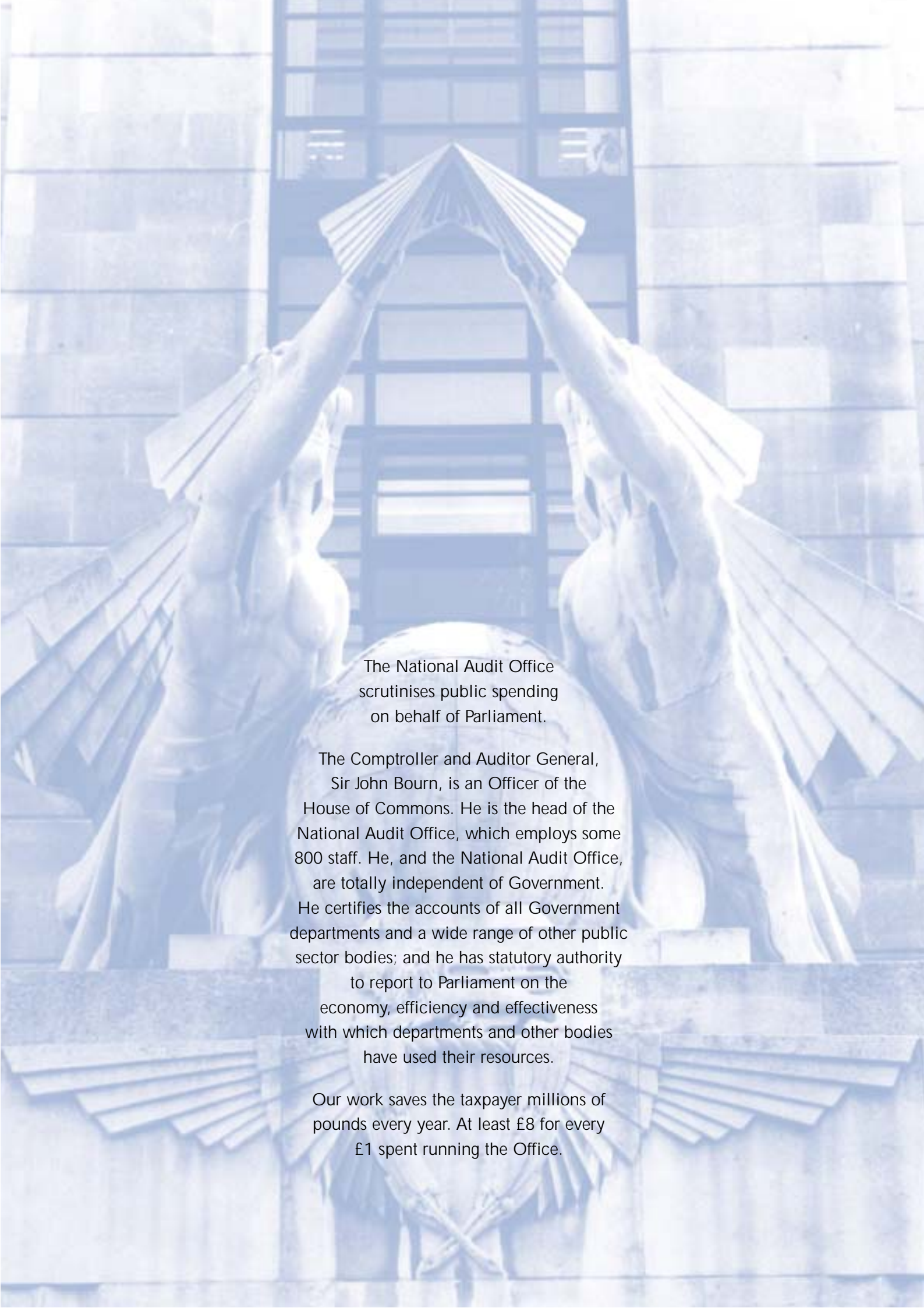


# The operation and wind up of Teesside Development Corporation

REPORT BY THE COMPTROLLER AND AUDITOR GENERAL  
HC 640 Session 2001-2002: 27 February 2002





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# The operation and wind up of Teesside Development Corporation



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# Contents

## Executive summary 1

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Background and main findings	1
Other findings	3

## Part 1

---

### Introduction 9

Urban Development Corporations	9
Teeside Development Corporation	11
What we did	12

## Part 2

---

### The Corporation's financial management 13

The impact of the Corporation's approach to regeneration on its cash flow	13
Adherence to Departmental and Treasury guidance	15
The Corporation's disposal of land and property	21
Other transactions that led to financial loss	24

This report has been prepared under Section 6 of the National Audit Act 1983 for presentation to the House of Commons in accordance with Section 9 of the Act.

*John Bourn* National Audit Office  
Comptroller and Auditor General 25 February 2002

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## Part 3

<b>The Corporation's management of its wind up</b>	<b>27</b>
The need for an orderly wind up	27
The assets and liabilities left to the Commission by the Corporation	27
Liabilities to which the Commission for the New Towns was committed after wind up	30
The Corporation's handover for the continued regeneration of the area	31

## Part 4

<b>Governance and accountability within the Corporation</b>	<b>33</b>
The Board and Chief Executive	33
The Corporation's internal audit	35

## Part 5

<b>The Department's oversight of the Corporation</b>	<b>37</b>
Responsibility for overseeing the Corporation	37
The effectiveness of the Department's financial oversight	37
The Department's powers to intervene	38
The Department's oversight of the Corporation's wind up	39
Retention of documents	40

## Appendices

1. Major lessons from the wind up of Leeds and Bristol Urban Development Corporations	41
2. Concerns about Teesside Development Corporation's business affairs	43
3. Former Teesside Development Corporation Board members and officials consulted by the National Audit Office	45
4. Valuation assumptions used by the District Valuer	46



# executive summary

## In this section

Background and main findings	1
Other findings	3

## Background and main findings

- 1 Urban Development Corporations were set up between 1981 and 1993 to achieve the physical, environmental and economic regeneration of urban areas experiencing long-term decline. To achieve this objective, the Corporations had extensive powers and the autonomy to develop their own approach to regeneration.
- 2 Teesside Development Corporation (the Corporation) was the largest Development Corporation in England, covering some 12,000 acres in the North East of England. Established in September 1987 and wound up on 31 March 1998, it received total government grants of £354 million and generated other income of £116 million, including income from the sale of land and property. Over its lifetime the Corporation helped attract private sector investment of £1.1 billion into the area, created over 12,000 new jobs and brought 1,300 acres of derelict land back into use. The Corporation achieved much of lasting benefit in a difficult area.



- 3 In November 2000 three Members of Parliament<sup>1</sup> for constituencies in the North East of England and a former contractor passed to us concerns about the Corporation's operations, as set out in detail in Appendix 2 to this report. In the light of these concerns, we examined the way the Corporation went about its business and handled its wind up.
- 4 Our main findings are:
  - Over its lifetime the Corporation operated broadly within available resources, but its approach to regeneration led to some financial difficulties in the mid-1990s. Around this time, the Corporation entered into 'forward funding arrangements' with developers and deferred payment agreements with contractors, and delayed payments to creditors. For some agreements the Corporation had not sought the required Departmental or Treasury approval, and delaying payment of sums due breached the rules of Government Accounting.<sup>2</sup> The Corporation paid out £1.6 million in compensation to developers, who had paid funds to the Corporation in advance of developments, when the developments did not proceed.

<sup>1</sup> Dr Ashok Kumar, MP for Middlesbrough South and East Cleveland, Dari Taylor, MP for Stockton South and Frank Cook, MP for Stockton North.

<sup>2</sup> Guidance for Government Departments and other public bodies issued by HM Treasury on the proper handling and reporting of public money.

- The Corporation sold or transferred land at values which suggest there may have been a shortfall of £4 million compared with the sites' regeneration value<sup>3</sup>, based on advice we obtained from the District Valuer. It also entered into transactions that resulted in losses of £5.3 million.
- When it wound up its affairs in March 1998, the Corporation estimated that it left the Commission for the New Towns<sup>4</sup>, the residuary body with responsibility for any outstanding matters, with a surplus of £14.5 million, if £16.25 million of uncertain receipts were included, or a deficit of £1.8 million on a more prudent basis later recommended by the Corporation's auditors. However, some liabilities were excluded and others understated, and none of the uncertain receipts has yet materialised. At February 2002 the Corporation's potential deficit is some £23 million, which may be offset if some of the uncertain receipts materialise, but which could rise further as outstanding liabilities are settled by the residuary body. The Corporation also left significant items of unfinished business.
- Governance at the Corporation could have been more robust. The Chief Executive often negotiated transactions himself and recommended them to the Board. Not all Board members had a clear understanding of their responsibilities or of the public sector financial framework within which the Corporation operated. They focused on the Corporation's regeneration efforts, and looked to the Corporation's external auditors, Price Waterhouse<sup>5</sup> and the Department for assurance on financial management issues even though these were primarily the Board's responsibility.
- The Department responsible for oversight of the Corporation was aware of the Corporation's approach to its business activities. In some cases, the Department too readily accepted the Chief Executive's explanations and assurances and in others it was ineffectual in bringing about remedial action. It did not invoke any of its more significant powers of intervention although it considered doing so.

## 5 Our other findings are set out opposite.

- 
- <sup>3</sup> *Regeneration value was expected to reflect the best price that could reasonably be obtained in relation to the proposed use of the land, rather than necessarily to maximise receipts by disposing of land for the most profitable use, providing that use was in line with Corporations' regeneration objectives.*
- <sup>4</sup> *The Commission for the New Towns was the residuary body that inherited any outstanding assets and liabilities upon the wind up of Urban Development Corporations. The Commission was merged with English Partnerships in May 1999 and now operates under the name English Partnerships.*
- <sup>5</sup> *Price Waterhouse were the Corporation's external auditors throughout the Corporation's lifetime. Price Waterhouse merged with Coopers and Lybrand in July 1998 to form PricewaterhouseCoopers.*





## Other findings

### On the Corporation's financial management of its activities and its wind up

- 6 In each of the four years 1992-93 to 1995-96, to cover expenditure already incurred, the Corporation anticipated in its financial statements between £18 million and £29 million of grants receivable in the following financial year. The sums anticipated ranged from 60 per cent to 100 per cent of the following year's grant, and some were anticipated in advance of Parliament voting the funds. And in its 1994-95 and 1995-96 financial statements the Corporation anticipated grants of £19 million and £20 million respectively not due until 2 years later. Treasury guidance did not permit anticipation of material amounts of grant. The Department interpreted Treasury guidance as permitting such anticipation of grant. The Corporation's Chief Executive and Director of Finance, and Price Waterhouse, told us that they understood that the Corporation's anticipation of grants was permitted under the Department's accounts directions (paragraphs 2.7 to 2.10).
- 7 The Corporation made commitments to four development schemes, totalling some £34 million, outside its delegated authority and without prior approval from the Department. The Department subsequently approved two of these schemes. In the case of one of the other schemes, the Corporation subsequently let contracts for elements of the scheme. The Government Office for the North East took the view that this had been done to bring them below the threshold for Departmental approval, and expressed concern to the Board that the Department's rules had been circumvented in this way (paragraphs 2.25 and 2.26).
- 8 On 20 March 1998, at its last meeting before wind up, the Board approved payments totalling £5.1 million without the knowledge of the Department or the Commission for the New Towns which was subsequently obliged to meet £1.9 million of these commitments. In the last few weeks of the Corporation's life, the Chief Executive also granted a £0.5 million mortgage to a developer, which was prohibited by the Urban Development Guidebook<sup>6</sup>. The developer subsequently went into administration and did not repay any of the mortgage (paragraph 3.9 and paragraph 2.34, Case C).

<sup>6</sup> *The Urban Development Guidebook set out detailed requirements for, and guidance on, Corporations' day-to-day activities and was binding on Corporations.*



- 9 Corporations were expected to secure an orderly and tidy exit, divesting themselves of all property, rights and liabilities by December 1997 and leave as little business as possible for the residuary body, the Commission for the New Towns. Where Corporations did not complete their divestment programmes before wind up, they were expected to leave the Commission with sufficient assets to cover outstanding liabilities. The Corporation's Chief Executive was still in negotiations with developers and others up to the close of play on the last day of the Corporation's operational life. The Corporation left the Commission significant items of unfinished business, some of which English Partnerships was still working to resolve at February 2002 (paragraphs 3.10 and 3.11).

### On governance and accountability at the Corporation

- 10 The Board minutes for Teesside Development Corporation show that the Chief Executive was the only officer who attended Board meetings. During the last four years of the Corporation's life the Corporation's Director of Finance attended only two Board meetings, both in June 1998. Board members told us that this policy had been agreed between the Chairman and the Chief Executive early in the Corporation's life, the Chairman noting that he had regular access to operational staff (paragraph 4.12).
- 11 The Corporation's Board was responsible for approving the Corporation's budget and monitoring income and expenditure. To discharge this latter function the Board received brief summary reports each quarter up to January 1995, when they were discontinued. Subsequently the Board received financial position statements as at October 1995 and January 1996, which showed the Corporation's cash budget, its actual income and expenditure and management's forecasts of total income and expenditure at the year-end. Major items of expenditure incurred to date were also listed. After January 1996 reporting lines changed, with detailed financial information being reported to the audit committee while the Board received no other financial reports other than the Corporation's annual financial statements. The Board did not see full business cases in support of major projects before approving them. Instead they relied on short reports from the Chief Executive for assurance that the projects provided value for money (paragraphs 4.6 and 4.7).
- 12 The Corporation's Board approved and paid the Chief Executive's full performance bonus each year up to and including 1998. The Department advised the Board to reconsider its decision to pay the Chief Executive the full 10 per cent bonus for 1998 of some £6,800; the Chief Executive subsequently repaid some £1,700 (paragraphs 4.16 and 4.17).



## On the Department's oversight

- 13 Responsibility for funding, monitoring and reviewing the Corporation's activities was shared between the Department's headquarters and the Government Office for the North East, which also sponsored the Tyne and Wear Development Corporation. The Director of Regeneration and, on occasion, the Regional Director at the Government Office liaised directly with the Corporation's Chief Executive and Chairman on an informal basis as and when required. Other parts of the Department were also involved in monitoring the Corporation including the Department's Finance, Environment and Sponsored Bodies Division, the Department's Accountancy Advisor and the Department's internal audit service (paragraphs 5.2 to 5.4).
- 14 The Department relied on the Corporation's Board for assurance that the Corporation's activities were being properly governed. It did not invoke any of its powers of intervention although it considered de-designating the Corporation's Chief Executive as the Corporation's Accounting Officer in the period immediately after the Corporation's wind up but before its final dissolution in June 1998; and it considered not recommending the Corporation's Chairman for re-appointment when his second term of office expired. It did not consider strengthening corporate governance in the Corporation by making other changes to the Board, or by taking up the Chief Executive's offer early on in the Corporation's life to nominate a representative to attend the Corporation's Board meetings (paragraph 5.10).
- 15 The Department considered commissioning an independent external audit of the Corporation in July 1996 because of its concerns about the reliability of financial information including that on cash flow and commitments. However, the Chairman threatened to consider his position if it did so, and the Department decided that it would not be helpful to undermine confidence on Teesside by precipitating the Chairman's and possibly other Board members' resignations. However, the Department commissioned additional work by the external auditors, intensified its monitoring of the Corporation's cash flow and pressed the Corporation to focus on an effective wind up (paragraphs 5.11 and 5.12).
- 16 In July 1996 the Government Office expressed concern about the Corporation's lack of progress with its preparations for wind up. The Government Office reviewed the Corporation's draft exit strategy and concluded that it might be inadequate to address major issues of concern. The Chief Executive had not set finalisation dates for individual projects, making it difficult for the Government Office to track progress. During the wind up period, the Government Office pursued the Corporation for delivery of its wind up strategies, regeneration statements, risk assessments and evidence of progress on land disposals. Staff at the Government Office compiled some of these schedules themselves from the available information and used the data to challenge the Corporation to make more progress (paragraphs 5.12, 5.13 and 5.17).
- 17 We were unable to find amongst the files left by the Corporation key information such as marketing and disposal files, and contract files with developers and contractors. The Department did not have a consistent policy on whether Corporations' papers were public documents subject to the requirements of the Public Records Act. For example, the papers of the London Docklands Development Corporation were covered by the Act, whilst Teesside Development Corporation's were not. The absence of any requirement for the Corporation to meet the strict provisions of the Public Records Act before wind up meant that the Corporation decided for itself which documents to retain, and which to destroy (paragraphs 5.18 to 5.20).

# Recommendations

- 18 The standards required for the proper conduct of public business are fully compatible with the entrepreneurial approach needed for successful regeneration activities. Bodies need to tailor their operations, however, to keep within public expenditure limits and to discharge their responsibilities for public funds in a proper manner. Boards must hold Chief Executives to account through proper challenge and scrutiny; and by maintaining a strong internal control framework supported by an independent internal audit function, itself overseen by an audit committee which is independent of the Chief Executive and senior finance staff. Departments must have sufficient understanding of the operations of the sponsored body to discharge effectively their own responsibilities for the proper use of public funds provided to that body.
- 19 Urban Development Corporations no longer exist but, based on the important issues of oversight and governance highlighted by this case, we make the following recommendations to government departments sponsoring other non-departmental bodies (NDPBs). Departments should:
  - 1 In appointing Board members of NDPBs, review carefully the composition of the Board to provide for an appropriate range of skills specific to the activities of the body, and also the financial, and wider business and other skills required; and satisfy themselves that the personalities of appointees will provide sufficient checks and balances to make for sound corporate governance.
  - 2 Provide people appointed to the Board or senior management positions with sufficient knowledge and understanding of the financial management and reporting requirements of public sector bodies, and in particular draw their attention to any differences which might exist between private and public sector practice.
  - 3 Encourage Boards to take advice and receive reports from key senior operational staff directly and not to rely exclusively on reports from the Chief Executive. In particular Boards should ensure that major decisions which they are asked to endorse have been scrutinised by those with relevant expertise, and that the financial implications have been fully considered.



- 4 Check that Boards receive and review regular financial information on the NDPB's activities to exercise sufficient oversight of its handling of public monies; and that the Board has considered, and taken appropriate action to manage, key risks relevant to their activities.
- 5 Ensure that a sufficiently independent (of operational/executive staff) audit committee is established; and review the effectiveness of the committee's oversight of the internal control framework, and of internal and external audit activity.
- 6 Facilitate comprehensive and effective oversight by designating a member of the Department with primary responsibility for monitoring all aspects of the NDPB's activities, with that person seeking advice from other specialists as required.
- 7 Focus oversight on those sponsored bodies which pose the greatest risk, based on a periodic risk assessment reflecting for example: the nature and profile of the body's activities; the amount of public monies at stake; the adequacy of the body's corporate governance arrangements; its financial performance; internal and external auditors' reports; and openness of communications between the body and the Department.
- 8 Where significant concerns about the body's activities or corporate governance arise, draw these to the attention of the whole Board (and the internal and external auditors where relevant) and seek explanations or assurances from the Board that appropriate action is being taken to address the areas of concern.
- 9 Protect public interests when a body is to be wound up, by seeking independent assurance on key transactions, financial commitments and cash flows; and where the activities to be wound up are significant, consider representation on the Board to ensure the wind up phase is conducted in a proper and successful manner.
- 10 Where the Chief Executive is eligible to receive a performance bonus on the recommendation of the Board, ensure performance objectives give due weight to the proper management and use of public funds as well as key operational achievements.





# Part 1

## Introduction

- 1.1 In November 2000, three Members of Parliament<sup>7</sup> for constituencies in the North East of England brought to our attention their concerns about the operation and wind up of the former Teesside Development Corporation (the Corporation). They were concerned about possible impropriety and mismanagement of public funds. At the same time, a former contractor for the Corporation provided us with details about specific projects where there were concerns about the way in which the Corporation had conducted its business. In light of these concerns, we decided to examine the issues raised, in so far as available information permitted and, in the context of the outcome of our review, to consider if there were any wider lessons to be learned.
- bringing land and buildings into effective use;
  - encouraging the development of existing and new industry and commerce;
  - creating an attractive environment; and
  - ensuring that housing and social facilities were available to encourage people to live and work in the area.
- 1.3 Corporations had extensive powers (**Figure 1**) to achieve their regeneration objectives. They had autonomy to develop and implement their own approaches to regeneration, within a strategic, economic and financial framework agreed with the Department and set out in three key documents:

## Urban Development Corporations

- 1.2 Teesside Development Corporation was one of twelve Urban Development Corporations (the Corporations) set up in England between 1981 and 1993<sup>8</sup> as short-life non-departmental public bodies. The Corporations were accountable to Parliament through the Secretary of State at the then Department of the Environment (now the Department for Transport, Local Government and the Regions). Their remit was to achieve over their lifetimes the self-sustaining physical, environmental and economic regeneration of designated urban areas experiencing long-term industrial and economic decline. Their main activities involved:

- a **Management Statement**, which defined the Corporations' roles and responsibilities and their relationship with the Department at a strategic and policy level;
- a **Financial Memorandum**, which contained the detailed financial delegations for each Development Corporation and required, in particular, that Corporations met the rules of Government Accounting, observed guidance issued by HM Treasury or the Department, and put into effect any Committee of Public Accounts' recommendations accepted by Government. The provisions of the Memorandum were binding and were not to be disregarded without the express consent of the Department; and

### 1 Powers of the Urban Development Corporations

*Urban Development Corporations were given wide-ranging powers to facilitate regeneration in their designated areas.*

Corporations had the power to:

- Acquire, hold, manage, reclaim and dispose of land and property, if necessary through compulsory purchase
- Carry out building and other operations
- Facilitate the provision of services
- Carry out any business or undertaking for the purpose of regeneration
- Award grants for economic, social, environmental and community purposes
- Make and determine planning applications
- Do anything that was necessary or expedient to regenerate their designated areas

Source: *Urban Development Corporation Guidebook*

<sup>7</sup> Dr Ashok Kumar, MP for Middlesbrough South and East Cleveland, Dari Taylor, MP for Stockton South and Frank Cook, MP for Stockton North.  
<sup>8</sup> There were also Development Corporations in Belfast and Cardiff.

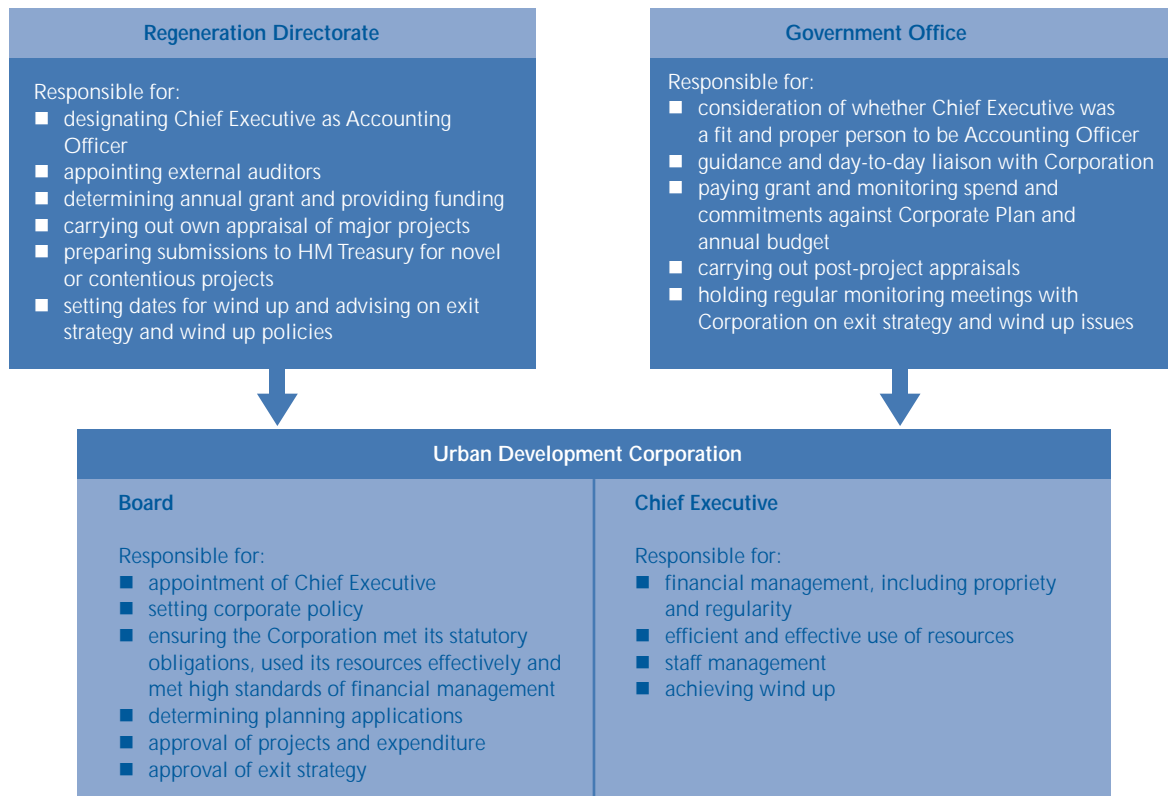
- the **Urban Development Corporation Guidebook** (the Guidebook), which set out detailed requirements for, and guidance on, Corporations' day-to-day activities. The Guidebook was binding on Corporations, and any uncertainty concerning its interpretation was to be referred to the Department.
- 1.4 Each Corporation was run by a Board, comprising a Chairman, Deputy Chairman and between 5 and 11 other members, all appointed by the Secretary of State and remunerated by their Corporations on a standard scale issued by the Department. The Board appointed a Chief Executive, subject to approval by the Secretary of State. Initially, the Department's Regional Offices, but later the Government Offices for the Regions, were responsible for determining whether Chief Executives were fit and proper persons to be designated Accounting Officers. Regeneration Directorate at the Department's headquarters was responsible for strategy and policy decisions affecting Corporations as a whole. It also shared responsibility for funding, monitoring and reviewing Corporations' activities with the relevant Regional or Government Office (in the case of Teesside, the Government Office for the North East). The Department appointed the Corporations' external auditors. Price Waterhouse were Teesside Development Corporation's external auditors throughout the

Corporation's lifetime. The respective roles of the Department's Regeneration Directorate, the Government Office and the Corporations are set out in **Figure 2**.

- 1.5 Each Corporation was expected to observe high standards of propriety, accountability and probity throughout its life. All of the Corporations were wound up between March 1995 and March 1998. They were expected to complete their operational tasks within their lifetimes, selling or transferring all of their assets and liabilities before wind up, obtaining the best return that could reasonably be achieved and not assuming that the Department or any other successor body would complete any unfinished business. The Corporations were required to make satisfactory arrangements for completing outstanding projects, transferring functions, making adequate financial provision for any outstanding liabilities at wind up and laying a solid foundation of sustained regeneration. Responsibility for ensuring that the Corporations complied with these requirements and minimised their commitments, within the framework of the Guidebook, rested with each Corporation's Chief Executive. The Commission for the New Towns<sup>9</sup> (the Commission) was the residuary body responsible for any outstanding matters not settled by the Urban Development Corporations.

**2 Responsibilities of the key bodies involved in Urban Development Corporations**

*The Department and Corporations each had responsibility for approving projects, monitoring expenditure and overseeing wind up.*



Source: National Audit Office

<sup>9</sup> The Commission for the New Towns was the residuary body that inherited any outstanding assets and liabilities upon the wind up of Urban Development Corporations. The Commission was merged with English Partnerships in May 1999 and now operates under the name English Partnerships.



1.6 In February 1997, in our report on the *Wind Up of Leeds and Bristol Urban Development Corporations* (HC 292, 1996-97), we highlighted some lessons to be learnt for future winds up of Urban Development Corporations (Appendix 1). In response, the Department added a chapter to the Guidebook on how Corporations should wind themselves up and hand over responsibilities to successor and residuary bodies.

## Teesside Development Corporation

1.7 Teesside Development Corporation was established in September 1987, employed around 40 staff and was wound up almost 11 years later on 31 March 1998. The Corporation was the largest Corporation in England in terms of area covered, spanning some 12,000 acres (about 19 square miles) between Cleveland and Hartlepool in the North East of England. It was also one of the largest Corporations in terms of its income and expenditure. The Corporation's annual accounts show that, over its lifetime, the Corporation spent some £475 million, and received income<sup>10</sup> totalling £470 million, comprising £354 million grant-in-aid from the Department, and £116 million from other income, including income generated from the sale of land and property.

1.8 A review of the activities and performance of eight Corporations, including Teesside Development Corporation, was carried out on behalf of the then Department of the Environment, Transport and the Regions in June 1998. The review was not a full evaluation designed to meet the requirements of Treasury guidance on the evaluation of regeneration projects and programmes as it was based only on limited discussions with Corporations' Chief Executives, consultations with local authorities and other stakeholders, and limited access to Corporations' papers. However, the review provides an indication of the local conditions that Corporations faced when they were set up and of what they achieved during their lifetimes.

1.9 The review presents estimated lifetime outputs for the eight Corporations covered, across a range of measures that the Department used to monitor Corporations' performance, including new jobs created, new floor space built and land reclaimed (Figure 3).

1.10 When Teesside Development Corporation was set up, there were only 15,000 people in employment in its designated area, which was largely wasteland. Figure 3 shows that, during the Corporation's lifetime, over 12,000 new jobs were created and over £1 billion of

### 3 Gross expenditure and estimated lifetime outputs of eight Urban Development Corporations

*During the lifetime of Teesside Development Corporation, thousands of new jobs were created, a large amount of land was reclaimed, and new commercial and residential developments and infrastructure were put in place.*

Corporation	Gross expenditure	Number of new jobs created	Private sector investment	Land reclaimed	Commercial floor space built	Homes built	Roads built
	£ million		£ million	Acres	Square metres		Miles
Tyne & Wear	480.4	33,707	1,115	1,287	982,476	4,550	24
Trafford Park	268.4	25,618	1,560	497	761,262	461	27
Merseyside	447.9	22,155	698	944	698,000	486	60
Black Country	436.3	21,440	1,150	988	1,096,700	3,774	24
Sheffield	126.3	18,037	683	593	500,000	-1	9
Teesside	462.5 <sup>2</sup>	12,226	1,089	1,295	428,300	1,306	22
Birmingham	60.3	4,656	211	341	311,896	802	30
Plymouth	51.5	427	8	-1	11,900	99	3
<b>Total</b>	<b>2,333.6</b>	<b>138,266</b>	<b>6,514</b>	<b>5,945</b>	<b>4,790,534</b>	<b>11,478</b>	<b>199</b>

#### NOTES

1 The review did not report the number of homes built or the amount of land reclaimed in the designated areas of Sheffield or Plymouth Development Corporations, respectively.

2 The gross expenditure figure of £462.5 million for Teesside Development Corporation is an estimate and does not reconcile exactly with the figure of £475 million at paragraph 1.7, which is based on the Corporation's audited accounts.

*Source: Urban Development Corporations: Performance and Good Practice, Department of the Environment, Transport and the Regions, June 1998*

<sup>10</sup> Excludes transfers of £33 million from the non-cash Capital Receipts Reserve.

private sector investment was attracted to the area. On Teesside, as in all other areas, some businesses and sites gained jobs while others lost them. Net employment growth was therefore less than the number of new jobs created. It is estimated that, by 1997, there were over 23,000 people in work in Teesside Development Corporation's designated area, an increase of more than 8,000 (70 per cent) over the Corporation's lifetime. Some 1,300 acres of derelict land were also reclaimed and some 430,000 square metres of new commercial floor space, 1,300 homes and 22 miles of roads were also built in the area.

1.11 There is no single indicator that can measure the overall cost-effectiveness of Corporations, because each Corporation produced a different mix of outputs. Nor do the measures take account of the severity of the problems faced by individual Corporations. These constraints preclude like-for-like comparisons between Corporations. Former Board members have stressed, however, that Teesside Development Corporation did well to achieve so much of lasting benefit in a difficult area. Former Board members and the Chief Executive have told us that, in their view, the Corporation's other main achievements included:

- creating a market for land and property in the area, where there had not previously been one, and helping to build up rents to levels that were attractive to private sector investors; and
- delivering flagship regeneration projects that had a major impact on the quality of life of the local community and on the image and reputation of the area. Key schemes included the Tees Barrage, Hartlepool Marina and Teesside Park.

1.12 As noted in paragraph 1.1, three local Members of Parliament and a former contractor for the Corporation raised with us specific concerns about the way Teesside Development Corporation approached its activities. These concerns are set out in Appendix 2. They can be summarised as follows:

- the use of unauthorised bank accounts and other forms of financing to circumvent borrowing restrictions;
- disposal of land without competition and at less than regeneration value<sup>11</sup>; and
- poor financial management, leading to financial loss.

1.13 Our overall conclusions in respect of these concerns are set out in the Executive Summary to this report together with recommendations. This report is not intended to review the overall performance of the Corporation but to respond to the specific concerns addressed to us by the three Members of Parliament and the former contractor. Our findings and conclusions in respect of these concerns should be considered in the overall context of capital transactions generating some £116 million of receipts and the wider regeneration achievements of the Corporation.

## What we did

1.14 We investigated the concerns where we could from the available records and the remainder of this report sets out our findings on concerns relating to:

- the Corporation's financial management during its lifetime (Part 2);
- the Corporation's management of its wind up (Part 3); and on:
- governance and accountability within the Corporation (Part 4); and
- the Department's oversight of the Corporation (Part 5).

1.15 In carrying out our examination, we examined files held by the Department and the Commission, and papers supplied by PricewaterhouseCoopers. We also examined papers from, and interviewed, former consultants and chartered surveyors who worked for the Corporation. We consulted a wide range of other people. These included former Corporation Board members and senior officials (Appendix 3); staff from the Government Office for the North East and from the Department's Regeneration Directorate, Internal Audit and Finance branches and its accountancy advisor; and developers who conducted business with the Corporation. We consulted HM Treasury about the interpretation of the financial rules applying to Development Corporations. We also referred to the District Valuer several key pieces of land and property that the Corporation had disposed of during its lifetime, to obtain his opinion on whether the Corporation had obtained appropriate consideration in disposing of them.

<sup>11</sup> Regeneration value was expected to reflect the best price that could reasonably be obtained in relation to the proposed use of the land, rather than necessarily to maximise receipts by disposing of land for the most profitable use, providing that use was in line with Corporations' regeneration objectives.

# Part 2

## The Corporation's financial management

- 2.1 This Part of the report reviews financial management issues at Teesside Development Corporation, in particular:
- the impact of the Corporation's approach to regeneration on its cash flow (paragraphs 2.2 to 2.5);
  - adherence to Departmental and Treasury guidance (paragraphs 2.6 to 2.26);
  - the Corporation's disposal of land and property (paragraphs 2.27 to 2.32); and
  - other transactions generating financial losses (paragraph 2.33).

### The impact of the Corporation's approach to regeneration on its cash flow

- 2.2 Corporations were not set up to make a profit but were at least expected to balance their annual income and expenditure. The Corporation's income and expenditure accounts show that the Corporation's main source of funding up to the final two years of its life was grant-in-aid and that it managed within its available resources over its lifetime (**Figure 4 overleaf**).
- 2.3 The Corporation's financial statements also show that the Corporation's indebtedness increased significantly over the three years from 31 March 1995 to 31 March 1997 (**Figure 5 overleaf**). The Corporation's regeneration strategy was critically dependent upon the timing of receipts, particularly on sales of land and property. This dependence brought the Corporation cash flow difficulties from 1993 onwards. Sums owed to the Corporation also increased, from £23 million at 31 March 1994 to more than £50 million at 31 March 1995 and 31 March 1996, the main item being future grant receivable from the Department.
- 2.4 In accordance with Auditing Standards, as part of their annual audits of the Corporation's financial statements, Price Waterhouse assessed the Corporation's ability to continue as a going concern. Price Waterhouse told us that they had raised concerns about the Corporation's cash flow management with the Corporation and the

Department in 1992. Their reports to the Board and the Department set out the extent to which expenditure legally or morally committed by the Corporation exceeded its secured capital receipts, and hence the maximum potential deficits (**Figure 6 on page 15**). They drew attention to the importance of securing the expected capital receipts and the need for contingency planning to address the possibility that such funds might not be received as planned. However, the Corporation was able to meet its liabilities because additional capital receipts were secured and not all of the forecast expenditure was incurred.

- 2.5 In June 1996 Price Waterhouse raised formally with the Corporation and the Department their concerns about the Corporation's ability to fund its future programme. Price Waterhouse told the Government Office that the Corporation was facing short-term deficits. Based on the Corporation's cash flow forecasts, the Government Office estimated that the Corporation might need additional funds of up to £10 million in 1996-97. In order to provide an unqualified opinion on the Corporation's 1995-96 accounts, Price Waterhouse sought the Department's assurance that the Corporation had access to extra funds. The Department confirmed that it had the power to make additional funding available to the Corporation if necessary. Minutes of the Board meeting of 21 June 1996 record that Price Waterhouse had discussed their doubts about the Corporation's solvency with the Department. At that meeting the Board discussed the responsibilities of members, the Corporation and the Department in the event of the Corporation being deemed insolvent. The Corporation's Chief Executive told the Department in June 1996 that Board members were increasingly concerned about their own personal position in such a situation. The Corporation relied on the Department's confirmation that it had the power to make additional funding available to the Corporation, if necessary, to keep the Corporation afloat. In 1996-97 the Department, with Treasury approval, granted the Corporation additional funds of £2 million and made a corresponding reduction in its grant for 1997-98. In September 1997, the Department increased the Corporation's reduced grant for 1997-98 by an additional £1.9 million.

#### 4 The Corporation's reported trading results<sup>1</sup> 1987-88 to 1997-98

The Corporation's accounts show that grant-in-aid from the Department was the Corporation's major source of income over the six years from 1990-91 to 1995-96. Capital receipts were the major sources of income in 1996-97 and 1997-98, together with transfers from reserves.

	87-88	88-89	89-90	90-91	91-92	92-93	93-94	94-95	95-96	96-97	97-98
	£m	£m	£m	£m	£m	£m	£m	£m	£m	£m	£m
Income											
Departmental grant released <sup>2</sup>	1.7	10.2	26.4	49.2	52.4	85.7	29.4	59.6	25.9	10.1	2.9
Retained surplus <sup>3</sup> released	0	0	0	0	0	0	7.3	0	10.4	12.0	3.8
Proceeds from sale of development assets <sup>4</sup>	0	0	0.7	1.0	3.7	25.8	5.6	7.0	10.1	3.3	28.8
European Regional Development Fund grant	0	0	0	0.4	0	0	4.2	3.8	1.8	1.1	0.7
Other receipts	0	0	2.5	0.6	1.2	2.9	3.5	1.3	2.5	1.4	1.9
Expenditure	(1.7)	(10.3)	(27.8)	(50.9)	(53.5)	(88.8)	(50.2)	(70.9)	(50.8)	(28.0)	(38.2)
<b>Operating surplus/(deficit)</b>	<b>0</b>	<b>0</b>	<b>1.8</b>	<b>0.3</b>	<b>3.8</b>	<b>25.6</b>	<b>(0.2)</b>	<b>0.8</b>	<b>(0.1)</b>	<b>(0.1)</b>	<b>(0.1)</b>
Interest received/(paid)	0	0.2	1.1	1.1	0.3	0.7	(0.1)	0.2	0.1	0.1	0.1
Tax rebated/(paid)	0	(0.1)	(0.7)	(0.6)	(0.9)	(1.5)	0.3	2.2	0	0	0
<b>Surplus after interest and tax</b>	<b>0</b>	<b>0.1</b>	<b>2.2</b>	<b>0.8</b>	<b>3.2</b>	<b>24.8</b>	<b>0</b>	<b>3.2</b>	<b>0</b>	<b>0</b>	<b>0</b>

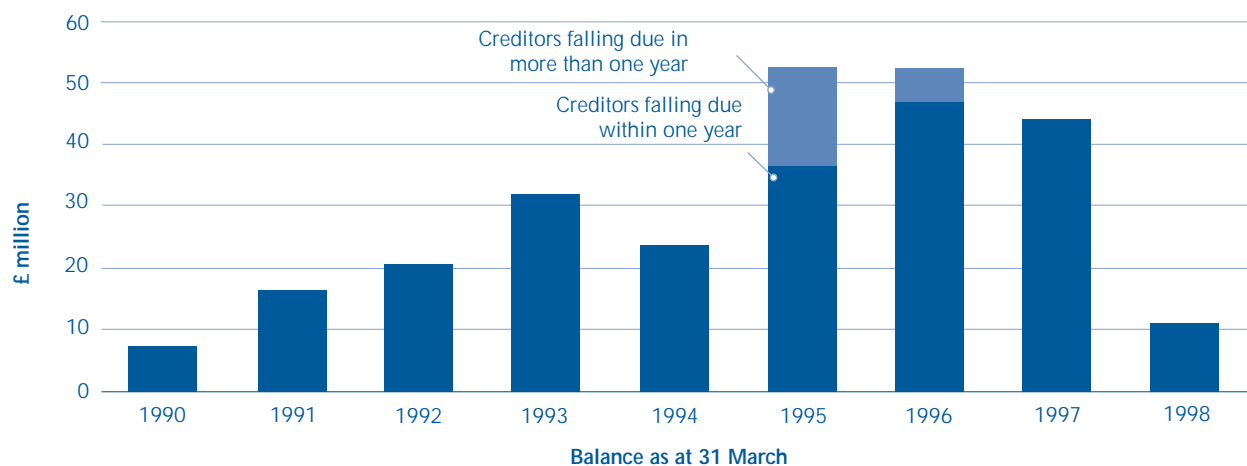
#### NOTES

- The results shown are those of the Corporation and its two subsidiary companies - Hartlepool Historic Quay Limited, which operated the themed maritime museum, and Tees Barrage Limited, which operated the Tees Barrage. All figures are rounded to the nearest £100,000.
- Departmental grant released is the sum of grant received in the year plus grant receivable in future years for expenditure incurred in this year less grant receivable this year for expenditure incurred in previous years.
- Retained surplus on the Corporation's income and expenditure account from previous years, shown as the Capital Receipt Reserve in the Corporation's financial statements.
- Proceeds from the sale of development assets are referred to in this report as capital receipts.

Source: Teesside Development Corporation's audited accounts

#### 5 Sums due to creditors at the end of each financial year, 1990-91 to 1997-98

Indebtedness rose significantly over the lifetime of the Corporation, peaking across the three years 1994-95 to 1996-97



#### NOTE

Creditors includes payments received on account, and accruals and deferred income.

Source: Teesside Development Corporation's audited accounts

## 6 The Corporation's projected income and expenditure in 1994, 1995 and 1996 for financial years 1994-95 to 1997-98

For three of the last four years of the Corporation's life, expenditure legally or morally committed for the year exceeded grants expected from the Department and secured capital receipts, leaving a gap to be filled by additional capital receipts.

Forecast as at:	1994-95 £m	1995-96 £m	1996-97 £m	1997-98 £m
<b>31 March 1994</b>				
Forecast Income <sup>1</sup>	39.6	31.8	30.1	0
Committed expenditure <sup>2</sup>	(58.1)	(52.4)	(23.3)	0
<b>Potential surplus/(deficit)</b>	<b>(18.5)</b>	<b>(20.6)</b>	<b>6.8</b>	<b>0</b>
<b>31 March 1995</b>				
Forecast Income <sup>1</sup>	0	39.3	27.7	32.0
Committed expenditure <sup>2</sup>	0	(50.8)	(41.1)	(31.9)
<b>Potential surplus/(deficit)</b>	<b>0</b>	<b>(11.5)</b>	<b>(13.4)</b>	<b>0.1</b>
<b>31 March 1996</b>				
Forecast Income <sup>1</sup>	0	0	46.1	31.7
Committed expenditure <sup>2</sup>	0	0	(49.3)	(28.8)
<b>Potential surplus/(deficit)</b>	<b>0</b>	<b>0</b>	<b>(3.2)</b>	<b>2.9</b>

### NOTES

- Forecast income includes grant-in-aid expected from the Department and secured capital receipts.
- Committed expenditure comprises legal and moral commitments. For example, at 31 March 1995, it included £30 million moral commitments on two projects where conditional agreements were subject to approval by the Department.

Source: Price Waterhouse's Management Letters to the Department and the Corporation's Board

## Adherence to Departmental and Treasury guidance

The Corporation accounted for grants receivable before Parliament had voted them, contrary to Treasury guidance

2.6 The Department and the Treasury gave directions to Corporations on the form and content of their annual financial statements. These directions required Corporations to observe all relevant guidance in *Government Accounting* and in *Trading Accounts: a Guide to Government departments and Non-Departmental Public Bodies*, issued by the Treasury. Corporations' accounts were also required to follow best commercial accounting practice and give a true and fair view.

2.7 *Trading Accounts* guidance issued by the Treasury in 1989 stated that Parliamentary grants should not be anticipated and that bodies' annual financial statements should show the amount of grant received in the financial year. However, amounts could be taken as receivable at the year-end on the condition that grants were assured, having already been received by the body or voted by Parliament by the time management approved the accounts. This would allow bodies to match income more closely to expenditure, consistent with the accruals concept of accounting. "Voted by Parliament" could include sums voted on account in the Autumn preceding the relevant financial year, which represents 45 per cent of the yearly total to be voted. The Treasury told us, however, that it did not expect all or most of the following year's grants to be anticipated.

2.8 As part of a consultation exercise to update the guidance, the Treasury wrote to departments in November 1995 accepting that grant-in-aid may be accounted for on an accruals basis so long as there were appropriate controls over the level of in-year expenditure and the availability of the grant was not in question. The Treasury updated the guidance in March 1996, emphasising that bodies could treat part of the following year's grant-in-aid as being receivable in the current year if:

- the amounts involved were not material; and
- there were adequate controls over amounts anticipated in this way.

2.9 In line with this guidance, the Development Corporation Guidebook placed responsibility on the Corporation to ensure that the amount of grant required in any year did not exceed the amount voted by Parliament. However, the Corporation's financial statements anticipated material amounts of grants due in future years before Parliament had voted them (**Figure 7 overleaf**). In each of the four years 1992-93 to 1995-96, the Corporation anticipated in its financial statements between £18 million and £29 million of grants receivable in the following financial year. The amounts anticipated ranged from 60 per cent to 100 per cent of the following year's grant. In the two years 1994-95 and 1995-96, the Corporation also anticipated a further £19 million and £20 million respectively of grants not due until two years later, which Parliament had not voted. In 1996-97, the Corporation anticipated £26 million of grants for the following year. Although these monies had already been voted by Parliament, they represented 90 per cent of the following year's

## 7 The Corporation's anticipation of grant

*The Corporation anticipated material amounts of future years' grant-in-aid for five consecutive years.*

Year	Grant voted in year	Grant anticipated not due until following year	Grant anticipated not due until two years later	Total grant anticipated
	£ million	£ million	£ million	£ million
1992-93	40.3	28.0	-	28.0
1993-94	37.0	17.7	-	17.7
1994-95	30.0	28.6	18.6	47.2
1995-96	28.6	24.6	19.9	44.5
1996-97	28.6	26.0	-	26.0

### NOTE

The sum of grant voted and grant anticipated in 1992-93 is less than the Departmental grant released for that year shown in Figure 4, because the latter includes retained balances carried forward from earlier years.

*Source: Teesside Development Corporation's audited accounts*

grant and were material to the Corporation's 1996-97 accounts. In their Management Letters on the 1996-97 and 1997-98 accounts, Price Waterhouse pointed out that the Corporation had drawn down 70 per cent and 59 per cent respectively of its annual grant in the first month of each financial year, to settle sums due to creditors carried forward from the previous financial year.

2.10 The Department told us that it had interpreted Treasury guidance as permitting such anticipation of grant. The Corporation's Chief Executive and Director of Finance, and Price Waterhouse, told us that they understood that

the Corporation's anticipation of grants was permitted under the Department's accounts directions. The Corporation's Chief Executive told us that, had the Corporation been aware that it was not permitted, the Corporation would not have anticipated grant in the way that it did. This would have required the Corporation to slow down its regeneration activities and pare back its annual expenditure, or show significant deficits in its annual accounts.

The Corporation entered into 'forward funding agreements' with developers, without Departmental or Treasury approval, which resulted in additional costs of £1.6 million

2.11 The Corporation's Chief Executive told us that the usual approach to regeneration involved public bodies incurring the costs of reclamation and infrastructure work in anticipation that private developers would then be attracted to particular sites. In contrast, Teesside Development Corporation entered into agreements with prospective developers under which developers took title to the development sites in exchange for an initial payment. The Corporation was to resolve certain obstacles to development of the sites, principally relating to highways or planning issues usually within specified timescales. If these conditions were not met, the developments did not go ahead and the agreements were terminated.

2.12 In two cases we examined, the Corporation reacquired the sites from the developer for the original sums paid for them plus £1.6 million without any of the developments having taken place. Details of the agreements are set out below.

## CASE A: Teesside Park

In October 1995, the Corporation sold its freehold interest in Phase 2 of the Teesside Park development for £4 million on condition that the Corporation would reacquire the freehold and pay an agreed sum over and above the original sale price, if development work was not completed by March 1996, which in turn depended on the Corporation resolving a separate dispute with the Highways Agency about the need for new access roads. Price Waterhouse reported in its 1995-96 Management Letter that, in April 1996, the Corporation repaid the developer £4 million, plus £635,000 to compensate for the costs of undertaking the purchase and sale transactions, to reacquire the site.

## CASE B: Middlehaven

Throughout 1995 and 1996, the Corporation negotiated an agreement to sell a piece of land on the Middlehaven site to a major food retailer for £6.85 million, for food and non-food retail development on the site. However, the agreement was taking time to finalise and therefore, in April 1996, the Corporation sold the land to a different developer, who paid the Corporation £7 million for the land and four adjacent plots. The sale agreement included a clause allowing the developer to sell the land back to the Corporation for any reason up to April 1997. However, in November 1996 the Corporation granted outline planning permission to the major food retailer for a supermarket scheme on part of the site, even though it had already sold the site. Price Waterhouse reported in its 1996-97 Management Letter that the Corporation repaid the £7 million, plus £962,000 to compensate for the costs of undertaking the purchase and sale transactions, to re-acquire all five sites from the developer in April 1997. At the same time as it reacquired the five pieces of land in April 1997, the Corporation signed a conditional agreement with the major food retailer for the proposed food and non-food retail development on one of the sites.

2.13 Price Waterhouse have explained that Corporation officials told them that these agreements were entered into in order to accelerate the underlying development projects so as to ensure the work was completed prior to the end of the Corporation's life. The Department became aware of these agreements when they were raised in Price Waterhouse's Management Letters for 1995-96 and 1996-97. The Department wrote to the Corporation asking for further information about the Teesside Park agreement. The Chief Executive and the Director of Finance replied that the development was a land disposal to a development company comprising a bank and other investors and explained the terms of, and reasons for, the Corporation's reacquisition of the site.

2.14 The Development Corporation Guidebook did not mention these types of agreement and whether they were permissible. However, it required the Corporation to seek early advice from the Department in cases of uncertainty, particularly concerning 'novel or contentious' proposals. 'Novel or contentious' included proposals that were:

- of a new, previously unknown kind; or
- likely to commit the Development Corporation to further consequential expenditure; or
- likely to bring the Corporation into disrepute; or
- to borrow money from sources other than the National Loans Fund.

2.15 Neither the Department nor the Corporations had delegated authority to approve such proposals, which had to be submitted to Treasury for approval. The Chief Executive told us that he had not consulted the Department or the Treasury about these agreements. Instead, he had consulted the Corporation's legal advisers, who had taken the view that these agreements were not loans but 'forward funding arrangements'.

2.16 The sales involved the Corporation putting in place arrangements with British Linen Bank by which the Bank advanced £11 million to a company set up specifically by the developer to receive the funds and buy the sites from the Corporation. The sales agreements between the Corporation and the developer permitted either party to terminate the agreements if the Corporation did not meet certain conditions by set dates, triggering the Corporation's payment of £890,000 in interest and of over £700,000 for the other costs incurred by the company in the purchase and sale transactions. The developer closed down the company after it had sold the sites back to the Corporation.



## The Corporation deferred payments to contractors

- 2.17 Contractors may sometimes offer public bodies deferred payment terms in return for interest payments to compensate for the delay beyond the time when payment would normally be due. Government Accounting specifies that deferred payment agreements must not be used to evade public expenditure controls, and requires departments and non-departmental public bodies to seek Treasury approval before entering into such agreements, unless they have appropriate delegated authority to do so. The Development Corporation Guidebook did not give Urban Development Corporations such authority. However, the Corporation entered into deferred payment agreements with contractors without Departmental or Treasury approval.
- 2.18 By December 1994, the Department had received two telephone calls from solicitors and a bank acting on behalf of developers, enquiring about what security the Corporation might be able to offer on a commercial loan. The Department became concerned that the Corporation was seeking to arrange other finance arrangements similar to the Warrior Quay deal. The Department therefore wrote a second time to the Corporation's Chief Executive in December 1994 asking for an explanation of what arrangements the Corporation was discussing with third parties that might have led to these enquiries. The Department reminded the Chief Executive that the Corporation should not directly, or through deferred payment agreements with contractors, borrow money privately. The Chief Executive told the Department that the enquiries from third parties had arisen from contractors who were tendering for Corporation work and from whom the Corporation was seeking assurances as to their financial proposals. However, the original enquiries from the solicitors and the bank concerned the security that the Corporation could offer to banks that were considering lending money to the Corporation's contractors. The Chief Executive told the Department that he was fully aware of the regulations concerning deferred payments.
- 2.19 When the Department wrote to the Corporation's Chief Executive in December 1994 about the reacquisition of Warrior Quay, it reminded him that the Corporation should not cause other bodies to borrow privately, in view of the likelihood that costs would in due course be passed back to the Corporation directly or indirectly. In their Management Letter for 1994-95, Price Waterhouse pointed out that they had spoken to the Corporation's legal advisers who had confirmed that there were no direct financing costs associated with the deferred payment agreements. In June 1995, in response to an enquiry from the Department, Price Waterhouse confirmed that they had not identified any indirect financing costs that needed to be separately highlighted in their Management Letter. However, in

## CASE A: Reacquisition of Warrior Quay

The Corporation sold the Warrior Quay site overlooking Hartlepool Marina to a housing developer. In 1992, the developer asked the Corporation to buy back the development of luxury flats because the housing market had turned down and the developer had suffered significant losses. The Corporation was anxious to secure development rights to the site but did not have the cash at hand to repurchase the site outright. It therefore paid the developer £0.3 million in May 1993, securing all rights to the site, and paid the balance of £1 million plus interest charges of £84,000 in May 1994, an effective annual interest rate of 8.4 per cent. Price Waterhouse, the Corporation's external auditors, referred to these transactions in June 1994 in their Management Letter for 1993-94 and the Department asked Price Waterhouse for further details. The Corporation told the auditors that the interest charge was one of a number of facets to the agreement and that the transaction as a whole could not be classified as one of a financing nature. The Department wrote to the Corporation's Chief Executive in December 1994, accepting the view that this transaction was "not legally a loan" but reminding him that transactions involving any form of deferred payment should be submitted to the Department for its consideration.

## CASE B: The construction of the sub-structure for Middlesbrough Football Club's BT Cellnet Riverside Stadium

In April 1995, a contractor completed the sub-structure works for the new stadium for Middlesbrough Football Club. The value of the works was £1.1 million. Although work was certified as complete by that date, the Corporation did not pay the contractor. The Corporation subsequently invited the contractor to enter into an agreement with British Linen Bank whereby the Bank paid the outstanding sum at a discounted rate around December 1996. Price Waterhouse referred to the deferred payment in their 1997 Management Letter to the Department and the Corporation's Board.



## CASE C: Construction of the Tees Barrage

In the early 1990s, the Treasury refused to approve a novel method of funding proposed by the Corporation for the construction of the Tees Barrage, which involved deferred payments. In 1994-95, however, the Corporation renegotiated the terms of the construction contract for the Barrage, to defer payments when it had to reduce its expenditure because of a shortfall in expected receipts from the sale of land. Under the new arrangement, the contractor refunded the construction costs of the Barrage already paid by the Corporation and agreed new payment terms with the Corporation, whereby the Corporation would pay the contractor for work done on completion of specific milestones. The contractor had to fund significant amounts of work between milestone payment dates. In July 1994, the contractor entered into an agreement with the British Linen Bank to fund the contractor's operations. The contractor assigned to the Bank sums due from the Corporation for the work, and the bank then advanced monies to the contractor against the security of the work carried out for the Corporation. The Corporation signed notices to certify the amount of work completed by the contractor and made payments, when due, directly to the Bank. The arrangement allowed the Corporation to defer payments of £14 million from 1994-95 until 1995-96.

## CASE D: Development of the Western Phase of Hartlepool Marina

In accordance with normal commercial practice, the Corporation negotiated in 1993-94 with the contractor on the Western Phase development in Hartlepool to make payments based on the satisfactory completion of stages of the work. To support its working capital needs, the contractor entered into an agreement with Barclays Bank to fund the contractor's operations. The contractor completed a key stage of the development in 1994 for which payment was to be made in 1994-95. During 1994-95, the Corporation renegotiated its agreement with the contractor, deferring payments of £5 million from 1995-96 until 1996-97.

## CASE E: The Preston Farm, South Bank and Teesdale developments

The Corporation signed agreements with a developer involved in several large developments, including Preston Farm, the South Bank and Teesdale. Under one of these agreements, the Corporation deferred payment of £2.1 million from 1995-96 until 1996-97. Under another agreement, the contractor entered into an arrangement, again with the British Linen Bank, under which the contractor drew down £1 million in December 1994 based on a claim certified by the Corporation. The Corporation deferred settlement with the Bank until April 1996.

July 1995, they told the Department that deferred payment agreements were an area of risk. Price Waterhouse found calculations of interest costs on the Corporation's files which appeared to show calculations of interest on deferred payments or loan agreements. The Corporation told Price Waterhouse that these calculations were hypothetical and were used to determine the value of the renegotiated contracts to the contractor.

- 2.20 The Department wrote to the Corporation's Chief Executive in August 1995, asking for his assurance that there were no hidden interest payments within the deferred payment agreements. In his reply, the Chief Executive told the Department that the Corporation's payment authorisation system precluded interest payments in respect of deferred payments. Price Waterhouse continued to draw the Board's and the Department's attention to deferred settlement arrangements in their Management Letters for the years ended 31 March 1996 and 1997. At the June 1997 meeting of the Corporation's audit committee to discuss Price Waterhouse's Management Letter for 1996-97, the Chief Executive told the committee that deferral of payments had only been occasioned where contractors had agreed to such action by the Corporation.

## The Corporation also delayed payments to creditors

- 2.21 Government Accounting requires public bodies to agree payment terms at the outset of a deal and honour them, settling debts promptly even if this results in a deficit. In July 1996, one of the Corporation's creditors complained to the Government Office that the Corporation had not settled a £100,000 debt. The Government Office contacted the Corporation and was told by the Director of Finance that the Corporation did not have sufficient cash to make payment. The Government Office was concerned that the Corporation's lack of cash would be reported in the media and advised the Corporation to settle the overdue invoice quickly. The Corporation refused to do so, claiming that this debt was not the first priority for payment. The Government Office met the Corporation's Chairman and insisted that the Corporation settle this debt, which it did shortly afterwards. The Government Office also asked the Corporation for a list of all other creditors owed over £10,000. In all, there were 41 creditors on the Corporation's list, owed a total of some £6.7 million by the Corporation; they included its external auditors, valuers and solicitors.

- 2.22 In September 1996 another creditor contacted the Government Office to complain that the Corporation had not settled a debt of £50,000. The Corporation's Director of Finance was able to satisfy the Government Office that the Corporation was about to make payment. The Government Office told us that, in

January 1997, the Corporation had assured them that the list of creditors had been substantially reduced.

- 2.23 Recognising that the Corporation had cash flow problems and the need for action if the Corporation was to be able to satisfy its creditors in a timely fashion, the Department sought and obtained Treasury approval in December 1996 to increase the Corporation's grant-in-aid for 1996-97 from £26.8 million to £28.8 million. However, in early 1997, a developer issued a writ against the Corporation for non-payment of £1.9 million. The developer had paid the Corporation £1.9 million in March 1996 for a proposed development of shops and a restaurant near Hartlepool Marina. The development did not go ahead and, in January 1997, under the terms of the agreement, the Corporation was legally obliged to re-pay the £1.9 million to the developer, but without any interest. Although the Corporation acknowledged the debt, it did not repay the monies until February 1997 after the developer had served it with a writ.

### The Corporation made financial commitments outside its delegated authority and without Departmental approval

- 2.24 The Corporation's Board had delegated authority to approve development projects up to £3 million. In March 1987, when the Corporation was being established, the Secretary of State wrote to the Corporation's Chairman setting out key ground rules concerning the relationship between the Corporation and the Department. These included the requirement that the Department should be advised of any large or potentially sensitive schemes early in their gestation. The Secretary of State emphasised that the Corporation was not to enter into commitments or negotiations before it had consulted the Department, otherwise there would be difficulties if the Department intervened at a late stage or when the Corporation had already entered into formal or informal commitments. The Chairman was asked to draw these rules to the attention of fellow Board members, the Chief Executive and other senior Corporation staff.
- 2.25 We found four cases where the Corporation had made commitments, totalling some £34 million, to projects outside its delegated authority and without prior Departmental approval, although the Department was aware of some of these projects at an earlier stage. In two cases the Department subsequently approved the projects.

### CASE A: University of Durham Stockton Campus

In 1991, the Corporation approached the Department for approval to fund the construction costs, estimated at £8.4 million, of the first phase of a new campus building on Teesdale for the University of Durham. By then, the Corporation had been negotiating with the University for three years and had already agreed with the University that the Corporation would meet the full cost of the development. Initially, the Department refused to approve the project on the grounds that the project had not been mentioned in the Corporation's Corporate Plan; the regeneration benefits had not been substantiated and the quantifiable outputs delivered poor value for money; the educational need had not been clearly demonstrated; and the Corporation was heavily committed and had already asked the Department for an additional £7.4 million to fund other projects. However, the Department reversed its decision in the light of the potential effect that any loss of confidence in the Corporation would have on other projects and developers in the area.

In approving the Corporation's grant to the University to build the first phase of the campus, the then Minister for Local Government and Inner Cities wrote to the Corporation's Chairman stating that there should be no further capital or revenue contributions to the University project at any stage.

### CASE B: Imperial War Museum

In 1992, the Corporation offered the Trustees of the Imperial War Museum a grant of £8.9 million towards the cost of constructing a new Imperial War Museum in Hartlepool and a further £5.5 million to help cover the Museum's running costs. The Corporation formally submitted the proposal, with the necessary detailed costings, to the Department in 1995. The Department noted that, by then, the Corporation's Chairman had already announced on national radio that the Museum would be built at Hartlepool. There was therefore an expectation and assumption that the scheme would go ahead. The Corporation had also already negotiated a contract with a company to build the Museum.

However, the Department refused to approve the scheme because the Corporation was proposing to provide most of the funds at a time when its resources were already fully committed. The Department was concerned that there were no private sector monies involved in the project and that the project was not viable, with deficits forecast for the foreseeable future. At the Department's suggestion, the Corporation reopened negotiations with the Trustees on the basis that the Trustees should fund the development of the Museum themselves. The Museum's Trustees had always recognised that any deal would require Departmental approval, but had equally assumed that the Corporation had cleared its offers in principle with the Department before making proposals to the Trustees. The Trustees did not accept the Corporation's revised proposals and terminated negotiations.

### CASE C: Access bridge between Middlesbrough Football Club's Riverside Stadium and Middlesbrough Dock

In December 1994, the Corporation agreed to fund the construction of an access bridge between Middlesbrough Football and Athletic Club's new BT Cellnet Riverside Stadium and Middlesbrough Dock, at a cost of some £3.9 million. This exceeded the Corporation's delegated authority and therefore required Departmental approval. The Department turned down the proposal, questioning whether it was appropriate for the Corporation to bear the full cost of the work and expressing concern at the poor quality of the Corporation's appraisals. However, the Department subsequently approved the scheme on public safety grounds.

### CASE D: Tall Ships Centre

In 1995, the Corporation sought Departmental approval to build a Tall Ships Centre at Middlesbrough Dock at a cost of £6.8 million, having already agreed its plans with the contractors and developers. The Department did not approve the scheme, because the Corporation had not provided information on how the Centre would be financed, its likely future capital and revenue funding requirements and on whether the Centre would be financially viable. The Corporation did not resubmit the proposal to the Department. However, in 1996, the Corporation's Board let contracts totalling some £6 million for some elements, in view of their regeneration value independent of the Tall Ships proposal, without reference to the Department. The Government Office took the view that the Corporation had divided the scheme into smaller elements, to bring them below the threshold for Departmental approval, and expressed concern to the Board that the Department's rules had been circumvented in this way.

2.26 In June 1998 the Government Office for the North East received project appraisal forms for 34 items of expenditure on projects approved by the Corporation's Board between April 1989 and March 1998. Although most of these forms concerned projects worth up to £1.5 million that were within the Board's delegated authority, they included 15 projects that should have had the Department's prior approval, mainly because they extended beyond the Corporation's lifetime. Some of the larger projects appeared in the Corporation's Resource Position Statement. A covering note from the Corporation's Finance Director to the Department explained that submission of these forms had been overlooked.

## The Corporation's disposal of land and property

2.27 The Development Corporation Guidebook stated that subjecting land and property disposals to open market competition was normally the most reliable way of ensuring that a fair price was obtained. Assets should be marketed so as to maximise price exposure to the market, except where a Corporation was satisfied that a more restrictive approach was justified and would achieve at least as high a price. The Guidebook and other Treasury guidance emphasised that, in disposing of assets:

- professional and competent advice should be obtained on the most appropriate sale methods, before deciding on proposed sales;
- the availability of sites for disposal should be advertised as widely as possible, to maximise the number of potential purchasers reached, even if the subsequent disposal of the site was by negotiated sale;
- a professional valuation should be obtained from a qualified valuer as a guide price immediately before negotiations commenced. In cases where the sale price was expected to exceed £5 million or the sale was potentially difficult, an independent valuer should be used. For lower value or less complex cases, Corporations could use retained consultants or their own qualified valuation staff. Where negotiations were on-going for more than six months, a revaluation might be needed;
- for each disposal, details should be retained of the marketing used and the prices offered;
- Corporations should obtain a certificate from a qualified valuer in advance of agreeing the sale, confirming that the proposed terms represented regeneration value;

- regardless of the size of the transaction, Corporations should ensure that there was adequate separation of duties between the individuals negotiating the sale and those recommending or approving the disposal; and
- any disposal over five hectares required prior Departmental approval.

## The Corporation's approach to land and property sales

- 2.28 The bulk of the Corporation's land disposals by value and volume occurred during the final two years of its life. Land disposal schedules for April 1996 to December 1997 that were available at the Government Office show that all but one of the 24 disposals completed by the Corporation were by negotiated sale. The Corporation's Chief Executive conducted sales negotiations personally, considered and accepted all deals on behalf of the Corporation and, where appropriate, reported and recommended their acceptance to the Board. Commercial valuers in the Middlesbrough area told us that the Corporation displayed general information boards at its sites, giving the Chief Executive's name as a contact. The Chief Executive considered that this approach complemented the Corporation's overall marketing strategy, which promoted Teesside as a place in which to invest.
- 2.29 The Chief Executive told us that he negotiated sales with developers whose continuing involvement in Teesside was a pre-requisite to sustaining regeneration in the area, and sold some sites adjacent to companies' existing facilities for the expansion of their businesses; and that the disposal of land at Teesside Park, Warrior Quay and the site previously proposed for the Imperial War Museum had been subject to competing offers. The Corporation's Chief Executive and its Chairman told us that the main reason for negotiated sales was that there was no market for development land in the area and negotiated developments were the only way to attract developers to the area.
- 2.30 The Corporation's surveyors told us that the Corporation's main valuers undertook annual valuations of each of the Corporation's sites, which were the equivalent of guide prices. The Chief Executive and Chief Internal Auditor pointed out that the Corporation also obtained a valuer's certificate for all land sales,

before agreeing the sale, to confirm that the proposed terms represented regeneration value. These certificates were based upon the information supplied by the Corporation and its surveyors. We could not find the negotiation files for individual asset disposals amongst the documents that the Corporation left the Commission for the New Towns upon wind up, and hence we were unable to determine whether valuations had been obtained before negotiations had commenced or had been concluded.

## The Corporation disposed of land at below regeneration value without Departmental approval

- 2.31 The Development Corporation Guidebook required Corporations to dispose of land and property at regeneration value. Regeneration value was expected to reflect the best price that could reasonably be obtained in relation to the proposed use of the land, rather than necessarily to maximise receipts by disposing of land for the most profitable use, providing that use was in line with Corporations' regeneration objectives. The Department preferred Corporations to sell the freehold of land, which would bring in more receipts than selling the leasehold. Corporations were required to justify any reduced receipt that might result from pursuing anything other than the most profitable use and to seek prior Departmental approval to sell assets at less than regeneration value. The Guidebook also precluded Corporations from disposing of land by way of gift and required Corporations to refer any disposal over five hectares to the Department for prior approval.
- 2.32 At our request the District Valuer reviewed ten transactions (see Appendix 4) and provided his view as to whether the consideration obtained was consistent with the likely regeneration value for the proposed use of the land at the time the transaction occurred. His review identified four cases where the Corporation disposed, or arranged disposal, of land at below regeneration value without prior Departmental approval, and that there may have been a shortfall in value of at least £4 million.

## CASE A: University of Durham Stockton Campus

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Having built the first phase of the University of Durham's new campus on Teesdale at a cost of £8.4 million, in 1993 the Corporation granted the University a 999-year lease on the 2.27 hectare site, at an annual rent of £100. The lease contained covenants preventing the land from being used for anything other than a university. The Department was aware that this approach was taken in order to make the University project financially viable and that sale of the freehold with restrictive covenants would have brought receipts of between £400,000 and £1 million. The Corporation justified disposal by way of a long lease on the grounds that freehold covenants would have been difficult to enforce and could have been lifted at a later date, allowing the University to sell the land at a greatly enhanced value. However, in 1997 the Corporation transferred the freehold of this site to the University at nil consideration. We found no evidence that the Department either knew about, or approved, this gift.

As part of the same transaction by which it gifted the freehold of the original campus to the University, the Corporation sold to the University the freehold of a further 4.7 hectares of land adjacent to the original campus for £500,000. The University told us that it paid the £500,000 for half of the area and that it received the other half for nil consideration. With a combined area of more than five hectares, Departmental approval should have been obtained before the Corporation disposed of the freehold to the original campus and the adjacent land. No such approval was sought or given. Based on an analysis of the sale price obtained by the Corporation in disposing of the freehold of an adjacent site, at around the same time and of similar condition but with even tighter restrictive covenants, the District Valuer advised us that a regeneration value of around £1.2 million could be arrived at.

## CASE B: Middlesbrough Football Club's Riverside Stadium

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In July 1997, the Corporation notified the Department that it had granted to Middlesbrough Football and Athletic Club a 999-year lease on the 8.9 hectare-site of its new BT Cellnet Riverside Stadium, at a peppercorn rent of £1. The Corporation's chartered surveyors valued the site at £1 in May 1997, based on the Corporation's instructions to value the site as contaminated, un-reclaimed and only partly serviced, requiring £8 million of reclamation, decontamination and infrastructure work. By then, however, the reclamation and infrastructure work had already been completed, funded by the Corporation, and the Stadium had been open since 1995. The Department had not been consulted on the terms of the deal, nor asked to give its approval. The District Valuer advised us that the regeneration value of the long leasehold, based on the site having been fully reclaimed and with infrastructure in place, was in the region of £1 million. The Corporation retained the freehold to the land, which it showed at a nil value in its 1997-98 accounts, while the leasehold was shown in the Football Club's accounts.

## CASE C: Preston Farm

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In February 1998 the Corporation put two agreements in place with a waste management company, under which the company would, in lieu of tax, pay £7.5 million to Teesside Environmental Trust under the Government's Landfill Tax Credit Scheme and the Corporation would pay the company the 10 per cent (£750,000) of this donation that could not be recovered from Customs & Excise under the rules of the Scheme. The Corporation paid in kind, by transferring to the company six parcels of undeveloped land, totalling some 42.8 hectares, at the Preston Farm site. The District Valuer considered that £750,000 was at or around the regeneration value of the land, given its condition at the time of the disposal and the proposed use of the land, where the six parcels were sold as one plot. However, he advised us that the Corporation could have secured significantly higher receipts had it sold the sites individually.

## CASE D: Site previously earmarked for the Imperial War Museum

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In March 1998, the Corporation sold for £1 million the 3.5 hectare-site that had been earmarked for the Imperial War Museum at Hartlepool Marina. The site was suitable for a variety of uses, including retail, leisure, commercial and residential with a proportion of the site reserved for public open space. The District Valuer advised us that, on these terms, the regeneration value of the site was £2.75 million. The site has been developed with a mix of retail, office and residential accommodation.

## Other transactions that led to financial loss

2.33 Transactions need to be considered in the context that well managed risk taking is a key part of successful regeneration. We found four cases where the Corporation entered into transactions that may have led

to financial losses of at least £7.4 million, where better management of risks may have reduced the Corporation's exposure to loss. We have included £2.1 million of this sum in our calculations of the Corporation's potential deficit upon wind up in Part 3; excluding this sum brings potential losses in this section to £5.3 million.

### CASE A: Middlehaven

Amongst the concerns drawn to our attention was that the Corporation had started ground works at the Middlehaven site, which were aborted when the proposed development did not go ahead. We found that the Corporation's Board had approved the start of works on the Middlehaven site, whilst aware of the impending judicial review of the Corporation's decision to grant planning permission for a retail development on part of the site, and whilst they had not secured funding for the work. The judicial review found against the Corporation, the Department announced a review of the planning approval and the Corporation's application for lottery funding was turned down, leaving the Corporation without funding for the work. Work on the site stopped in 1997. As at February 1998, the Corporation had paid some £4 million on ground works. English Partnerships has yet to complete its detailed designs for the redevelopment of the Middlehaven site. It is not certain whether all or any of the works paid for by the Corporation will prove abortive.

The Corporation's financial appraisals and business case to support the decision to sell the leases failed to recognise that, on the under-leases, the Corporation had agreed to pay annual rents that were almost twice the prevailing market rates and did not take account of the penalty costs that the Corporation or its successor body would have to pay for early disengagement from these agreements. By February 2002 expenditure by the Corporation and its residuary bodies on Tees House and Stephenson House exceeded income from the sale of the leases by some £1.9 million. However, this figure does not include the costs that English Partnerships will incur in disengaging from the Stephenson House lease. English Partnerships estimate that this will cost at least £0.65 million, which would bring total losses on the office accommodation to £2.6 million. We have included £2.1 million of this sum in calculating the Corporation's potential deficit in Part 3, as it was incurred by the Commission and English Partnerships after wind up.

### CASE B: The Corporation's office accommodation

Despite being a limited life body, in 1988 and 1989 the Corporation entered into 125-year leasehold agreements for its own office accommodation at Tees House and Stephenson House, at a cost of some £1 million. The Corporation expected that these agreements would have a financial value for any successor body that inherited them. In 1991, the Corporation moved to a third property, Dunedin House, leaving Tees House and Stephenson House vacant until April 1993, when it sold its leases for £1.5 million to third parties, in return for taking out 20-year under-leases on each property.



### CASE C: Haverton Hill shipyard

In March 1998, the Corporation sold the former Haverton Hill shipyard estate for £740,000 to a newly formed firm. The firm paid the Corporation £240,000, but was unable to raise the remaining sum due to buy the site outright, so the Corporation's Chief Executive granted it a mortgage of £500,000 to part-fund the acquisition. With Value Added Tax, the total sum due to the Corporation was £587,500. On the same day, he signed an agreement assigning the Corporation's charge securing the mortgage second priority behind a private sector creditor in any claim on the firm's assets were the firm to go into liquidation. Disposal of assets by mortgage was explicitly prohibited in the Urban Development Corporation Guidebook.

These actions took place after the final Board meeting on 20 March 1998, and without Board approval or the knowledge of the Department or the Commission. The Corporation did not assess the viability of the new firm, particularly its ability to repay the mortgage. The Corporation was, however, at that time suing another company set up and run by the same directors for non-payment of some £800,000 for its acquisition of part of the same estate under an earlier agreement. The new firm went into administration in February 2000 and did not repay any of the Corporation's mortgage. The Commission inherited a potential future liability of some £0.7 million for cleaning up the contamination left by previous industrial uses of the site. English Partnerships is negotiating with the administrators to buy the site as the best available option, to secure the site's regeneration. Taking account of the unpaid mortgage and unpaid interest thereon, losses are expected to amount to £650,000.



### CASE D: Ukrainian Training Ship Tovarisch

The Corporation funded a project that fell outside the categories of work identified in the Development Corporation Guidebook as eligible for grant-in-aid funding. In 1995, before that year's Tall Ships race, the then Marine Safety Agency detained the Ukrainian Training Ship Tovarisch in port in Newcastle after one of the Agency's surveyors inspected the ship and found that it was not seaworthy. The ship remained in port because the master and crew did not have the funds to rectify the ship's deficiencies. After negotiating with the Government of Ukraine, the Corporation agreed in February 1997 to tow the ship to Middlesbrough where it would be renovated at a Tall Ships Centre proposed by the Corporation, and to meet the subsistence costs of the ship's master and crew for two years. The ship was moved to Middlesbrough in May 1997 with the permission of the Marine Safety Agency but the plans for the Tall Ships Centre had to be reconsidered in February 1998, when the Corporation's bid for National Lottery monies to fund the Centre was rejected. The Corporation redrew its proposals, aiming to site the Centre at Hartlepool instead. However, Hartlepool Dock was found to be too shallow to accommodate such a large ship, which remained at Middlesbrough Dock until August 1999 when the Commission for the New Towns paid for the ship to be towed to Germany. Subsistence costs for the ship during its 27 month stay in Middlesbrough and towing costs amounted to some £240,000 (£150,000 of which was incurred by the Commission).







# Part 3

## The Corporation's management of its wind up

3.1 This Part examines the Corporation's wind up. In particular, it examines:

- the assets and liabilities left to the residuary body, the Commission for the New Towns, for the continued regeneration of the area (paragraphs 3.5 to 3.8);
- liabilities to which the Commission was committed after wind up (paragraph 3.9); and
- the Corporation's handover to the Commission for the continued regeneration of the area (paragraphs 3.10 to 3.13).

### The need for an orderly wind up

3.2 In our February 1997 report on *The Wind Up of Leeds and Bristol Development Corporations* (HC 292, 1996-97), we found that neither corporation had been wholly successful in winding up its affairs and identified lessons to be learned for future winds up (Appendix 1). The Department responded to our report by revising and reissuing, in February 1997, the chapter of the Development Corporation Guidebook concerning wind up. The new chapter stressed that the overall aim of wind up was to secure an orderly and tidy exit, putting in place suitable succession arrangements while at the same time maximising the return on public investment. Corporations were required to plan ahead to ensure that:

- they divested themselves of all property, rights and liabilities before wind up, with the residuary body viewed as a home of very last resort;
- all assets were disposed of for the best price that could reasonably be obtained;
- satisfactory arrangements were made for completing outstanding projects and tasks and for transferring functions to other bodies; and
- a solid foundation was laid for sustaining the impetus of regeneration after the Corporations' demise.

3.3 The Guidebook emphasised the need for Corporations to keep the Commission for the New Towns fully apprised of any matters that might come its way at wind up so that the Commission could plan and budget for the workload. Corporations were expected to secure a home for all their assets and liabilities by 31 December 1997 and provide as little business as possible for the Commission. The Commission itself was expected to have a short life and was not to be left with public assets requiring long-term maintenance. In the event that Corporations were unable to complete their divestment programmes before wind up, they were expected to leave the Commission with detailed schedules of assets and liabilities, so that the Commission was fully apprised of all outstanding transactions, including potential receipts from overage<sup>12</sup> and clawback provisions, and actual and contingent liabilities. Corporations were expected to leave the Commission sufficient assets to cover any outstanding liabilities.

3.4 As part of the management of its wind up, the Corporation prepared an exit strategy and maintained a schedule of assets and liabilities, which it updated as it disposed of assets and liabilities during the last two years of its life. The Corporation commissioned Price Waterhouse to carry out five reviews of its progress in implementing the exit strategy at key intervals during the final year of the Corporation's life. With the knowledge of the Department and the Corporation, however, the auditors undertook only limited verification work and relied on information and explanations given to them by the Chief Executive and other Corporation officials. The auditors' reports highlighted that the scope of their work therefore differed significantly from an audit conducted in accordance with Auditing Standards. The reports were addressed to the full Board and presented to the audit committee.

<sup>12</sup> An overage is a receipt due to the Corporation or its residuary bodies from developers if particular contractual conditions are met at some future date.

## The assets and liabilities left to the Commission by the Corporation

3.5 The Corporation provided successive assurances to the Commission and the Department that it would leave the Commission with no outstanding assets or liabilities. The Corporation prepared a draft Resource Position Statement in early April 1998 showing assets and liabilities left for the Commission upon wind up of the Corporation. The Statement showed a surplus of assets over liabilities of some £14.5 million (**Figure 8**). The Statement included cash required by the Corporation after it was wound up, to prepare its final accounts and report and close down its operations before it was finally dissolved on 30 June 1998.

### 8 The Corporation's Resource Position Statement, April 1998

*The Corporation's draft Resource Position Statement showed a £14.5 million surplus of assets over liabilities as at 31 March 1998.*

	£'000	£'000
Cash balance as at 31 March 1998		2,753
Less: cash required for 1 April to 30 June 1998		<u>(1,700)</u>
		1,053
Add:		
Receipts due after 31 March 1998	10,992	
Other income previously excluded	7,650	
Potential overages	16,250	
Less:		
Expenditure incurred by the Corporation	(10,326)	
Other expenditure	(11,125)	
		<u>13,441</u>
Surplus		14,494

*Source: Letter from the Corporation's Director of Finance to the Commission's Deputy Director of Finance dated 8 April 1998*

## Potential overages

3.6 After wind up, the Department commissioned Price Waterhouse to review the Corporation's March 1998 operations, including the draft Resource Position Statement as at 31 March 1998. In their June 1998 report, Price Waterhouse drew attention to the inclusion of potential overages of £16.25 million within the Statement, and noted that, for some of these receipts to be realised, significant expenditure was first required. Price Waterhouse considered that, on a more prudent basis, the Statement should have shown a potential net deficit of some £1.8 million (**Figure 9**). Price Waterhouse reiterated this view in their Management Letter for 1997-98. The potential overages were:

- £8 million, built into the Corporation's leasehold agreement with Middlesbrough Football and Athletic Club, that might come about were there to be a change of control of the Club before May 2007;
- £6 million, if any new planning consent for retail or leisure developments were granted at Teesside Park before March 2003; and
- £2.25 million, if a major food retailer obtained planning consent to build a supermarket on a site at Middlehaven before March 2008.

### 9 The Corporation's Resource Position Statement, discounting potential overages

*Omitting potential overages from the Corporation's draft Resource Position Statement gives a potential deficit of £1.8 million as at 31 March 1998.*

	£'000
Surplus per draft Resource Position Statement at Figure 8	14,494
Less: uncertain receipts/overages	<u>(16,250)</u>
Potential net deficit	(1,756)

*Source: Price Waterhouse review of the Corporation's March 1998 operations, June 1998*

3.7 In early June 1998, at a meeting with the Government Office, the Corporation's Director of Finance accepted that the figures for potential overages from developments were uncertain, but considered that other receipts included in the Resource Position Statement after 31 March 1998, such as receipts from the disposal of properties on Teesdale, should materialise. At its final meeting in late June 1998, the Corporation's Board considered that at least some of the potential overages would materialise. The Corporation's Chief Executive and Director of Finance told us that each of these items had a potential value and were included in the draft Resource Position Statement in order to provide a complete picture of assets and liabilities. The items were uncertain in terms of whether and when they might materialise and contingent upon decisions outside the direct control of either the Commission for the New Towns or the Department. None of the overages has yet materialised.

## Changes since wind up

3.8 The Corporation left the Commission more cash than it envisaged in its Resource Position Statement and, since the wind up, some committed expenditure shown in the Statement has not occurred (Case A), while liabilities have proved to be greater and some asset values and receipts have proved to be less (Cases B-E), than estimated at the time that the Statement was drawn up, resulting in a potential deficit of some £23 million at February 2002, which may be offset if some of the uncertain receipts materialise (Figure 10). The final deficit may rise further as English Partnerships will incur further expenditure to meet the liabilities it inherited from the Corporation.

### 10 The Corporation's Resource Position Statement, discounting potential overages and adjusting for changes since wind up, February 2002

*Since wind up, some committed expenditure has not occurred, while liabilities have proved to be greater, and some asset values less, than estimated in the Corporation's Resource Position Statement, resulting in a potential deficit of some £23 million at February 2002.*

	£'000	£'000
Potential net deficit after adjusting for potential overages (Figure 9)		(1,756)
Add: additional cash left by the Corporation		1,651
Add: committed expenditure that did not occur after wind up - Tall Ships Centre		3,200
		3,095
Less:		
Expenditure understated in the draft Resource Position Statement		
Tees Barrage	(17,700)	
Corporation's office buildings	(3,150)	
Settlement of joint venture on Teesdale	(870)	
		(21,720)
Less: net receipts that have not materialised		(4,328)
Potential deficit		(22,953)

*Source: National Audit Office*

## CASE A: Tall Ships Centre

At its last operational meeting on 20 March 1998, the Corporation's Board approved grants totalling £3.2 million associated with the Tall Ships Centre: £1.5 million towards the cost of the Centre at Hartlepool, £1.3 million to the Sail Training Association and £0.4 million to the Association of Sea Cadets for ship renovation at the proposed Centre. After the Corporation was wound up, the developer reduced significantly the scope of the planned development and the amount of grant funding that the Commission was required to pay. However, after further investigation, the Commission refused to pay anything to the developer because it found that the developer had used steel pilings paid for by the Corporation and originally intended to strengthen the dock wall at Middlesbrough, for purposes other than those set out in the grant agreement. Grant offers to the Sail Training Association and to the Association of Sea Cadets expired without the associations making a claim.

## CASE B: Tees Barrage

The Corporation's Resource Position Statement (Figure 8) did not include significant liabilities associated with the disposal of the Tees Barrage in 2001. The Corporation prepared a separate schedule, which the Chief Executive considered provided a balanced package of assets and liabilities on the Barrage. To reduce the uncertainty about the long term maintenance of public assets, the Guidebook required Corporations to consider, at the time decisions were taken to develop such assets, the future affordability of maintaining the assets and to consult with the body likely to inherit the asset, where that was known. The Chief Executive had been negotiating for more than two years to agree terms with a successor body to take over responsibility for the Barrage, including a dowry to cover future long-term liabilities on the Barrage. The Corporation proposed to make available land and buildings along the North bank of the Tees (not included in Figure 8) which it believed to have a value of some £9 million. However, it also considered that it would require additional resources - probably about £6 million, to complete the dowry.

However, in January 1998 British Waterways, the preferred successor, decided against taking on the Barrage, considering that the land and buildings offered as part of the dowry were worth considerably less than the value placed on them by the Corporation. At around the same time, Northumbrian Water, the other potential successor body, told the Corporation that it would be prepared to take on the Barrage for a dowry of £17 million. By February 1998, the Corporation had still not agreed terms with a successor body. In April 1998 the Department transferred responsibility for negotiating the disposal of the Barrage to the Commission for the New Towns. From April 1998 until March 2000, the Commission managed the Barrage itself, at a cost of

£800,000. In March 2000, after competition to find a successor body, British Waterways assumed management responsibility for the Barrage from English Partnerships, receiving £17.7 million cash, plus one of the sites previously offered by the Corporation, as a dowry to meet future liabilities. British Waterways took formal ownership of the Barrage in February 2001 by Statutory Instrument. English Partnerships has retained the other parcels of land not transferred to British Waterways as part of the dowry, the net value of which is estimated to be minimal.

### CASE C: The Corporation's office buildings

The provision for the settlement of outstanding leases on the Corporation's office buildings (Tees House, Stephenson House and Dunedin House) also proved insufficient. The Corporation had taken out 20-year under-leases on Tees House and Stephenson House and a 25-year lease on Dunedin House, paying annual rents that exceeded prevailing market rates. In its Resource Position Statement the Corporation made provision for expenditure of £640,000, which Price Waterhouse told us represented the cost of two years' rent for Tees House and Stephenson House, and one years' rent for Dunedin House, which was the Corporation's estimate of the expected timescale and cost of disposing of these leases.

However, English Partnerships subsequently bought back the Tees House headlease for £1.15 million (which it is now marketing for £0.6 million) and paid the owners of Dunedin House £1.7 million for early surrender of that lease (along with the freehold), as the best available options for disengaging from its liabilities on these properties. In addition, English Partnerships will have to pay a further sum, expected to be around £0.65 million, for early surrender of the lease on Stephenson House. By February 2002, rental and other payments on the Stephenson House lease had cost English Partnerships some £253,000. By February 2002, the difference between the Corporation's provision and actual expenditure was £3.15 million (although this may be reduced by receipts from the sale of the Tees House headlease).

### CASE D: Settlement of joint venture agreement on Teesdale

The provision to settle outstanding liabilities on a joint venture with a developer of the Teesdale site has also proved insufficient. The joint venture agreement involved developing the site and sharing the proceeds. The Corporation's Resource Position Statement included £130,000 to settle these liabilities. However, there had been disputes between the Corporation and the developer during the lifetime of the development and the estimated liabilities of £130,000 were not agreed by the developer before wind up.

The Commission for the New Towns subsequently had to pay over £1 million to the developer, based on an independent audit of the proceeds from the development, to settle just part of the liabilities. English Partnerships remains liable to complete agreed infrastructure works on the site at a cost of £670,000 and to pay the developer a part share of the proceeds of any disposals of unsold development land on the site, which English Partnerships estimates will total around £350,000.

### CASE E: Receipts due after 31 March 1998

The Corporation's Resource Position Statement included receipts of some £14.77 million that have not materialised. These related to disposals at the Riverside and North Bank sites. The Corporation included in its Statement projected expenditure of some £10.44 million associated with preparing these sites for disposal. English Partnerships has found no binding commitments by developers to acquire any of the Riverside site, and is now planning a much larger development for both sites. It expects that it will have to spend more on decontaminating and reclaiming the North Bank site than it will secure in sales proceeds. As English Partnerships' plans for the development of these sites are not comparable with what the Corporation envisaged for them, it would be prudent to exclude the anticipated net receipts of £4.33 million from the Corporation's legacy.



## Liabilities to which the Commission for the New Towns was committed after wind up

3.9 The Development Corporation Guidebook prohibited Corporations from committing residuary bodies to make any payments after their wind up unless those bodies had agreed to take over such liabilities, arrangements had been made to fund the bodies or transfer to them an equivalent value in assets, and Corporations had obtained the Department's prior approval. At their last operational meeting on 20 March 1998, the Corporation's Board approved payments totalling £5.1 million (Cases A-C overleaf). The Corporation made provision for these commitments in its draft Resource Position Statement. These sums are therefore included in the expenditure figures at Figure 8. However, the Commission had not agreed to take over these liabilities. Nor had the Corporation obtained the Department's approval before committing these resources. The Department and the Commission did not become aware of these liabilities until after wind up. The Commission was subsequently obliged to meet £1.9 million of these commitments.

## The Corporation's handover for the continued regeneration of the area

3.10 Corporations were expected to secure a home for all their assets and liabilities by 31 December 1997 and provide as little business as possible for the Commission. At the end of February 1998, however, one month prior to the end of its operational life, the Corporation still had at least 80 sites requiring disposal and more than 75 outstanding liabilities that needed to be settled. The number of schemes the Commission was to inherit varied on a daily basis, as the Corporation's Chief Executive was negotiating with developers and other bodies until the last day of the Corporation's operational life. The Commission had difficulty establishing in advance what it would inherit, and hence in making operational plans to manage the workload. The Commission responded to this uncertainty by appointing from 1 April 1998 its own team to assess the financial inheritance and deal with unfinished business.

3.11 The Development Corporation Guidebook emphasised that the Commission would not be able to take on the task of completing any unfinished Development Corporation projects. The Commission's role was to dispose of any unsold assets or outstanding liabilities, but only as a home of last resort. However, Teesside Development Corporation left the Commission to deal with outstanding matters on some of the Corporation's major projects, and at February 2002, some four years after the Corporation was wound up, the Commission was still trying to resolve some significant issues.

3.12 It was a common feature of the Corporation's agreements with developers to use claw back clauses and joint venture agreements to share financial gains between the Corporation and developers on Corporation-funded projects. The Commission told us that, in its view, there had not been a full and proper handover from the Corporation in respect of such agreements and, as a result, neither the Commission nor English Partnerships could be certain that all of the agreements where monies might be due had been identified. English Partnerships has examined legal documentation inherited from the Corporation and Land Registry entries to ascertain the extent of clawback provision protected by restrictions on title or by legal charges. However, there is a risk that English Partnerships is not aware of other legal liabilities to the extent that these are unregistered or not contained in documentation left by the Corporation.

3.13 Upon wind up, Development Corporations were expected to leave a solid foundation for sustaining the impetus of regeneration after their demise, and each Corporation was expected to produce a regeneration statement to transfer its knowledge and experience of the needs and conditions of the area, and of the development opportunities and difficulties of individual sites, to its successors. The regeneration statement prepared by Teesside Development Corporation summarised the Corporation's achievements and some general lessons for regeneration. However, the Department considered that the Corporation had not done enough to highlight development opportunities and difficulties presented by individual sites left at wind up, and to set out the Corporation's views on how regeneration of the area should be taken forward and in what priority, thereby passing on to others the wealth of detailed, local knowledge the Corporation had built up over its lifetime.

### **CASE A: Chair of Regeneration and new amenities building at University of Durham Stockton Campus**

The Board approved grants of £1.3 million to the University of Durham to endow a Chair of Regeneration at the University's Stockton campus and to meet the costs of a new amenities building for students. This was despite the fact that, in approving the Corporation's £8.4 million grant to the University in September 1991 to build the first phase of the campus, the then Minister for Local Government and Inner Cities had written to the Corporation's Chairman stating that there should be no further capital or revenue contributions to the University project at any stage. After representations from the University, the Commission met the cost of the Chair as a full legal commitment, and the cost of the amenities building, on the grounds that, although the amenities building was a moral commitment, expanding higher education facilities in areas of economic and social disadvantage made a vital contribution towards development and regeneration.

### **CASE B: Portrack Incinerator**

The Board approved grants of £0.6 million towards the cost of demolishing the Portrack Incinerator, a local eyesore. In April 1998 Stockton Borough Council notified the Commission of this commitment. Due to unforeseen problems encountered during the demolition, the cost of demolition rose significantly and the Commission agreed with the Department to increase its contribution towards the cost of the work to £0.76 million.

### **CASE C: Tall Ships Centre**

The Board also approved grants of £1.5 million towards the cost of the Tall Ships Centre at Hartlepool, £1.3 million to the Sail Training Association and £0.4 million to the Association of Sea Cadets. None of these commitments subsequently resulted in any expenditure (paragraph 3.8, Case A).



# Part 4

## Governance and accountability within the Corporation

4.1 This Part of the report reviews governance and internal control within the Corporation.

### The Board and Chief Executive

4.2 The Development Corporation Guidebook stated that the Board of a Development Corporation was accountable to the Department for every aspect of the Corporation's activities and its compliance with all of the guidance issued to it. The Board's main responsibilities included:

- ensuring that the Corporation met its statutory obligations, used its resources effectively and met high standards of financial management;
- approving and monitoring the Corporation's budget;
- taking account of guidance issued by the Department or HM Treasury in making and executing its decisions;
- approving projects, subject to the Department's approval where project costs exceeded the Corporation's delegated authority; and
- appointing and supervising the Chief Executive.

4.3 The Guidebook also stated that the Chief Executive's main duties as Accounting Officer were to:

- be accountable for resources provided by Parliament for the day-to-day operation of the Corporation's business;
- ensure that the Corporation complied with relevant legislation, particularly in respect of the preparation of annual financial statements;
- ensure that all relevant requirements of Government Accounting were met; and
- take personal responsibility for ensuring that resources provided by Parliament were used economically, efficiently and effectively, handled with propriety and regularity, accounted for properly and used for the purposes for which they were intended.

4.4 In July 1997, HM Treasury issued guidance to remind Accounting Officers of their role and responsibilities, drawing on established best practice. The guidance stressed that an Accounting Officer had a personal responsibility for the propriety and regularity of the public finances for which he or she was answerable. The guidance, which re-iterated previous guidance, set out seven key rules that should govern an Accounting Officer's actions (Figure 11).

#### 11 Seven key rules that should govern an Accounting Officer's actions

*HM Treasury has laid down seven key rules for Accounting Officers.*

- Don't bend or break the rules
- Put in place and follow clear procedures
- If approval is needed, get it first
- Don't allow a conflict of interest to affect, or appear to affect, decisions
- Don't use public money for private benefit
- Be even-handed
- Record the reasons for decisions

*Source: Regularity and Propriety, HM Treasury, July 1997.*

4.5 The Chief Executive told us that he considered his primary role was to foster the commercial regeneration of Teesside, by adopting an entrepreneurial approach in his dealings with private sector investors. He acknowledged his responsibility for ensuring that the Corporation had adequate accounting systems in place to budget and monitor expenditure, report financial commitments to the Department and seek Departmental approval where necessary. He also acknowledged his responsibility for ensuring that the Corporation prepared and executed an orderly wind up.

## The Board's monitoring of the Corporation's financial position

- 4.6 The Corporation's Board was responsible for approving the Corporation's budget and monitoring income and expenditure. To discharge this latter function the Board received brief summary reports each quarter up to January 1995, when the reports were discontinued. Subsequently the Board received financial position statements as at October 1995 and January 1996, which showed the Corporation's cash budget, its actual income and expenditure, and management's forecasts of total income and expenditure at the year-end. Major items of expenditure incurred to date were also listed. After January 1996, the Board received no financial reports other than the Corporation's annual financial statements.
- 4.7 The business cases for new schemes put forward by the Chief Executive for Board approval contained limited financial data and did not identify or quantify the attendant financial risks. In particular, they did not identify the impact of proposed new projects on the Corporation's cash flow and whether the Corporation had funds for the proposed projects.
- 4.8 The Department told us that the Corporation's Board members were appointed for their business or political skills and experience in the private, public and voluntary sectors, and that members drawn from local authorities, in particular, would have been aware of requirements for handling public funds. However, a number of the Board members told us that they had little or no knowledge or experience of central government accountability requirements, or of the specific guidance issued for Development Corporations such as the Development Corporation Guidebook. They believed that it was appropriate for the Board to concentrate on delivering regeneration, whilst looking to the Department and internal and external audit for assurance that the Corporation was complying with its operational and financial management framework.
- 4.9 Guidance on the role, responsibilities and proper conduct of Board members was set out in the Corporation's Code of Conduct, the Corporation's Management Statement, HM Treasury's *Model Code of Best Practice for Board Members of Public Bodies* and a Departmental document concerning the responsibilities of Board members of Non-Departmental Public Bodies. However, Corporation Board members told us that they had received little or no training on their role in general, nor any advice or guidance from the Department on how they should monitor the Corporation's finances in particular.
- 4.10 We reviewed departmental guidance given to schools, colleges and other bodies, such as health trusts, museums and galleries whose governing bodies have a similarly high proportion of members drawn from

industry, local government and the community. The guidance is much more detailed and specific than the Department's guidance to Development Corporations and contained examples of best practice. The Department told us that it now informs new Board members of training seminars organised by the Civil Service College.

- 4.11 None of the guidance relevant to Urban Development Corporations set out who was expected to report to the Board. Corporations' Chief Executives, as the designated Accounting Officers, were responsible for ensuring that their Boards received appropriate advice on all matters of financial propriety and regularity and on prudent and economical financial management. Over the eleven-year life of the Corporation, the Board had great confidence in its Chief Executive and trusted him to discharge his Accounting Officer, financial and probity responsibilities professionally.
- 4.12 The Board minutes for Teesside Development Corporation show that the Chief Executive was the only officer who attended Board meetings. During the last four years of the Corporation's life the Corporation's Director of Finance attended only two Board meetings, both in June 1998. Board members told us that this policy had been agreed between the Chairman and the Chief Executive early in the Corporation's life, the Chairman noting that he had regular access to operational staff.

## Performance pay arrangements for the Chief Executive

- 4.13 The Corporation's Chairman assessed the Chief Executive's annual performance against key objectives agreed between them in advance. These objectives related primarily to the Corporation's regeneration objectives, such as the number of jobs created and inward investment attracted. There were no objectives relating to the discharge of the Chief Executive's responsibilities for financial control, use of resources or for the proper use of public funds. The Chairman told us that, as he considered it implicit that the Chief Executive should be efficient in management control and proper use of public funds, the objectives set for the Chief Executive reflected the greater emphasis on achieving regeneration results.
- 4.14 For 1994-95, the Department emphasised to the Chairman the importance of setting an additional objective for the Chief Executive concerning the wind up of the Corporation. The Chairman and the Department agreed between themselves the objective that the Chief Executive should identify and evaluate all of the tasks needed to eliminate any outstanding liabilities by 31 March 1998 and present a three-year action plan to the Board for the wind up of the Corporation. Prior to submitting the Chief Executive's performance objectives



to the Department, the wind up objective was changed with the agreement of the Chairman, to replace the requirement of a three-year action plan with the more general aim of establishing a wind up programme to ensure the implementation of all relevant matters. The Department accepted the revised objective although it expressed concern to the Chairman that the objective might not identify the work to be done to achieve satisfactory succession arrangements for the Corporation's remaining assets and liabilities.

4.15 From April 1993, the Department delegated authority to Corporations' Boards to pay Chief Executives a bonus of up to 10 per cent of their salary depending on their performance. Corporations had to consult the Department before awarding a bonus. Where a Chief Executive had missed a performance target and a Corporation's Board had not reduced the level of the bonus appropriately, the Department could ask a Board to re-consider the level of the award.

4.16 On the Chairman's recommendation, the Corporation's Board approved and paid the Chief Executive the full bonus each year up to and including 1998. The Chairman told us that he considered the bonuses to be pre-agreed and warranted, as the required regeneration was achieved.

4.17 In June 1998 the Departmental Accounting Officer met a delegation of Board members and the Chairman to discuss the Corporation's legacy. Unaware that the Corporation had already paid the Chief Executive's bonus with his March 1998 salary, the Departmental Accounting Officer advised the Board to re-consider its decision to pay the Chief Executive the full 10 per cent bonus of some £6,800. The Board subsequently reduced the bonus to 7.5 per cent; the Chief Executive subsequently repaid some £1,700.

## The Corporation's internal audit

4.18 The Development Corporation Guidebook required Corporations to have effective internal audit arrangements in accordance with the objectives, standards and practices outlined in HM Treasury's *Government Internal Audit Manual*. Internal audit was required to cover the whole of a Corporation's internal control system, including its operations, resources, services and responsibilities for other bodies. In particular, it was expected to ensure the economical and efficient use of resources, compliance with established policies, procedures, laws and regulations and the safeguarding of assets and interests from loss of all kinds.

4.19 Throughout its life, the Corporation employed two internal auditors. Internal audit reports were submitted to the Chief Executive and were also copied to the Department. As part of their audits of the Corporation's financial statements, Price Waterhouse reviewed the

work of internal audit. Each year, Price Waterhouse considered that internal audit operated in accordance with the Government Internal Audit Manual and that the scope and effectiveness of internal audit's work was appropriate. In particular, Price Waterhouse was able to place reliance on internal audit's work on tendering and payment procedures and therefore to reduce external audit work in these areas.

4.20 In June 1993, as part of a larger exercise covering five Corporations, the Department's internal audit assessed the Corporation's systems of financial control, including its finance and internal audit sections. The review identified deficiencies in the Corporation's internal audit:

- the Corporation's internal audit testing focused solely on financial procedures and did not cover the correct operation of the Corporation's systems or whether the procedures themselves were adequate;
- a full risk analysis of the Corporation's business had not been carried out. Internal audit worked to a three-year strategic plan, drawn up by the Chief Internal Auditor based on his experience in other bodies;
- internal audit usually did not produce reports setting out its findings, recommendations and action plan. Instead it produced memoranda and agreed its findings with Corporation staff on an informal basis; and
- there was no audit committee and copies of the annual audit report were not seen by the Board.

4.21 The Department continued to review the Corporation's internal audit reports and spoke to the internal auditor to confirm that his work was in more depth than his reports suggested. However, in 1994, the Department reviewed the Corporation's internal audit reports and concluded that the lack of critical comment in them pointed to a lack of independence on the part of the internal audit team. The Department recommended that the Corporation establish an audit committee to strengthen the position of internal, as well as external, audit within the Corporation. The Corporation set up an audit committee in September 1994. Best practice in other public sector bodies points out that, to maximise an audit committee's independence and objectivity, officers with executive responsibilities should not serve as committee members. At the Corporation, however, the Chief Executive was a member of the audit committee. The Department carried out another review of the Corporation's internal audit arrangements in February 1995, and concluded that internal audit was complying with HM Treasury's *Government Internal Audit Manual* in all material respects.



# Part 5

## The Department's oversight of the Corporation

5.1 In this final Part of the report, we review the Department's oversight of the Corporation and its response to issues drawn to its attention.

### Responsibility for overseeing the Corporation

- 5.2 Responsibility for funding, monitoring and reviewing Corporations' activities was shared between the Department's headquarters and, initially, the relevant Regional Office of the then Department of the Environment, but from April 1994 with the relevant Government Office (in the case of Teesside, the Government Office for the North East). The Department was expected to gain awareness of Corporations' activities through the corporate planning process, in which Corporations set out their regeneration proposals over a rolling three-year programme, quarterly financial monitoring returns, monthly grant claims, review of Board minutes and regular liaison meetings.
- 5.3 The Director of Regeneration and, on occasion, the Regional Director at the Government Office liaised directly with the Corporation's Chief Executive and Chairman on an informal basis as and when required. Other Government Office staff met the Director of Finance and Chief Accountant to review expenditure plans, income forecasts and progress of the wind up. In 1988, the Chairman invited the head of the Government Office for the North East to attend Board meetings but he declined. Throughout the Corporation's lifetime, the Government Office and, from early 1997, the Department's Regeneration Directorate in London, received copies of Board papers and minutes, which they used to monitor the Corporation's strategy and commitments.
- 5.4 Other parts of the Department were also involved in monitoring the Corporation. The Department's Finance, Environment and Sponsored Bodies Division was responsible for the management and financial framework and budgeting for Urban Development Corporations as a whole. Its functions included responsibility for accounts and accountability and for

alerting the Department's Accounting Officer to matters of concern. The Department's Accountancy Advisor received copies of the Corporation's audited accounts and attended meetings with the Corporation's external auditors as an advisor to the Government Office. The Department's internal audit received copies of the Corporation's internal audit reports and reviewed them for Regeneration Directorate, providing feedback to the Directorate on the scope and sufficiency of the Corporation's internal audit work.

### The effectiveness of the Department's financial oversight

#### The Department's response to the Corporation's cash flow problems

- 5.5 The Department knew that the Corporation's regeneration programme was causing the Corporation cash flow problems from 1994 onwards. In June 1996, Price Waterhouse highlighted that the Corporation faced a shortage of funds in 1996-97 and sought assurance that the Department would make additional funds available to the Corporation, if necessary. The auditors' concerns stemmed from the Corporation's latest cash flow forecasts, which the Department had not seen.
- 5.6 Initially, the Department assumed that these forecasts were incorrect, believing the Corporation's finances to be sound. The Chief Executive told Regeneration Directorate that the Corporation might become insolvent if the judicial review of the proposed supermarket at Middlehaven, and a longstanding dispute with the Highways Agency over access roads, held up its proposals for the development of the Middlehaven site. Regeneration Directorate considered that the Chief Executive's reference to impending severe financial problems might be a tactic to get the Department to help resolve the impasse on these projects. The Department considered that the Corporation's budget and expenditure statements and cash flow forecasts prior to June 1996 showed a state of equilibrium. It took the view that, had there really been

a major impending crisis, the Chief Executive would have spelt this out to the Board and would have ensured that cash flow problems were a prominent feature in the Corporate Plan meeting with Ministers and the Department.

- 5.7 The Department responded to Price Waterhouse's concerns in June 1996, telling them that the Department could make additional funding available to the Corporation as necessary and that, because Corporations were "owned and controlled" by the Government, the Department would meet the Corporation's liabilities. In 1996-97 the Department, with Treasury approval, granted the Corporation additional funds of £2 million and made a corresponding reduction in its grant for 1997-98. In September 1997, the Department increased the Corporation's reduced grant for 1997-98 by an additional £1.9 million. The Department required the Corporation to provide regular detailed cash flow statements, which it used to monitor the Corporation's finances.

## Departmental awareness of the Corporation's approach to business

- 5.8 Departmental papers show that staff at the Government Office, Regeneration Directorate and in the Department's financial support teams were aware of the Corporation's approach to its business affairs from around 1991 onwards. The Government Office received quarterly returns from the Corporation, which showed that the Corporation disposed of most of its land and property by negotiated sale rather than through open competition. The Department was also aware that it was the Chief Executive who disposed of most of the Corporation's land and property holdings by negotiated sale. The Department did not seek explanations from the Board or the Chief Executive on this way of doing business, although the Development Corporation Guidebook stated open market competition as the preferred method of disposing of property. Nor did it query the Chief Executive's lead in both the negotiation of disposals, and in accepting deals and recommending their approval to the Board.
- 5.9 In each of their Management Letters from 1990-91 to 1997-98, Price Waterhouse drew attention to the Corporation's use of deferred payments and conditional development agreements. On several occasions, the Department wrote to the Corporation's Chief Executive or the external auditors seeking further information and, in one case, reminded the Chief Executive that deferred payment agreements were forbidden. The Department also became aware that the Corporation had entered into agreements without the necessary Departmental and Treasury approval, and had deferred payments to creditors. It was also aware that the Corporation was agreeing the terms of deals with, and making moral

commitments to, developers, contractors and other parties without approaching the Department for approval first. However, each time the Department accepted the Chief Executive's explanations and took no further action. The Corporation's Chairman told us that the Department did not share its concerns about the Corporation's financial management with the Board. Meetings with the Department had focused on delivering regeneration for Teesside.

## The Department's powers to intervene

- 5.10 The Department relied on the Board for assurance that the Corporation's activities were being properly governed, rather than invoke its more significant powers of intervention. These powers included:

### Reducing or removing a Corporation's delegated authority to approve projects

- Both of these steps would have increased the number of projects requiring approval, increasing the Department's workload and perhaps slowing down the pace of regeneration activity.

### De-designating a Corporation's Chief Executive as its Accounting Officer

- De-designation as Accounting Officer would have rendered the Chief Executive's position untenable, requiring a successor to be appointed. The Department did consider using this power immediately after the Corporation's wind up, but before its final dissolution in June 1998, as a mark of its disquiet at the Corporation's handling of its wind up.

### Removing a Chairman or Board member from office

- The Department had the power to remove Board members who were judged unable or unfit to discharge their responsibilities. The Department did consider not recommending the Corporation's Chairman for reappointment when his second term expired. It decided, however, not to object to his re-appointment. It did not consider strengthening the governance of the Corporation by making other changes to the Board, or by taking up the Chief Executive's offer early on in the Corporation's life to nominate a Department official to attend Board meetings.

- 5.11 The Department also had the power to commission an independent external audit of a Corporation, where it had doubts about the way in which a Corporation was managing its business affairs. The head of the team in Regeneration Directorate responsible for overseeing the

Corporation considered commissioning such an audit of the Corporation in July 1996. The Department told the Corporation's Chairman that, if it was not satisfied with the cash flow information provided by the Corporation, the Department would seek a full external audit of the Corporation's financial position. The Chairman told the Department that, if such a course of action were taken, he would reconsider his position as Chairman. The Department considered that it would not be helpful to undermine confidence on Teesside by precipitating the resignation of the Chairman and possibly other Board members. The Department therefore did not commission such an audit, and focused instead on easing the Corporation's immediate financial problems by increasing the Corporation's grant-in-aid and expenditure limits for 1996-97, and on monitoring the Corporation's cash flow information.

5.12 The Corporation commissioned Price Waterhouse to carry out five reviews of its progress in implementing its exit strategy at key intervals during the final year of the Corporation's life. With the knowledge of the Department and the Corporation, however, the auditors undertook only limited verification work, relying on information and explanations given to them by the Chief Executive and other Corporation officials.

## The Department's oversight of the Corporation's wind up

5.13 During the wind up period, the Government Office asked the Corporation to produce its wind up strategies, regeneration statements, risk assessments and evidence of progress on land disposals. Staff at the Government Office compiled some of these schedules themselves from the available information and used the data to challenge the Corporation to make progress.

5.14 In July 1996 the Government Office expressed concern about the Corporation's lack of progress with its preparations for wind up. The Government Office reviewed the Corporation's draft exit strategy and concluded that it might be inadequate to address major issues of concern. Information submitted to the Government Office by the Corporation showed that there were still some 300 hectares of land, including the International Nature Reserve, Middlehaven and Hartlepool Marina, awaiting disposal. This was inconsistent with the Chief Executive's assurances that there was very little land left. The Government Office also recognised that the Corporation was overly dependent on its Chief Executive, who was handling almost all of the key negotiations himself. The Chief Executive had not set finalisation dates for individual projects, making it difficult for the Government Office to track progress.

5.15 The Department considered that the Corporation's priorities were wrong after its immediate cash flow problems had been resolved in 1996. The Department expressed its concern to the Corporation that the Corporation was continuing to negotiate additional schemes with developers when it should have been readying itself for wind up. The Department also noted that the Chief Executive was reluctant to contemplate transfer of land to local authorities, even though Departmental guidance advised Corporations to discuss their exit strategies with local authorities. The Department told us that it had been so concerned by lack of progress on the disposal of the Tees Barrage and the need to put a Statutory Instrument in place to secure the transfer of powers and ownership of the Barrage, in particular, that it instigated close monitoring of progress in the latter months of the Corporation's life. The Department liaised directly with potential successor bodies to keep itself fully up to date with the progress of negotiations and to ensure that interim arrangements were made for the management of the Barrage after the Corporation's wind up.

5.16 In April 1997, the Department asked the Corporation for further information about its plans for wind up. In particular, as the Corporation had identified numerous pieces of land and property for transfer to the Commission for the New Towns, the Government Office reminded the Corporation that disposal to the Commission was a last resort and that the Corporation should seek to dispose of assets and liabilities to other bodies. The Corporation also needed to prepare detailed legal documents, known as Section 165 agreements, and obtain Departmental and Treasury consents, in order to transfer the Corporation's rights and liabilities to local authorities. The Government Office was concerned that the Corporation had under-estimated the time needed to do so.

5.17 In June 1997, the Department still did not know how much it was going to cost to settle the Corporation's liabilities. In addition, there was insufficient information on essential additional expenditure on administration, terminal bonuses, on-going regeneration projects and estates management. The Department earmarked an additional £10 million for 1998-99 to cover the cost of transferring the Barrage to another body after the Corporation's wind up because it was concerned that the Corporation might not leave the necessary funds for the dowry.

5.18 In the period before wind up, the Department discussed the Corporation's legacy with the Commission for the New Towns. In particular, the Department identified that the Commission would need more staff to handle the legacy, preferably operating from a dedicated office in the North East. The Department also responded by taking a more active role in monitoring the Corporation in the closing stages of wind up, involving direct contact

with the Corporation. The Government Office also adopted an even more rigorous approach in its dealings with the Corporation, closely monitoring the Corporation's cash flow and placing greater emphasis on the Corporation satisfying the requirements of the Development Corporation Guidebook.

## Retention of documents

5.19 We were unable to find key information such as marketing and disposal files and contract files with developers and contractors amongst the files left by the Corporation. The Development Corporation Guidebook stated that Corporations should be very cautious about destroying files unless they were sure that they would not be of use to the Commission or another body. It particularly highlighted that files and other records relating to Board meetings, projects, grant cases and acquisitions and disposals of land and property should be retained and should provide a clear audit trail to show when and by whom decisions were taken and payments were certified and authorised. The Guidebook pointed out that, in practice, probably the vast majority of files and other records were likely to be of continuing value after wind up.

5.20 However, the Department did not have a consistent policy on whether Corporations' papers were public documents subject to the requirements of the Public Records Act. For example, the papers of the London Docklands Development Corporation were covered by the Act, whilst Teesside Development Corporation's were not. Public bodies covered by the Act are required to retain all registered files for at least seven years for financial data and five years for other information. Teesside Development Corporation's files and other records did, however, become public documents under the Public Records Act when they passed to the Commission in April 1998.

5.21 The absence of any requirement for the Corporation to meet the strict provisions of the Public Records Act before wind up meant that the Corporation decided for itself which documents to retain, and which to destroy. The Corporation hired a shredding machine, which was openly placed in the office reception area for Corporation staff to use.

# Appendix 1

## Major lessons from the wind up of Leeds and Bristol Urban Development Corporations

In February 1997, in our report on the *Wind Up of Leeds and Bristol Urban Development Corporations* (HC 292, 1996-97), we highlighted lessons to be learnt for future winds up of Urban Development Corporations. In response, the Department issued a new chapter of the Urban Development Corporation Guidebook on securing the successful wind up of Corporations.

National Audit Office findings and recommendations	Requirements of the Guidebook
<p>In order to reduce the uncertainty about the long term maintenance of public assets, limited life bodies should, at the time decisions are taken to develop such assets:</p> <ul style="list-style-type: none"> <li>■ estimate the whole life costs of the asset;</li> <li>■ consider the future affordability of the proposed maintenance regime; and</li> <li>■ consult with the body likely to inherit the asset, where that is known.</li> </ul>	<p>When developing assets, Corporations should:</p> <ul style="list-style-type: none"> <li>■ establish the whole life costs of the asset;</li> <li>■ consider the future affordability of the proposed maintenance regime; and</li> <li>■ consult with the body most likely to inherit the asset.</li> </ul>
<p>Corporations should provide the Department or residuary body with a regularly updated risk assessment which:</p> <ul style="list-style-type: none"> <li>■ examines the likelihood of wind up tasks not being completed;</li> <li>■ proposes corrective action; and</li> <li>■ identifies possible strategies for managing any outstanding tasks.</li> </ul> <p>This should enable the Department or any residuary body to develop a contingency plan for managing, staffing and funding any unfinished business.</p>	<ul style="list-style-type: none"> <li>■ Corporations should produce a risk assessment by February 1997 and update it at least every two months.</li> <li>■ Exit and succession strategies must include full descriptions of how projects will be brought to a conclusion and how, when and to whom assets and liabilities will be disposed of.</li> </ul>
<p>Both Leeds and Bristol Development Corporations maintained the regeneration momentum by awarding grants and issuing contracts to improve the infrastructure of their respective urban development areas during wind up.</p>	<p>Finances permitting, Corporations should strike a suitable balance between the desire to continue regeneration and the need to achieve a tidy wind up by:</p> <ul style="list-style-type: none"> <li>■ limiting new projects to those which can be completed within its lifetime or be handed over readily to a willing and suitable successor;</li> <li>■ avoiding financial liabilities which cannot be readily transferred to another body, or arranging for these to terminate before windup; and</li> <li>■ avoiding the acquisition of leases extending beyond the Corporation's lifetime.</li> </ul>
<p>The designated residuary body for Corporations winding up in March 1998 is the Commission for the New Towns. However, as the Commission itself is a short life body, Corporations should make suitable long-term succession before wind up.</p>	<p>As the Commission for the New Towns will have only a relatively short life, it is not a suitable home for matters requiring a long-term solution. The Commission should not be left with public assets requiring long-term maintenance and will not be able to take on the task of completing unfinished projects.</p>
<p>Bristol Development Corporation handed over more than 100 incomplete tasks to the Department at the end of its life.</p>	<p>The Commission is to be viewed as a home of last resort for those few residual assets and liabilities for which there is no alternative successor. Corporations should consider alternative courses of action to resolve issues which might go beyond March 1998.</p>
<p>Bristol Development Corporation failed to leave its successor with sufficient funds to cover expected liabilities.</p>	<p>Corporations should ensure that provision is made for successor bodies to meet the costs of handling bequeathed liabilities.</p>

National Audit Office findings and recommendations	Requirements of the Guidebook
<p>Corporations should help maintain regeneration by consulting widely on future regeneration possibilities for the area and by paying more attention to the transfer of knowledge on the development opportunities provided by individual sites.</p>	<p>To assist in maintaining the continuity of regeneration, Corporations should produce a regeneration statement to transfer to their successors knowledge of their areas and of the development opportunities presented by individual sites.</p>
<p>Corporations should ensure that their document storage and retrieval systems are of a high standard and left in good order to facilitate access after wind up by the Department and other bodies. In particular, Corporations should exercise great care to ensure that files on sensitive issues are not destroyed and that, after wind up, reliable records are available.</p>	<p>Files and other records which may be of use to the Commission or other bodies should be retained, including those relating to:</p> <ul style="list-style-type: none"> <li>■ Board meetings;</li> <li>■ projects;</li> <li>■ grant cases;</li> <li>■ acquisitions and disposals of land and other property; and</li> <li>■ management of buildings.</li> </ul> <p>Files should show when and by whom decisions were taken and payments made.</p>



# Appendix 2

## Concerns about Teesside Development Corporation's business affairs

Concern	National Audit Office findings
The Corporation had an arrangement with British Linen Bank (a subsidiary of the Bank of Scotland) and private developers, which enabled the Corporation to circumvent borrowing restrictions.	The Corporation and contractors put in place arrangements with banks that allowed the Corporation to defer payments to contractors, contrary to the rules of Government Accounting (paragraph 2.17, Cases B, C, D and E and paragraph 2.18).
The Corporation had operated a secret bank account.	The National Audit Office found no evidence that the Corporation operated a secret bank account.
There had not been any tendering for the disposal of land and property during the wind up of the Corporation, resulting in "fire sales" at knock-down prices well below the estimated valuation of the land and property.	Most of the land disposals completed by the Corporation during the final two years of its life were by negotiated sale rather than by open market competition. The National Audit Office identified four cases where the Corporation disposed, or arranged disposal, of land apparently at below regeneration value, resulting in a possible shortfall of at least £4 million (paragraphs 2.28 to 2.32).
The Corporation had made payments to contractors for decontaminating the site for Middlesbrough Football Club's BT Cellnet Riverside Stadium, but the site was not subsequently de-contaminated or was not contaminated in the first place.	The Corporation's chartered surveyors valued the site at £1 in May 1997, based on the Corporation's instructions to value the site as contaminated, un-reclaimed and only partly serviced, requiring £8 million of reclamation, decontamination and infrastructure work. By then, however, the reclamation and infrastructure work had already been completed, funded by the Corporation, and the Stadium had been open since 1995 (paragraph 2.32, Case B).
There had been double counting of the Riverside Stadium as an asset in both the Corporation's, and the Football Club's, accounts.	The Corporation granted Middlesbrough Football and Athletic Club a long lease on its new stadium. The Corporation retained the freehold to the land, which it showed in its 1997-98 accounts at nil value. The Football Club showed the leasehold in its accounts (paragraph 2.32, Case B). There was therefore no double counting of the stadium between the Corporation's, and the Club's, accounts.
The Corporation had paid City Grant to a developer in advance of need and the developer had misused the Grant.	English Partnerships is satisfied that the grant was used for the purposes provided.
The Corporation had sought to establish an international nature reserve during the last year of its life, with Board members as trustees, and to finance this by selling clay extraction rights to a local company at less than best price.	The Corporation set up the Teesside Environmental Trust to run the International Nature Reserve. Corporation Board members were among the trustees of the Trust until May 1999. The Corporation granted a firm conditional rights to extract clay from the site of the Nature Reserve, which would generate income for the Trust. The Corporation had agreed in principle with the Church Commissioners, the owners of the clay extraction rights, that the Commissioners would be prepared to grant the Trust the right to remove and sell clay from the site in return for one-third of the income generated. The National Audit Office found no evidence that the Corporation proposed to sell the clay extraction rights at less than best price.
Steel pilings purchased for a planned Tall Ships Centre at Hartlepool had been transferred to a private company for free when this project had not gone ahead.	At their last operational meeting on 20 March 1998, the Corporation's Board approved the payment of £3.2 million towards the cost of the Tall Ships Centre at Hartlepool, committing the Commission to pay these monies after the wind up of the Corporation. However, the Commission refused to pay anything to the developer because the developer had used steel pilings paid for by the Corporation and originally intended to strengthen the dock wall at Middlesbrough, for other purposes (paragraph 3.8, Case A).

Concern	National Audit Office findings
<p>The Corporation had hired two industrial shredding machines to shred many documents during wind up. In particular, the Chief Executive and his secretary had the only keys to a room which housed one of the shredders, allowing him to shred documents in secret.</p>	<p>We were unable to find key information such as marketing and disposal files and contract files with developers and contractors amongst the files left by the Corporation. The Corporation's papers were not covered by the Public Records Act, which requires all registered files to be retained for at least seven years for financial data and five years for other information. The Corporation was therefore able to decide for itself which documents to retain, and which to destroy. The Corporation hired a shredding machine, which was openly placed in the office reception area for Corporation staff to use (paragraphs 5.19 to 5.21).</p>

# Appendix 3

## Former Teesside Development Corporation Board members and officials consulted by the National Audit Office

### Former Board members of Teesside Development Corporation

Sir Ronald Norman OBE, Chairman of the Board

Lord Dormand of Easington, Deputy Chairman

Mr Ian Mathieson, Chairman of audit committee

Mr Alexander B Anderson

Mrs Susan Bush

Mr Michael Carr

Mr Alan Cherry MBE

Lady Eccles of Moulton

Mr Bryan Hanson OBE

Mr Roger Kingdon CBE

Mr John Sutcliffe CBE

Mrs Joan Wade

### Former officials of Teesside Development Corporation

Mr Duncan Hall, Chief Executive

Mr Douglas Ross, Director of Finance and Administration

Mr Ian Watt, Director of Development

Mr John Ardron, Chief Accountant

Mr David Dawson, Chief Internal Auditor

Mr Tony Devine, Assistant to Chief Executive

Mr Paul Jackson, Projects Officer

# Appendix 4

## Valuation assumptions used by the District Valuer

The District Valuer based his conclusions on a desk top appraisal of each site. No inspections were undertaken and the District Valuer relied on information provided by the National Audit Office (NAO), local office records and his local knowledge. No additional research was undertaken.

The District Valuer had sight of the previous disposal valuations undertaken on behalf of the Teesside Development Corporation. He was instructed to adopt the assumptions and statements in those reports relating *inter alia* to tenure, tenancies, planning permissions, covenants and restrictions, contamination, ground conditions and mining.

The District Valuer appraised the sale prices of the sites by reference to Open Market Value (as defined in the Royal Institution of Chartered Surveyors' (RICS) Appraisal and Valuation Manual) but with the proviso that they would reflect no higher value than that to be derived from the planning permission granted in respect of each property. He thus reflected the planning permission granted for each site but did not have regard to any possible higher value uses.

The definition of Open Market Value in the RICS Appraisal and Valuation Manual is as follows:

'An opinion of the best price at which the sale of an interest in property would have been completed unconditionally for cash consideration on the date of valuation, assuming:

- a) a willing seller;
- b) that, prior to the date of valuation, there had been a reasonable period (having regard to the nature of the property and the state of the market) for the proper marketing of the interest, for the agreement of the price and terms and for the completion of the sale;
- c) that the state of the market, level of values and other circumstances were, on any earlier assumed date of exchange of contracts, the same as on the date of valuation;
- d) that no account is taken of any additional bid by a prospective purchaser with a special interest; and
- e) that both parties to the transaction had acted knowledgeably, prudently and without compulsion'.

It should be noted that the valuations and appraisals provided by the District Valuer might be subject to significant alteration if further details were provided or different assumptions relating to the various sites were adopted.