

Ref: G & A Committee Feb/24
Date: 14th March 2024

Andrew Gregory
Director
Planning Transport & Environment

Gavin McArthur
Chair of the Governance & Audit Committee

Dear Gavin,

Special Purpose Vehicle & Outstanding Internal Audit Recommendation

Further to my attendance at the committee on the 23rd January 2024 and your subsequent letter dated 2nd February 2024. In your letter you requested some further information in relation to two areas. The first being the special purpose vehicle in relation to Cardiff Heat Network and the second, outstanding internal audit recommendations.

Special Purpose Vehicle

You may be aware that the Committee has had a particular focus on “partnership” arrangements during 2023/24. In paragraph 40 of your report note the “special purpose vehicle” (a company wholly owned by the Council) for the Heat Network project; which is perhaps one of the more unusual arrangements in place. I would be grateful if you could outline for the Committee:-

a) How the risks to the Council arising from the formation of the “special purpose vehicle” have been identified, managed and reported on?

The Cardiff Heat Network (CHN Ltd) business case was developed using Central Government (Heat Network Development Unit) Grant funding. An initial [Outline Business Case](#) was presented to and approved by Cabinet and this paved the way for work on a more detailed [Full Business Case](#) Report which reached Cabinet in December 2020. These reports examined risk from a number of perspectives including financial, contractual and H&S risk:

Financial risks were partially mitigated through our successful securing of Central Government grant funding and Welsh Government soft loan funding for the delivery of the project. Certain financial risks remain, and these are recognised in the financial advice given for the Cabinet reports. We have a regular dialogue on these as necessary, via the governance arrangements set out below, to monitor

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Mae'r Cyngor yn croesawu gohebiaeth yn Gymraeg, Saesneg neu'n ddwyieithog. Byddwn yn cyfathrebu â chi yn ôl eich dewis, dim ond i chi roi gwybod i ni pa un sydd well gennych. Ni fydd gohebu yn Gymraeg yn arwain at oedi.

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and address any issues. CHN Ltd is also externally audited annually in a process that can identify and raise concerns about any emerging or “going concern” issues. These reports considered by CHN’s Board of Directors and are shared with the Council who can then raise any questions or issues.

Contractual and H&S risks have been substantially addressed through formal arrangements embedded in our Design, Build, Operate, and Maintain Contract. The selected contractor has a range of contractual and legal roles and responsibilities in these respects which are monitored via an independent Contract Management consultant also procured to support the Company in the delivery of the scheme. CHN Ltd’s role as “Client” in respect of Health and Safety legislation is managed via a separate appointment of specialist H&S consultants acting on the role of “Principle Designer” which is a specific role and requirement arising from the national Health and Safety Executive’s “Construction Design and Management Regulations”. Any matters arising are reported and addressed via the governance arrangements set out below.

Other risks, such as reputational risk, and lessons learned from other similar schemes elsewhere were also discussed as part of the Cabinet Reporting process. Cardiff Heat Network Ltd’s Board of Directors undergoes regular training on their roles and responsibilities as directors of a public sector owned company to ensure that these sorts of risks and challenges are understood and measures put in place to mitigate them.

As the project moves from its Design and Build phase through to its Operate and maintain phase this year we are also working to bring more formality to the relationship and communication between the Board and the Council via its Shareholder’s Representative (see below).

b) How the company is held to account by the Council?

The approval of the [Full Business Case](#) authorised the Incorporation of Cardiff Heat Network Ltd as a company wholly owned by the Council. The company’s composition, roles and reporting structure were informed by specialist legal advisors experienced in public sector companies and Energy Services operations.

The company’s specific role is to deliver the Cardiff Heat Network project according to the approved business plan. The details of this, and how the company reports to and is held to account by the Council are set out in the companies associated Articles of Association and Shareholders Agreement. These were approved by Cabinet as part of the decision to proceed with the Heat Network project and were used in the company’s formal Incorporation.

In summary, a Board of Directors oversees the company and the activities of the Design, Build, Operate and Maintain contractor. The Board is appointed by the Council’s CEx. The Board acts within strict terms set out in the Incorporation documentation and receives frequent training on these duties. The Company’s

finances are also subject to external audit annually with reports submitted to Companies House and reviewed by Council finance officers.

A “Shareholder’s representative” was also appointed by Cabinet. This role sits apart from the Board and is the conduit through which the Board conveys any issues that might affect the everyday delivery of business plan to the Council. It is also the conduit through which any strategic issues or instructions that might affect the everyday delivery of the Business Plan are passed by the Council to the Board. This mechanism, together with periodic project progress updates with senior officers and the relevant Cabinet Member ensures that the company’s activities are understood and that the company is held to account.

An informal officer level project progress meeting is also held bi-monthly, chaired by the CEx, where any emerging issues can be conveyed and discussed in an informal setting. Any formal recommendations or instructions that might start to emerge from these meetings are subsequently conveyed to the Board by the Shareholders Representative and this would be subject to relevant internal processes procedures and scrutiny as necessary, including Officer Decision reporting and Cabinet reporting. The project, and the activities of the company are also subject to internal (and external) audit, Scrutiny and Performance monitoring.

As the project develops we are taking further legal advice on how to bring more formality and transparency to the process of communication between the Board and the Council. We are developing bespoke Terms of Reference for the project update meetings to ensure compliance with our Articles of Association, Shareholders Agreement and general company law, with advice from our solicitor. This will set out how the Council is briefed on project development, how it registers and tracks emerging risks and solutions and how it, in turn, advises the Shareholder’s representative in his communications with and instructions to the Board.

c) Who has responsibility for the governance of the company and what arrangements are in place for them to gain an assurance on the adequacy of the company’s systems of internal control and risk management?

Cabinet signed off and have ultimate responsibility for the existing governance arrangements as set out above. The Board follows the general advice and limitations set by the Articles of Association and Shareholder’s Agreement and in its meetings is briefed on and can scrutinise the internal project/contract risks and emerging issues in this context. A regular Health and Safety briefing note is provided summarising issues arising from Project CDM arrangements and the Board receives and signs off external audits of accounts. Major emerging issues relating to project delivery or business plan matters are dealt with as formal agenda items at the Board Meetings. The focus of the company in recent months has been on the delivery of phase 1 of the network. I am pleased to report that ‘Heat on’ testing will take place this summer. Operational risks in this regard are managed by the appointed consultants and contractors.

As the company now begins to look forward more in regards to future development it is in the process of reviewing and updating the risks as identified in the full business plan. As part of this the Council's legal advisers continue to be engaged in the arrangements of the SPV as it continues to develop and learn from its ways of working.

I hope the above provides you and the committee with the further information you were looking for. If, however, there are any further areas information you would like clarified in regards of the special purpose vehicle please do not hesitate to contact me.

Outstanding internal audit recommendations

With regards to updating you on outstanding audit recommendations. Officers are working with the appropriate auditors to complete the final recommendations and I expect to be able to give you an update to be circulated in advanced of the committee's July meeting.

Yours sincerely



Cyfarwyddwr / Director

Cynllunio, Trafnidiaeth a'r Amgylchedd / Planning, Transport and Environment