

3.6 Local Authority Governance of Subsidiary Entities

3.601 Also in March 2001 we published our report *Local Authority Governance of Subsidiary Entities*.¹⁵

What Is The Report About?

3.602 The report is about current and emerging issues of how local authorities govern their subsidiary entities. In our 1994 report *Governance of Local Authority Trading Activities*, we commented on the relationships between local authorities and their commercial trading entities.¹⁶

3.603 Since then, local authorities have continued to explore new ways to carry out their commercial and non-commercial functions. In this report, we examine how some of these new governance arrangements are working and make a number of recommendations for good practice.

What Is The Report Based On?

3.604 We based our report on our expectations of good governance practice. We discuss our findings from three case studies:

- Watercare Services Limited;
- Infrastructure Auckland; and
- the Canterbury Landfill Joint Venture.

3.605 We also review relationships between local authorities and trusts or other non-profit entities.¹⁷ Finally, we examine relationships between shareholding local authorities and their commercial trading enterprises.

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16 ISBN 0 477 02844 6, June 1994.

17 In other jurisdictions the equivalent description is “not-for-profit” entities.

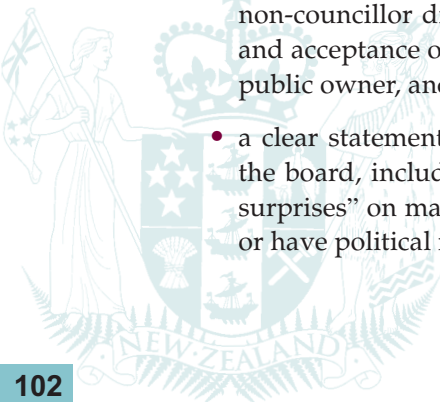
Summary of Recommendations

- 3.606 We make a number of recommendations on three subjects:
- roles and responsibilities;
 - governance structures; and
 - monitoring and accountability arrangements.
- 3.607 Our recommendations are intended primarily for local authorities. However, effective governance relies on constructive, well-understood relationships among a number of different parties. In particular, governing bodies and individual board members play an important part in making governance arrangements work. We encourage all parties to consider how our recommendations could usefully be applied to their own circumstances.

Roles and Responsibilities

Responsiveness to the Expectations of the Public Owner

- 3.608 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.
- 3.609 In consultation with the board, the local authority should establish:
- director selection and appointment processes which require non-councillor directors to have a sound understanding and acceptance of the wishes, needs, and priorities of the public owner, and the needs of the community;
 - a clear statement outlining the council's expectations of the board, including a commitment by the board 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; and
- ongoing communication between the council and the board chairperson, and between entity executives and local authority officers, on matters of common interest.

The Accountability of a Non-profit Entity

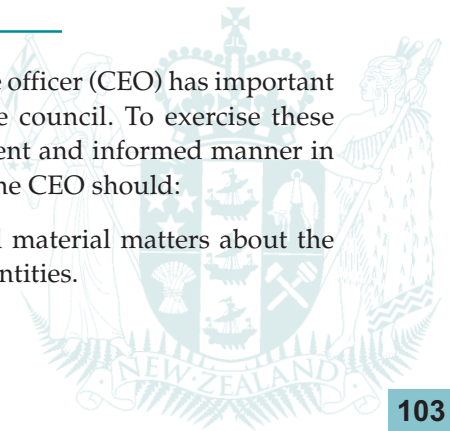
- 3.610 A local authority with an interest in a trust or other non-profit entity should ensure that:
- a service agreement framework is drawn up within which the entity can be held transparently accountable for the use of ratepayer funds or assets; and
 - performance monitoring is undertaken at arm's length and with reference to a clear and agreed set of expectations.

Appointing the Governing Board of a Non-profit Entity

- 3.611 A local authority should:
- document clearly its processes for appointing the governing body of a trust or other non-profit entity; and
 - consider following processes similar to those used for board appointments to commercial trading enterprises.

The Role of the Local Authority Chief Executive Officer

- 3.612 A local authority chief executive officer (CEO) has important advisory responsibilities to the council. To exercise these responsibilities in an independent and informed manner in relation to subsidiary entities, the CEO should:
- Be kept fully informed of all material matters about the local authority's subsidiary entities.



- Take no part in the internal governance of subsidiary entities. In many local authorities this advisory role will be delegated to local authority managers – who also should not, as a rule, sit on the governing bodies of subsidiary entities.
- Be assigned formal responsibility for reviewing, or commissioning regular reviews of, the subsidiary entities and for putting policy options to the council based on those reviews.

Governance Structures

The Role of a Holding Company

3.613 A local authority with a holding company should:

- monitor the performance of its holding company in managing local authority investments against measures of financial and non-financial performance specified in the company's Statement of Corporate Intent (SCI);
- obtain, and where necessary respond to, information about activities or intentions of a subsidiary company which may have political implications or raise community concerns;
- review its investment strategy at regular intervals, having regard to the objectives specified in investment policies and balancing strategic, community, and commercial considerations; and
- consider whether to reserve the right to approve board appointments and SCIs in order to obtain assurance about governance and strategic direction in operating subsidiaries.



- 3.614 The board of the holding company should ensure that the company is fully accountable to the parent local authority, by:
- defining, through the SCI, the role and reporting requirements of the holding company;
 - establishing and reporting against a range of financial and non-financial performance measures;
 - maintaining an awareness, and keeping the local authority informed where required, of strategic and business issues in subsidiary companies;
 - monitoring the quality of SCIs of subsidiary companies, reviewing them for compatibility with the local authority's strategic aims; and
 - keeping the local authority fully informed of all significant matters relating to management of its investment portfolio through regular reporting and briefings to councillors.
- 3.615 In determining the balance of councillor and external directors consideration should be given to:
- the desired mix of skills and experience for the holding company's role as the local authority's professional investment manager;
 - the nature of the local authority's investment portfolio; and
 - the relationship between the holding company and the local authority.

Joint Ventures

- 3.616 In establishing the governance framework for joint ventures, a local authority should have regard to the following key factors which are likely to be vital to the success of any such venture:
- A governance framework that creates a forum for effective collective decision-making, preserves the autonomy of the local authority, and maintains a balance of power and influence among the participants.

- Delegations, authorities, and lines of communication that underpin the relationship between the joint venture partners collectively and each individual partner. These should reflect the commitments of the local authority to the partners collectively, on the one hand, and the ultimate accountability of the authority to its community, on the other.
- Agreed policies and strategies that ensure that a venture is based on common objectives at political and operational levels.
- Provisions to promote the commercial viability of the venture, and the proper control of current and future costs.

Trusts and Other Non-profit Entities

3.617 A local authority should:

- specify key accountability arrangements when setting up a trust or other non-profit entity;
- draw up a formal service agreement which documents the scope and purpose of the association between the entity and the local authority, defines the services to be provided, and specifies how the entity will be held to account for delivery of those services;
- follow an objective process for appointing the governing body, based on a documented set of competencies relevant to the functions and activities of the entity;
- establish a means (conceivably in the context of its own annual planning process) for the local authority to approve or endorse the entity's philosophy, direction and strategies, planned programmes and activities, financial and non-financial targets, and outcome measures; and
- put in place an agreed framework for regular reporting against stated measures of performance, in order to provide the local authority with information as to how the entity is meeting the terms of its service agreement and contributing to the achievement of agreed outcomes.

Group Structures

- 3.618 A local authority should ensure that it:
- has the opportunity to consider proposals by sub-entities to make significant investments, on the basis of a comprehensive assessment of risk and opportunities; and
 - is kept fully informed about the status and outcome of new business ventures.

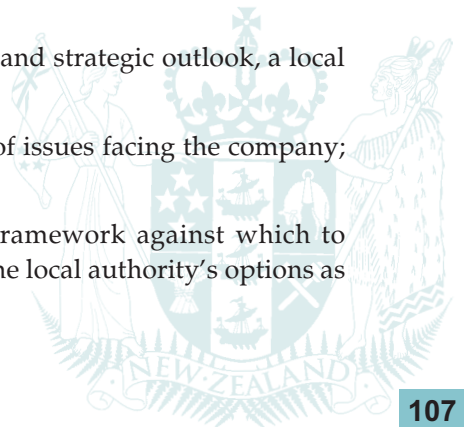
Monitoring and Accountability Arrangements

Information Flows

- 3.619 A local authority should:
- seek strategic information, as necessary, in order to manage its investments as a diligent and informed investor; and
 - where necessary, negotiate arrangements for the supply and handling of commercially sensitive information.

Business Planning and the SCI

- 3.620 A company board should consult its shareholding local authority on the key features of the board's business plan, and brief the authority on the strategic outlook for the company.
- 3.621 Drawing on the business plan and strategic outlook, a local authority should:
- review its interests in light of issues facing the company; and
 - use this information as a framework against which to consider the draft SCI and the local authority's options as an investor.



Disclosing Corporate Governance Practices

3.622 A company board should:

- include in its SCI a corporate governance statement disclosing how the board proposes to conduct its business and discharge its obligations; and
- outline in the company's annual report how those commitments and obligations have been met.

