets out the statutory role and obligations of directors. Provisions include:

128 Management of company

- *The business and affairs of a company must be managed by, or under the direction or supervision of, the board of the company.*
- *The board of a company has all the powers necessary for managing, and for directing and supervising the management of, the business and affairs of the company.*

- *(3) Subsections (1) and (2) of this section are subject to any modifications, exceptions, or limitations contained in this Act or in company's constitution.*

131 Duty of directors to act in good faith and in best interests of company

- *Subject to this section, a director of a company, when exercising powers or performing duties, must act in good faith and in what the director believes to be the best interests of the company.*

Section 128 reserves to directors the management of the company. It has been employed, for example, as the basis for disallowing a shareholders' resolution at an annual meeting seeking to give the board directions on management.

Section 131 draws another important distinction. The responsibility on directors is to act in good faith in the best interests of the company. Case law recognises that the company is not simply current shareholders - even where there is simply one shareholder - but the company as a separate entity with its obligations to third parties including creditors.

International

In recent years there have been a number of high level reports on corporate governance - particularly in Europe and North America - articulating the role and responsibility of directors. The following quotations provide examples of what is expected.

United Kingdom

1. Cadbury Report
   "The board should …. retain full and effective control over the company and monitor the executive management."
2. Hampel Report
   "The prime responsibility of the board of directors is to determine the broad strategy of the company and to ensure its implementation. To do this successfully requires high quality leadership. It also requires that the directors have sufficient freedom of action to exercise their leadership."
3. The Combined Code / Turnbull Report
   (The code is the code governing listed companies.)
   "Every listed company should be headed by an effective board which should lead and control the company."

United States

National Association of Company Directors Report

"The objective of the corporation (and therefore of its management and board of directors) is to conduct its business activities so as to enhance corporate profit and shareholder gain. In pursuing this corporate objective, the board's role is to assume accountability for the success of the enterprise by taking responsibility for the management, in both failure and success. This means selecting a successful corporate management team, overseeing corporate strategy and performance, and acting as a resource

for management in matters of planning and policy."

Canada

Dey Report

"The board of directors of every corporation should explicitly assume responsibility for the stewardship of the corporation and, as part of the overall stewardship responsibility, should assume responsibility for the following matters:

Report of the Committee on the Financial Aspects of Corporate Governance (Cadbury Report) (1 December 1992).

Committee on Corporate Governance - Final Report (Hampel Report) (January 1998).

London Stock Exchange Committee on Corporate Governance, The Combined Code: Principles of Good Governance and Code of Best Practice (June 1998); Institute of Chartered Accountants in England and Wales, Internal Control: Guidance for Directors on the Combined Code (Turnbull Report) (September 1999).

National Association of Corporate Directors ("NACD"), Report of the NACD Commission on Director Professionalism (November 1996).

Toronto Stock Exchange Committee on Corporate Governance in Canada, "Where Were The Directors?" Guidelines for Improved Corporate Governance in Canada (Dey Report) (December 1994).

- *Adoption of a strategic planning process.*
- *The identification of the principal risks of a corporation's business and ensuring the implementation of appropriate systems to manage these risks.*
- *Succession planning, including appointing, training and monitoring senior management.*
- *A communications policy for the corporation; and*
    - *The integrity of the corporation's internal control and management information systems."*

Australia

- Bosch Report
  "Directors should use their best efforts to ensure that the company is properly managed and constantly improved so as to protect and enhance shareholder wealth in perpetuity, and to meet the company's obligations to all parties with which the company interacts - its stakeholders. The essence of any system of good corporate governance is to allow the board and management the freedom to drive their company forward but to exercise that freedom within a framework of effective accountability."

OECD Corporate Governance Principles

"The corporate governance framework should ensure the strategic guidance of the company, the effective monitoring of management by the board, and the board's accountability to the company and the shareholders." "Together with guiding corporate strategy, the board is chiefly responsible for monitoring managerial performance and

achieving an adequate return for shareholders, while preventing conflicts of interest and balancing competing demands …. It also implements systems designed to ensure that the corporation obeys applicable laws, including tax, competition, labour, environmental, equal opportunity, health and safety laws. In addition, boards are expected to take due regard of, and deal fairly with, other stakeholder interests including those of employees, creditors, customers, suppliers and local communities. Observance of environmental and social standards is relevant in this context."

Some of the reports quoted were dealing explicitly with listed public companies. Others, such as the OECD Principles and the NACD Report were dealing with all companies (including public sector companies). The Controller and Auditor General's report was focused specifically on the circumstances of local authority controlled entities.

Working Group representing Australian Institute of Company Directors, Australian Society of Certified Practicing Accountants, Business Council of Australia, Law Council of Australia, The Institute of Chartered Accountants in Australia & The Securities Institute of Australia Corporate Practices and Conduct (Bosch Report) (3rd ed. 1995).

Organisation for Economic Cooperation and Development ("OECD"), Principles of Corporate Governance (April 1999); Business Sector Advisory Group on Corporate Governance, Corporate Governance: Improving Competitiveness and Access to Capital in Global Markets (the Millstein Report) (April 1998).

All have a common theme. The board of directors has the responsibility to manage the company and must have the freedom to do so, exercising the board's judgement and acting in the best interests of the company. At the same time, boards of directors must be responsive to stakeholder interests including in particular those of shareholders but also others.

The board's role, as these various quotations make clear, is in matters such as setting the strategic direction, approving the key policies to be implemented by management, selecting the chief executive, monitoring management performance, ensuring compliance, and providing leadership. The board is responsible for ensuring that management is effective, not for acting as managers as such.

Section 49 has the potential to transfer the board's responsibility back to the local authority. If the local authority is to approve the directions and strategies, the planning outcomes and activities, the financial and non-financial targets and the outcome measures of the council-controlled organisation, then it is effectively undertaking the role of the board of directors.

The consequences are potentially serious. For example:

- How can the local authority effectively hold directors if the local authority has taken the primary role in exercising the very discretions which directors themselves normally have?
- To what extent will competent commercial directors be prepared to offer themselves if the local authority has, in effect, reserved to itself the principal discretions which directors would exercise?

It seems unlikely that government does in fact intend to transfer back to local authorities the principal role and authority of the board of directors. It seems more likely that Section 49 is something of an over reaction to a concern that some council-controlled organisations may not have been fully accountable.

The Controller and Auditor General's report cited above does report some difficulties with the current process. In paragraph 252 the report states:

"However, we were not satisfied that consultation on the key features of their strategic business plans was always taking place between boards and shareholding local authorities prior to preparation of the draft SCI. In the absence of prior consultation on the assumptions underlying business plans, and on the risks and prospects for their companies, shareholding local authorities will be poorly placed to provide informed comment on the content of the SCI."

The changed timing for preparation of the draft SCI may, to an extent, resolve this issue but there clearly is a problem which needs to be addressed.

It would make much better sense to provide that local authorities should have in place a process for reviewing with council-controlled organisations their business planning assumptions, directions and strategies, planning outcomes and activities and so on for the purpose of ensuring that:

- The local authority was adequately informed on the board's exercise of its stewardship role in respect of the company; and
- The board of directors, in discharging its responsibilities and developing its strategies, planning documents etc, had a clear understanding of the shareholders' expectations.

Such a provision would formalise the type of communication which should in any event be taking place (and which does take place between shareholding ministers and SOEs) without shifting from directors to shareholders the primary decision making role.

Such an approach should be sufficient to meet the concerns underlying the proposed Section 49. In this respect, it should not be forgotten that:

- In respect of companies, local authority shareholders always have the power, if they feel it necessary, to dismiss directors and replace them with people whom they regard as more likely to recognise the interests of the owner; and
- In respect of other council-controlled organisations, which for the most part will be council funded, the discretion which the council has over continuing funding is a very powerful discipline.

Recommendations

1. The change in process for development of the statement of corporate intent should be welcomed but supported by the development of an annual information cycle equivalent to that used by central government in respect of State Owned Enterprises (this need not have a statutory basis but it would be desirable to have a common understanding in the local authority sector of the principles and process which should apply).

2. Section 49(a) should be rewritten so that, instead of vesting in the local authority the power of approving or endorsing the matters listed, the provision was worded along the following lines:

"A local authority that is a shareholder in a council-controlled organisation must: (a) have in place a process for exchange of information between itself and the directors of that organisation covering the organisation's directions and strategies, planning outcomes and activities, financial and non-financial targets, and outcome measures of that organisation with the purposes of:

- *Ensuring that the local authority has a good understanding of how directors will exercise their stewardship of the organisation and the opportunity of commenting to the directors in a timely way; and*
- *The directors, in developing those directions and strategies and other matters, have a good understanding of the objectives of the local authority and its expectations of the board.*

Role Of Directors

Principal Changes

The Bill introduces a new provision on the role of directors of council-controlled organisations:

"45. The role of a director of a council-controlled organisation is to ensure that the organisation meets its objectives and any other requirements in its statement of corporate intent or performance agreement."

Effects

Neither the effects nor the purpose of the proposed new section are clear. The Bill carries forward a provision, common in legislation dealing with public sector-owned companies, in Section 46 that

"All decisions relating to the operation of a council-controlled organisation must be made by, or under the authority of, the directorate of the organisation in accordance with -

- *Its statement of corporate intent or performance agreement;*
- *Its constitution."*

The immediate question is what does Section 45 add that Section 46 does not already require? It must be implicit in Section 46 that the purpose of taking decisions in accordance with the statement of corporate intent or performance agreement is to meet the organisation's objectives or the other requirements set out in those documents. Section 52, dealing with the content of reports on operations of council-controlled organisations, requires the half yearly and annual reports to contain the information necessary to enable an informed assessment of the organisation's operations including:

- A comparison of the performance with the statement of corporate intent or performance agreement;
- An explanation of any variances between that performance and the

statement of corporate intent or performance agreement.

If the intent of the section is simply to include within the role of the board ensuring that the organisation meets its objectives and other requirements, then it seems redundant.

There is an alternative possible explanation. The role of directors, in the sense of the overriding obligations and responsibilities a director undertakes, has traditionally been stated in the Companies Act rather than in special purpose legislation such as the State Owned Enterprises Act or the Local Government Act. It includes provisions such as Sections 128 and 131 (quoted above) which make it clear that it is the board which has the responsibility for management of the company.

An alternative interpretation of the proposed Section 45 is an intent to exclude that overarching responsibility for management by "writing down" the role of director from responsibility for management to one of some kind of super-monitor (leaving aside the question of how extensive the powers of the board might need to be to "ensure" if an organisation is not performing).

The proposed new section seems redundant if its purpose is purely to underscore what is already in Sections 46 and 52. If it is to write down the role of director, then it is both repugnant to good governance and, given the way it is drafted, a likely source of confusion.

Recommendation

Local Government New Zealand should seek to establish from officials and/or ministers the intent of this section and the justification for its inclusion. Unless a compelling case is made, consistent with the principles of good governance, that the section is required, it should be deleted.

DRAFTING

Incorporation of a wider range of organisations within the ambit of the legislation has given rise to some drafting anomalies.

The draftsman has sought to minimise the need for additional wording by providing in Sections 42(3) a series of provisions to the effect that, if the council-controlled organisation is not a company, then references to terms such as shareholder, director etc take on a different meaning clearly intended to embrace the non-company organisation. There are problems with this approach, principally with the term "shareholders".

The term "shareholders" is defined to include any partners, joint venture partners, members, or other persons **holding equity securities** in relation to that organisation (emphasis added) and equity securities in turn *"include any form of voting rights in that organisation".*

The problem with this approach is that, for most council-controlled non-profit organisations there will be no equity securities held by the council. The typical example is a trust (whether charitable or not or incorporated or not). Within the typical trust, it is the trustees who hold the voting rights, not the council. The same will apply if the council has used (say) an incorporated society.

The effect of this approach can be seen in Schedule 6, Clause 2(b) and (c) and Clause 5. Presumably those provisions are intended to apply **all** council-controlled organisations, not just ones which genuinely have shareholders with equity securities. Currently, none of those provisions - which go to the heart of accountability - will apply to entities such as trusts or incorporated societies.

A similar problem arises with the way the expression "equity securities" has been used in Schedule 7, Clauses (1) and (5). Both deal with important issues affecting the transfer of undertakings - especially Clause (5) which has the effect of saving a number of contractual and other arrangements. They will not apply to bodies such as trusts as councils do not hold "equity securities" in them.

This report has not included a full review of the entire Bill to ensure that there are no other drafting anomalies. However, there are three more which have been identified and merit attention.

The first is Clause (6) of Schedule 6 which deals with the modifications of performance statements by resolution of shareholders. As drafted, the section applies solely to council-controlled profit organisations. Its title should reflect this and it would be appropriate to use the term "statement of corporate intent" rather than the term "performance statement" in the clause.

Secondly, Section 50(2)(a) dealing with the contents of a half yearly report wrongly refers to Section 50. The intended reference appears to be Sections 52 and 53.

Finally, Clause 20 of Schedule 8 dealing with the contents of an annual report of a local authority requires audited consolidated financial accounts which *"must cover all council-controlled organisations and all other entities controlled by the local authority".* If a council-controlled organisation is a trust or an incorporated society, as examples, neither the income nor the capital of the organisation will belong to the council. Accordingly, consolidation of these entities will be misleading.

Recommendation

In particular, the Bill should be carefully reviewed to ensure that the attempt to apply terminology coming from company law and practice to non-company entities does not defeat the purpose of individual provisions of the Bill.