

**REPORT OF THE CLERK TO THE JOINT COMMITTEE OF THE LONDON 2012
OLYMPIC AND PARALYMPIC HOST BOROUGHS**

CREATE – ARRANGEMENTS FOR THE FUTURE	Classification Public	Enclosures None
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1. INTRODUCTION

- 1.1 CREATE is a festival rooted in the London boroughs of Greenwich, Hackney, Newham, Tower Hamlets and Waltham Forest. It is centred on the delivery of an annual festival which is delivered in partnership with over fifty local arts organisations, the five boroughs and with national arts partners. CREATE is a celebration of the creativity and diversity of east and south east London as well as a catalyst for cultural development across the region. The intention is for CREATE to continue to build quickly to 2012, and then to remain as a secure and sustainable legacy for the sub-region.
- 1.2 CREATE10 attracted audiences of over 930,000 with opportunities for 54,000 to actively participate at events on the day, with a further 7,000 individuals able to engage through volunteering, mentoring and training. CREATE10 represents an arts programme valued at just over £2m. For the period 2009/10 to 2011/12, about £1.4m of new funds have been secured by the Host Boroughs Unit culture team to present new work as part of the festival, along with supporting participation programmes for local communities. Additionally, over £3m of in-kind partner programming and activity was levered in as part of the festivals. Key partners include the Barbican, the O2, Whitechapel Gallery and galleries and theatres across the sub region. Key funders include the Arts Council, Deutsche Bank and Bank of America Merrill Lynch.
- 1.3 Alongside the focus on community participation, CREATE spearheads a campaign to put east and south east London on the cultural tourism map, working in partnership with the local creative and artistic community. Following endorsement by Leaders and Mayors of the Host Boroughs, it is proposed that CREATE, and associated activity, should remain as the substantive Cultural Legacy for the Host Boroughs and that a review and refinement of organisational structure would be necessary to ensure the work could be carried out in the most sustainable and efficient manner for the future.
- 1.4 This report presents such a proposal.

2. RECOMMENDATIONS

It is recommended that:

- 2.1 a limited company with charitable status be established to deliver the CREATE programme;
- 2.2 the Clerk to the Joint Committee be authorised to take all necessary actions to register and launch the company actions;
- 2.3 the Chief Executives' Board be authorised to appoint 6 independent directors and after consultation with Leaders and Mayors, an independent Chair;
- 2.4 That six members, one from each of the Host Boroughs with effect from 1 April 2011, be nominated to the Board of CREATE;
- 2.5 That the London Borough of Hackney retain its operational and administrative supporting role for the CREATE programme on behalf of the Host Boroughs, including some short term administrative support to the company.

3. RELATED DECISIONS

- 3.1 None

4. ALTERNATIVE OPTIONS

- 4.1 The alternative to establishing a charitable company is for CREATE to continue as part of a local authority. This will preclude grant aid being maximised as certain funders will not make grants and donations to public sector organisations, and in order to capitalise on all available funding streams, a different type of organisation, a private limited not-for-profit company is the preferred option.

5. SUSTAINABILITY AND LEGACY

- 5.1 The arrangements now presented should provide the basis for the Host Boroughs to realise their objectives in this area.

6. ECONOMIC IMPACT

- 6.1 An effective cultural legacy programme should stimulate the economies of all the Host Boroughs by attracting grant aid and investment based on the staging of the Olympic and Paralympic Games.

7. HUMAN RIGHTS

- 7.1 There are no human rights implications arising from this report.

8. RISK

- 8.1 At present, the Host Boroughs bear the risk of any overspends on the CREATE budgets, although existing control arrangements have ensured that overspends have not arisen. A private company limited by guarantee is a separate legal entity and would not place the Boroughs at risk save in respect of any obligations which may arise with grant agreements involving the Boroughs. If a loss was made by a private company, the company and its directors would be responsible to the extent of the guarantee under which it is established, subject to the directors/trustees complying with their legal and charitable obligations.

9. FINANCIAL CONSIDERATIONS

Benefits, Funding and Costs

- 9.1 The main benefit of forming a limited company with charitable status will be the ability to secure grants and donations which are not currently available to local authorities. Once the company is registered, and prior to the commencement of trading, it is the intention to apply to a number of bodies for over £700,000 of grants and donations in respect of the year 2011/12. The bodies include the Paul Hamlyn Trust, the Gulbenkian Fund, Big Lottery Fund, and the Arts Council National Portfolio.
- 9.2 Joint funding from the host boroughs for the Create Festival/Culture was £135,294 in 2009/10, is forecast to be £149,211 in 2010/11, and budgeted to be £150,000 in 2011/12. This funding is only committed on an annual basis by the host boroughs, and funding currently set aside by boroughs is unlikely to extend much beyond 2012. The £150,000 is intended to cover the core costs of managing the service and securing external funding. This core cost may increase as more effort is put into securing funding which cannot be accessed by local authorities.
- 9.3 External funding totals were £274,787 in 2009/10, are forecast at £527,350 in 2010/11, and currently budgeted to be £571,446 in 2011/12 before allowing for additional funding to be secured by the company.
- 9.4 Due to the additional regulatory and taxation requirements, administrative costs are expected to be higher with a charitable company. The company will also incur irrecoverable VAT which will be a real additional cost, and may incur some corporation tax.

Budget 2011/12

- 9.5 On the 17th December 2010 the Chief Executive's Board approved a Create Festival/Culture Budget for 2011/12 of £721,446, which includes provision for four existing staff. The £721,446 is expected to be funded as follows: £161,446 Arts Council Grant; £200,000 LOCOG; £150,000 Deutsche Bank; £60,000 Bank of America; and 6 host borough contributions of £25,000 totalling £150,000.
- 9.6 Subject to agreement by the funding organisations, the budget and funding could be transferred to the proposed limited company with charitable status. There is no separate provision in the budget for a company Chief Executive and Company Secretary.

Taxation

- 9.7 Preliminary advice has been received from KPMG on the significant taxation implications which would arise once the budget and funding are transferred to the company.
- 9.8 VAT at a rate of 20% is chargeable on external costs in the £721,446 Budget including agency staff and supplies and services bills. If the Budget continued to be managed by Hackney as lead host borough all of this input VAT can be recovered from HMRC (Revenue and Customs) under the normal VAT legislation applicable to local authorities. However, KPMG advise that “the VAT incurred (by the new company) will not be recoverable in full ... and the irrecoverable VAT will represent a real cost to the business”. KPMG also indicate that the company would be obliged to register for VAT and submit quarterly VAT returns.
- 9.9 If all four existing staff were to continue to be paid by Hackney via its payroll and agency staff arrangements, and seconded to the company, Hackney would have to raise a charge to the company for the staff and add 20% VAT (£44,320 on the £221,604 staffing budget for 2011/12). Alternatively, if all four staff were on a company payroll there would be no VAT cost. Also, if Hackney were to provide other support services to the company these are likely to be subject to 20% VAT.
- 9.10 At worst, almost all of the £721,446 Budget spent by the company could be subject to 20% VAT of up to £144,000, which could be irrecoverable. The usual way in which a business recovers such input VAT is to charge VAT on the goods and services it supplies to customers. This is known as output VAT, and provided the total of output VAT charged to customers (on sales) is equal or greater than the input VAT paid to suppliers (on purchases), VAT will not be a cost to the company.
- 9.11 It is likely that the £210,000 of funding from Deutsche Bank and Bank of America can be treated by the company as sponsorship income, such that the company is making a taxable supply of marketing services to the banks (classified as business activities for VAT purposes). This would enable the company to charge the banks VAT at 20% on the £210,000 to produce up to £42,000 of output VAT to offset against input VAT. Funding to the company from the Arts Council and the host boroughs is to be regarded as grants or donations. As grants and donations do not constitute payments for services or a business activity, there would be no VAT chargeable. The draft LOCOG funding agreement states that “LOCOG considers the payment under this Agreement to be a grant for VAT purpose and, accordingly, intend to treat it as outside the scope of VAT ... (but) LOCOG and Hackney will comply with any final official VAT ruling from HMRC in relation specifically to this Agreement”.
- 9.12 Offsetting input VAT against output VAT is not necessarily a straightforward matter. Input VAT has to be attributable to business activities before it can be recovered from output VAT. More work will therefore need to be done to determine the level of irrecoverable VAT which is likely to fall on the company.

- 9.13 KPMG advise that there is “no blanket exemption from corporation tax for charities”. Corporation tax is a tax on business or trading profits. Where the proposed company is, for example, supplying marketing services to banks, there could be a corporation tax liability (currently 21% for a company with annual profits of up to £300,000). Where it can be demonstrated that trading profits arise from charitable activities and are applied for charitable purposes only, there should be no tax due. However, KPMG indicates that the company may have to produce corporation tax returns, and it will be necessary for the company to carefully consider the tax treatment of each sponsorship arrangement.
- 9.14 It is clear from the above analysis that there is a case for structuring the operational and financial arrangements of the company in ways which will limit the level of irrecoverable VAT and avoid corporation tax. In addition, more irrecoverable VAT is likely to arise as more grants and donations are secured.

Regulation and Control

- 9.15 The process for forming the proposed company commences with registration with Companies House followed by registration with the Charity Commission. An application for company registration has to include the company name, subscriber details, and company Memorandum and Articles of Association, etc. An application for charitable status has to include the name, charitable objects, evidence of funding, company number and certificate of incorporation, governing document (Memorandum and Articles), and trustee details and signed declaration, etc.
- 9.16 Once the registration process is complete it will be necessary to open a bank account, and establish accounting (and possible payroll) records and audit arrangements. In order to enable the company to be freestanding, it is suggested that a Company Secretary should be appointed to be responsible for these matters and for financial monitoring and control, annual reports and accounts, tax returns, company and charity returns, and board/trustee meetings, agendas and minutes, etc. Unless this activity can be carried out on a voluntary basis, the administrative costs are likely to be higher than the alternative of continuing administration of the Create Festival/Culture Budget by Hackney. As lead borough for the host boroughs, Hackney will need to specify what regular operational and financial monitoring information is required from the company whilst the host boroughs continue to provide annual funding to the company.
- 9.17 Progressing the regulatory and control processes will require project management and legal and taxation advice which will all have to be funded from the Host Borough Unit budgets approved in accordance with the Host Boroughs Inter Authority Agreement.
- 9.18 As the establishment of the company proceeds, additional VAT and taxation advice will be sought externally from KPMG.

10. LEGAL CONSIDERATIONS

- 10.1 By virtue of Section 2 of the Local Government Act 2000 a local authority is empowered to do anything to promote the economic, social and environmental wellbeing of an area subject to any prohibitions, limitations or restrictions contained in any enactment.
- 10.2 The Local Government Act 2003 contains a power for local authorities to trade. These provisions enable (Best Value) authorities to do for a commercial purpose anything which they are authorised to do for the purpose of carrying on any of their ordinary functions. As with the limitation on the well being powers, the LGA 2003 only enables local authorities to trade where such trading is for the purpose of carrying on their ordinary functions. An ordinary function is that which a local authority ordinarily provides or would be expected to provide, such as promoting the art and culture of and for the people of the borough. It is also important to note that the authority to trade is only exercisable through a company and therefore the requirement to set up CREATE as a company.
- 10.2 One statutory restriction is that a local authority must not use the wellbeing powers to raise money. While CREATE is to be used a special purpose vehicle to attract grant and donor funding as well as private sponsorship, this funding is not for the benefit of the Host Boroughs but is to be used to deliver the CREATE programme. Any funding that is raised will therefore be that of CREATE and not of the Host Boroughs.
- 10.3 The setting up of CREATE and the appointment of Host Borough representatives to the Board of CREATE are executive functions which have been delegated to the Joint Committee by the Host Boroughs. The terms of reference of the Joint Committee appended to the Inter Authority Agreement of March 2010, include the following:
- “Development, negotiation and implementation of joint arrangements in relation to bidding for, accepting and distributing external funding;
- Development, negotiation and implementation of joint cultural event programmes and policies. to develop and implement a co-ordinated Olympic programme and to secure local benefits and a sustainable legacy from the Olympic and Paralympic Games to be held in London in 2012; and
- Any other executive functions relating to joint activities or areas of common concern in relation to the 2012 Olympic and Paralympic Games in relation to which funding is allocated through the annual budget or in respect of which external funding or any other financial resources are allocated to the Joint Committee.”
- 10.4 The Local Authorities (Companies) Order 1995, made under the Secretary of State’s powers contained in Part V Local Government and Housing Act 1989, sets out rules concerning local authorities’ involvement in “regulated companies” which are subject to controls, and their involvement in other companies where a number of rules apply.
- 10.5 “Regulated companies” are so defined if they are controlled or influenced by the local authority. “Influenced” means at least 20% local authority interest plus a business relationship with the company accounting for over 50% of the company’s

turnover and/or the company was located on local authority land leased or sold for less than best consideration. "Controlled" means over 50% local authority interests, and "minority" less than 20% interest. It does not matter whether the interest of the Council arises through its direct nominations or those made by others. Accordingly, it is necessary to keep track of whether any Members are Directors/Members regardless of whom they represent or who nominated them on to the Board/Company. The Council needs to provide information on regulated companies and issues can occur, for example, if the Council is liable for any debts which a regulated company may incur. Where a company is under the effective control of the local authority, it will be subject to capital finance regime and special propriety controls. In broad terms, the test as to whether companies are local authority influenced is whether the local authority has the right to or in fact does exercise a dominant influence over the company in question.

- 10.6 As it is the intention for the CREATE Board to be comprised of six Local Authority nominated members being one from each of the Host Boroughs plus a further six from art and cultural backgrounds and an independent Chair to comprise a Board of 13 members, no single Council will have any control or influence over CREATE and the Joint Committee through its nominations to the Board will not have control of the company. Furthermore, other than the annual sum of £150,000 received from the Host Boroughs to sustain its operations, CREATE receives all of its other funding from external grant and sponsorship funding, which is currently estimated to total £571,000 for 2011/12. CREATE will therefore not be a regulated company as set out in the Local Authorities (Companies) Order 1995 and therefore will not be subject to the accounting requirements of regulated companies.
- 10.7 In order for CREATE to be incorporated at Companies House, the founding documents need to be lodged and the name approved. The founding documents comprise the Memorandum and Articles of Association. While the Memorandum sets out the objects of the company the Articles set out the corporate governance and administration regime of the company.
- 10.8 Only once the company has been incorporated at Companies House can an application be made to the Charities Commission for charitable status.
- 10.9 As the establishment of the company proceeds, additional legal advice upon company formation, charitable status, company governance, state aid, procurement and, any other legal implications will be sought externally from Trowers and Hamlins, Solicitors with specific expertise in this area.

11. DETAIL

- 11.1 In 2009 with the support of Arts Council England, the Host Boroughs Unit culture team commissioned leading UK cultural consultants JS3 to explore future CREATE business and governance models and to produce a vision statement for CREATE. This work was developed in consultation with key CREATE stakeholders including the Boroughs, the CREATE Advisory Group and a number of creative organisations based in the Host Boroughs. The recommendations summarised in this paper follow this substantive piece of work.

11.2 **CREATE core business activity over the next three years**

- i) To ensure the cultural sector of east and south east London is embedded into the long term legacy planning for the region.
- ii) To continue to work with arts organisations, the Host Boroughs and creative agencies alongside local and national cultural bodies to encourage them to deliver work as part of the CREATE festival (paid for by, or in partnership with, those organisations.)
- iii) To promote, maintain, improve, develop and advance public engagement in the arts including (but not limited to) music, opera, singing, dancing, literature, theatre, visual arts and in particular (but without prejudice to the generality of the foregoing) the holding of festivals of culture, ideas and creativity.
- iv) To mount specific commissions for which CREATE fundraises, including London 2012 projects
- v) To deliver co-commissions and joint approaches to generating further activity
- vi) To act as a facilitator and broker between east and south east London's cultural sector and key public stakeholders

11.3 **Financial priorities for CREATE over the next three years**

11.3.1 This strategy acknowledges there will be increased pressure on public finances from 2010 and therefore, as much as is possible, the organisation needs to be income generating.

11.3.2 In order to meet our key aims of:

- i) Growing audience figures and participation opportunities for local residents;
- ii) Bringing economic and social benefits to local residents and businesses, CREATE is looking to sustain and grow its income in order to increase its world-class programmes alongside a suitably enhanced marketing vehicle.

11.3.3 Financial priorities include:

- (i) Maximising opportunities as part of the Cultural Olympiad and the Olympics to deliver specific commissions in 2012;
- (ii) Attracting significant private sector sponsorship for particular commissions and events. CREATE has been successful in attracting

private sponsorship and it should continue to expand its portfolio of private investors;

- (iii) Embedding relationships with the Arts Council - the most significant core funder (aside from the boroughs);
- (iv) Start to attract more public sector funds through key trusts and foundations.

11.4 Organisational Arrangements

11.4.1 The legal structure CREATE currently sits within severely limits its fundraising capability. It is ineligible to apply for the majority of trusts, foundations and grant awards due to its current legal status (a local authority). It has been unable to exploit recent opportunities such as the ELBA *Transformers* fund and has had to work through a third party to secure funding from a key CREATE sponsor, Bank of America Merrill Lynch.

11.4.2 A refined organisational structure will enable the organisation to perform a number of different functions and will help CREATE to lever in new additional funds to sustain and increase activity. This will reduce the risk and burden on the Host Borough partners.

11.4.3 The vast majority of arts organisations operate as a Company Limited by Guarantee with charitable status. This has been proposed as the most appropriate model for CREATE in the future and is in-line with advice from our consultants JS3, the legal team at LB Hackney and Arts Council England.

11.4.4 The proposed model follows that of the leading UK City festivals - Manchester International, Brighton and Edinburgh Festivals. Here, the corporate objectives of the local authorities – as primary stakeholders - are closely tied to that of the delivery company who are unrestricted in their efforts to raise funding from key trusts, foundations, national arts bodies and private sponsors.

11.4.5 The proposed arrangements will significantly enhance the ability for CREATE to raise additional funding from the public sector and to attract more private sponsors. This is a crucial next step in securing the future of CREATE and capping the financial burden and risk for the boroughs.

11.4.6 Importantly, CREATE has been invited to apply for the Arts Council's new National Portfolio funding programme. Refining its organisational arrangements is a condition of meeting the Arts Council's objectives for the programme. This is a significant opportunity to secure three years of annual funding and to ensure east and south east London's cultural sector remains positioned as a key strategic priority with the Arts Council post 2012.

11.5 Governance Arrangements

- 11.5.1 It is essential that the new company is not local authority controlled or its accounts would fall into the accounts of the constituent local authorities. In order for that to be assured, it would be necessary for the Board to have the majority of members who are not nominated by the constituent local authorities. It is therefore proposed that the company should have six local authority Board members, one from each local authority with a further six from arts and cultural backgrounds together with an independent Chairman.
- 11.5.2 In view of the size of the Board, the day to day running of the company needs to be delegated to an Executive, comprising the Chairman of the Board, one local authority Board member, one culture/arts Board member and the Chief Executive and Company Secretary which can take most executive decisions and monitor the ongoing business.
- 11.5.3 The Directors of the new company will be appointed under charity commission guidelines to represent the range of skills and expertise necessary for the proper running of the organisation. This group will have a legal oversight role and their liability will be limited by guarantee.
- 11.5.4 It is recommended that at least one of the Directors bring financial and business experience especially in strategic development and financial management. As exists already, an executive group will continue to be a part of the governance arrangements and will be made up of key officers from the Host Boroughs and from cultural organisations involved in the festival.
- 11.5.5 There will be the opportunity for each of the participating boroughs to nominate an individual to sit on the Board of Directors alongside independent board members.

11.6. Operational Arrangements

11.6.1 Currently CREATE receives c. £150,000 annually to sustain its operations. This is from the overall borough contributions to the Host Boroughs Unit, and it covers:

- 1 Full time Member of Staff
- Office Space
- IT and Telecoms
- Travel and other expenses
- Marketing and communications
- Accounting and banking

- Human Resources

- 11.6.2 All additional (agency) staff and all project costs are covered by external grant and sponsorship income. This levered income is currently estimated to total £571,000 for 2011/12.
- 11.6.3 The team is based in the Hackney Service Centre and Hackney provides all of the services listed above and charges this against the £150,000 budget for borough contributions.
- 11.6.4 The staffing issues need more detailed consideration. Agency staff can be terminated by the host Council and engaged afresh by the Company however the situation is more complex in relation to permanent staff employed by the Council albeit on long fixed-term contracts. The financial and employment considerations require analysis in order to determine whether it would be advantageous for the Company to employ staff direct or for secondments to the Company to be effected. This can be determined during the set-up phase.
- 11.6.5 A range of operational issues have still to be determined following the receipt of external professional advice and these include the location and trading address of the company having regard to independence but also operational costs and the important legal and financial roles of the Company Secretary.

11.7 Proposed changes

- 11.7.1 It is proposed that the annual contribution of £150,000 from the Host Boroughs continues to be subject to annual approval and that the company continues to function within this core budget and the operational arrangements described above. NB: most grant income and sponsorship streams are restricted to festival/arts activities and cannot cover core costs.
- 11.7.2 It would be beneficial to the CREATE company, at least during the first few months of trading, for London Borough of Hackney to provide some operational support, and maintain oversight of the new organisation.
- 11.7.3 Keeping a small executive team, with the ability to employ temporary staff as needed on a project-by-project basis, will keep both costs and risks down. It is recommended that core company staff currently contracted by London Borough of Hackney are initially seconded to the new company. These staff will continue to function as the executive team for the CREATE project.
- 11.7.4 In order to change the legal status of the organisation, London Borough of Hackney as the current accountable body, will in the first instance register CREATE as a limited company with charitable status, and give advice and oversight for providing headquarters, and appointing auditors and banking facilities.

11.7.5 To comply with legal requirements, a new banking and financial structure for CREATE will need to be arranged with new grants or other financial awards contracted and banked with the new company. Decisions on signatories and access to banking will need to be established.

12. CREATION AND LAUNCH OF THE COMPANY

12.1 The foregoing illustrates the complex requirements for the establishment of a limited company with charitable status and this needs to be co-ordinated professionally to ensure that all relevant aspects are placed within a project plan and so that relevant timescales for the launch of the Company can be realised.

12.2 It is proposed that a Project Manager be appointed to develop a Project Plan and to manage its implementation. This will be a short-term appointment for the period of the set-up of the company which will be finalised when the project plan timetable is produced.

13. SUMMARY

- 13.1 There are additional costs and risks associated with setting up a charitable company to develop the CREATE project, but the costs and risks should fall to the company.
- 13.2 Additional opportunities to lever in funding will be opened up by the new arrangements which will benefit the participating boroughs.
- 13.3 Additional partnerships with key stakeholders and a stronger board will benefit the development of the project considerably.
- 13.4 The continuation of Hackney's operational supporting role through the early months of 2011/12 will make the transition smooth and manageable.

Tim Shields

Chief Executive of the London Borough of Hackney

Clerk to the Joint Committee of the London 2012 Olympic and Paralympic Host Boroughs

Report Originating Officer:	David Rees London Borough of Hackney	☎020-8356 3321
Financial considerations:	Bruce Bainbridge London Borough of Hackney	☎020-8356 3103
Legal Comments:	Graham White London Borough of Hackney	☎020-8356 6234

Background papers

CREATE Business Plan September 2010

Draft company memorandum and articles of association