

December 2005/48

**Good practice**

Guidance for governors and senior managers

Higher education institutions set up related companies for a variety of reasons to help them manage their activities efficiently and flexibly.

This guide outlines the issues and risks associated with assurance, compliance and accountability that are faced by institutions when using related companies. The guidance is not prescriptive, but a tool for institutions to use as they think fit.

# **Related companies: guidance for higher education institutions**

**Produced for the UK funding bodies by  
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# Contents

Section	Page
1 Executive summary	2
2 Introduction	5
3 Risk assessment guidance	10
4 Activities and entities for related company activity	30
5 Checklists	36
Acknowledgements	53
Glossary of terms	55
<b>Appendices (separate file on the web at <a href="http://www.hefce.ac.uk">www.hefce.ac.uk</a> under Publications)</b>	
Appendix I – Duties of the Nominated Officer	58
Appendix II – Nominated Officer's report	59
Appendix III – Duties of companies' officers	66
Appendix IV – Contents of key documents	69
Appendix V – Specimen memorandum of understanding	74
Appendix VI – Outline business plan	78
Appendix VII – Protection and exploitation of technology and intellectual property rights	97

# 1 Executive summary

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## Introduction

1. Institutions set up related companies for a variety of reasons: for example to carry out commercial activities, to provide a focus for commercial enterprise in a culture different from that of the institution itself, or to protect the institution's charitable status and/or provide advantageous tax or estate planning. Increasingly, related companies are also being used to commercially exploit intellectual property.
2. Related companies provide institutions with opportunities to manage their business efficiently and with a degree of flexibility and varying involvement. However, the use of related companies also exposes institutions to a number of risks.
3. This guidance has been produced by RSM Robson Rhodes for HEFCE, on behalf of the UK higher education funding bodies, to outline the assurance, compliance and accountability issues and risks faced by institutions in the use of related companies.
4. In line with the principles of better regulation, the guidance is not prescriptive. It is a tool for each institution to choose to use and adapt, as it feels appropriate, in accordance with its own objectives, priorities and assessment of risk.

## Background

5. In 1995 HEFCE commissioned RSM Robson Rhodes to conduct a study of related companies operating within the higher education sector, and to produce guidance for the sector in the form of recommended practice guidelines. In 1999 HEFCE commissioned RSM Robson Rhodes to review how the guidelines had been used and whether they could be improved. Updated guidelines (HEFCE 00/58) were subsequently published in December 2000 (available on the web at [www.hefce.ac.uk](http://www.hefce.ac.uk) under Publications).
6. Against a background of a fast-changing environment for related companies in higher education, HEFCE commissioned RSM Robson Rhodes to update the guidance. In particular, the guidelines now take into account new and emerging risks, the differing objectives and activities of related companies, and consider a wider definition of related company (body). The legal content of these guidelines has been reviewed by Eversheds LLP.
7. A consultative approach was adopted to develop the guidance: RSM Robson Rhodes held telephone interviews with 23 higher education institutions to ascertain the sector's views on the usefulness of previous guidance and requirements from the updated guidance. Site visits to six of these institutions were subsequently conducted to explore in more detail the institution's approach to related company activity.
8. The development of the guidance was overseen by a steering committee of representatives from the sector and from each of the funding bodies.

## Key elements of the new guidance

### **Risk assessment guidance**

9. The key objective was to assist institutions in identifying risks and opportunities that are specific to related companies in achieving the institution's strategic objectives.

10. Central to this new risk-based approach, and where the guidance differs significantly from previous versions, is the risk assessment guidance (Section 3).

11. It is important that institutions are able to define, evaluate, monitor and where necessary take action to ensure that opportunities are maximised whilst risks are mitigated to an acceptable level. Each institution will have its own risk management framework and processes.

12. The risk assessment guidance seeks to provide a working tool for managers in mapping key related company risks, to supplement institutions' own risk management processes. The guidance addresses the most likely strategic risks, which should be considered and understood by all senior management of the institution; and the most likely operational risks relating to each strategic risk, which should be considered and used by operational management as needed.

### **Activities and entities for related company activity**

13. Consultation with the sector provided evidence that knowledge of the types of related companies available to institutions was varied. It also showed that some institutions were undertaking related company activities without consulting the guidance, because they believed that the type of activity or organisation was not covered by the guidance.

14. Whilst the guidance cannot provide an exhaustive list of activities which should be deemed related company activity, Section 4 does define a number of entities which may be considered to be related companies or whose attributes are similar to those of related companies. This section also details the key advantages, disadvantages and risks associated with each of these entities.

### **Checklists**

15. The related company checklists have been a feature of these guidelines from the start. Consultation with the sector in 2000 and again during 2004 found that institutions were using the checklists to varying extents. Some used the checklists in full, some incorporated elements within their own procedures, and some used the checklists for reference only. However, it was widely felt that the checklists were a useful tool in the management of related company activity.

16. The guidelines are now risk based, and their use should be driven by the risk assessment guidance. However the checklists have been retained in order to provide additional information and best practice once institutions have determined their key risks.

## Using the new guidelines

17. These guidelines will be relevant, at least in part, to all members of the board and management of each institution and of its related companies: their implications should be considered at all relevant committee and management meetings.

18. As a minimum the following key strategic risks identified within these guidelines should be considered by all institutions:

- the institution may not have a clear strategy for the use and development of related companies and/or other entities;
- the institution may not have due regard for the issue of public accountability;
- institutional governance structures do not reflect the appropriate level of influence over related companies;
- the institution does not identify and evaluate all potential commercial opportunities in line with an agreed strategy;
- the formation of a related company (or other commercial entity) may not be properly planned and controlled; and
- the related company's performance may not meet its budget and objectives.

19. The guidelines are layered in structure. Those responsible for the strategic direction of the institution as a whole, for example the Vice Chancellor, may read only the executive summary and the introduction to gain an understanding of the key strategic risks and considerations; whilst the entire guidelines may be relevant to those involved in the day to day operation of the related company activity.

20. The implementation of the guidelines should be through each institution's own risk management framework. This should ensure that the guidelines are introduced at an appropriately senior and diverse level to ensure sufficient ownership and accountability.

## 2 Introduction

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### Introduction

#### **The higher education funding bodies**

21. In 1992 Funding Councils were established in England (HEFCE), Scotland (SHEFC) and Wales (HEFCW) to administer public funds for the provision of teaching, research and related activities in higher education institutions (HEIs). In Northern Ireland there is no funding council and institutions are directly funded by DELNI.

22. One of the funding bodies' key objectives is to promote the efficient use of institutional assets and effective accountability for public funds, whilst recognising the autonomy of institutions.

23. Accordingly in 1995 HEFCE commissioned RSM Robson Rhodes to conduct a study of related companies operating within the higher education sector, and to produce guidance for the sector in the form of recommended practice guidelines. These guidelines were updated in 2000 (see HEFCE 00/58) and now in 2005.

24. All four funding bodies have participated in the original and/or follow-up studies, and are partners on the steering committee for developing this updated guidance. The guidelines are therefore intended to be of use to all publicly-funded HEIs, and reference to HEFCE within these guidelines should be taken to refer to any of the higher education funding bodies.

#### **Institutions**

25. HEIs are legally independent bodies (usually corporate), which have a common charitable purpose of providing education and, in most cases, undertaking research. They are accountable through their governing bodies, which carry ultimate responsibility for all the affairs of the institution.

26. The constitutions and powers of HEIs are extremely diverse and may (depending upon the type of institution) be laid down in, for example, the Royal Charter and statutes of the institution, or in the Education Reform Act 1988 (as amended by the Further and Higher Education Act 1992), together with the instruments and articles of government.

27. Members of governing bodies (governors) act in a fiduciary capacity and must act in the best interests of the institutions they govern. In certain circumstances, for example if they act negligently, they may face personal liability for loss.

28. Not all institutions have the power to set up related companies or the power to set up all types of related company; in addition, some of the proposed activities of such companies may not be directly in accordance with the institution's constitution. Governors should seek proper advice on all aspects of proposed projects.

29. More detail on the responsibilities of institutions may be found in the 'Guide for members of higher education governing bodies in the UK' (Committee of University Chairmen, HEFCE 2004/40).

## Related companies

30. Institutions set up related companies for a variety of reasons. Historically, most related companies were set up to carry out commercial activities, which may protect the institution's charitable status and incidentally provide advantageous tax or estate planning; to provide a focus for commercial enterprise in a culture different from that of the institution itself; or as a means of conducting joint ventures.

31. Increasingly, however, related companies are being established to commercially exploit intellectual property. The activities of related companies can vary considerably. Some take advantage of specialist skills by selling training and consultancy expertise; others exploit the commercial potential of research and intellectual property. Some retain ownership of activity and intellectual property, whilst others attract private funders to share in the risks and rewards of ventures which institutions may not otherwise be able to fund.

32. Some institutions are now experienced in generating commercial income from spin-out companies or the licensing of intellectual property, whilst many others are actively developing mechanisms for this purpose.

33. UK HEIs are making a growing contribution to the number of companies being spun-out for commercial purposes worldwide; however, to date only a small proportion of these companies have become profitable. Work by the Economic and Social Research Council<sup>1</sup> suggests that the poor success rate is a symptom of a lack of academic commitment to spin-outs, a lack of clear structure to spinning-out the company, and a lack of seed funding to conceptualise inventions.

34. The Government has a clear agenda to promote UK science and technology through HEIs, and has highlighted the successes of several institutions and centres of excellence. Regional Development Agencies have played a role by providing funding for science and technology incubator centres. However, the Government is also conscious of the lack of consistent control and regulation of spin-outs and poor success rates. It has recently been criticised from within the sector for demanding more detailed business plans from academics applying for commercial funding.

35. By establishing a related company to undertake a commercial activity, an institution may be able to ensure that its powers are not exceeded, that its legal duties (specifically under the law relating to charities) are not breached, and that its governors reduce the risk of personal liability.

36. By carrying out activities through a company it may be possible to limit liabilities which may arise, for example, through negligence or breach of contract. However, in certain circumstances (particularly where the institutional "parent" exercises a high degree of control), limited liability may not fully protect the institution. In those circumstances, individual directors of the related company who are also institutional employees or governors (or individuals who may be deemed to be performing or instructing the role of a director i.e. shadow directors) may face personal liability. This may occur where an institution continues to nurture a related company beyond the point of failure. Likewise the institution may be at risk of reputational damage by virtue of its association with the related company (regardless of ownership). In each case, proper professional advice should be sought and risk management

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<sup>1</sup> The Economic and Social Research Council is the UK's leading research funding and training agency addressing economic and social concerns, and providing research on issues of importance to business, the public sector and government.

processes invoked, both at the preliminary consideration stage and at subsequent stages where problems may arise.

## Background

### **A changing environment**

37. As a consequence of the changes occurring within the sector and in particular the changing face of related company activity, these guidelines have been updated to take into account new and emerging risks, the differing objectives and activities of related companies, and to consider a wider definition of related company (body) than hitherto. For example they take account of joint venture arrangements, new forms of legal entity, private provision and connected institutions, where a different entity is used but the risks are similar to those of related companies (defined as any legal entity over which the institution has control or exercises a substantial degree of influence in relation to that company's activities).

38. The way institutions choose to use related companies will result in a number of different issues and risks arising. The purpose of related companies or similar entities, the method of regulation and control, and the use of institutions' officials as directors or shadow directors are all matters deserving careful consideration.

39. This guidance therefore focuses on the assurance, compliance and accountability issues and risks faced by institutions. In particular it addresses:

- the differing purpose/objectives of related companies, for example protection of charitable status, tax planning, income generation, knowledge transfer, or educational provision;
- the degree of influence and control and accountability exercised by the institution, and the degree of decentralisation/autonomy enjoyed by the related company;
- the complexity of legal status structures, arrangements, and shareholdings;
- audit access;
- consolidation within the institution's accounts;
- intellectual property (licensing);
- managing conflicts of interest;
- degree of risk to institutions (significant losses or reputational impact); and
- ensuring proper accountability.

### **Review of current related company activity**

40. Best practice guidance can only be effective in the management of an institution's activities if it is derived from a thorough understanding of the issues involved, and the current level and nature of activity in the sector.

41. The approach taken by RSM Robson Rhodes in conducting a review of current activity included:

- an initial desktop review of all reported activity by related companies within the sector;
- interviews with representatives of 23 HEIs, based on a short and focussed questionnaire. The purpose of these interviews was to gain a greater understanding of the level and nature of related



company activity, how this is managed by the institution, and how previous guidance has been applied (participating institutions are listed in the Acknowledgements); and

- site visits to six of these HEIs to explore in detail the institution's approach to related company activity, the management of this activity, and the risks and concerns encountered by both the institution and the related company.

42. The findings of this work informed the update of this guidance, and were instrumental in enabling the production of the risk assessment guidance (Section 3) and the analysis of activities and entities for related company activity (Section 4).

43. The risk assessment guidance should be used as the starting point for applying the guidelines. It comprises two tables, and advice on how to use them. Table 1 details possible strategic risks to the organisation and will be most useful to governors and senior management. Table 2 provides a more detailed mapping of possible operational risks relating to each of the strategic risks mentioned in Table 1.

### Entity considerations

44. New activities undertaken by institutions can be packaged, monitored and controlled in a number of different ways by using different types of entity, each with their own set of risks and opportunities. Institutions should give careful consideration to choosing the most appropriate entity for the activity they are undertaking.

45. The activities considered within these guidelines (although not an exhaustive list) are as follows:

- subsidiary company;
- associated company;
- spin out company;
- joint venture; and
- licensing.

46. The types of legal entity which could be a related company under these guidelines include:

- private company limited by shares;
- public company limited by shares;
- company limited by guarantee;
- unlimited company limited by shares;
- limited partnership;
- limited liability partnership;
- European Economic Interest Grouping (and other legal entities current or proposed by the EU);
- industrial and provident society;
- community interest company;
- charitable incorporated organisation (if enacted in the Charities Bill currently before Parliament); and
- interests in foreign legal entities.

47. They could also encompass unincorporated arrangements such as trusts, partnerships and unincorporated associations.

48. Section 4 gives further guidance on the use of the most commonly used entities and the typical risks and opportunities associated with each. However the institution's unique activities will be the key driver of the level of risk and opportunity offered by any particular entity. An unlimited company limited by shares is only rarely used and is not considered further in these guidelines. Institutions should always seek professional advice in choosing the most appropriate entity.

### Risk/opportunity considerations

49. Activities undertaken through related companies or similar entities will carry with them a number of risks and opportunities relevant to the achievement of the institution's strategic objectives. It is important that institutions are able to define, evaluate, monitor and where necessary take action to ensure that opportunities are maximised whilst risks are mitigated to an acceptable level.

50. The risk assessment guidance in Section 3 aims to assist institutions in identifying and mapping these key risks and opportunities.

## 3 Risk assessment guidance

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### Introduction

51. Activities undertaken through related companies or similar entities will carry with them a number of opportunities as well as risks to achieving the institution's strategic objectives. It is therefore important that institutions are able to define, evaluate, monitor and where necessary take action to ensure that opportunities are maximised whilst risks are mitigated to an acceptable level.

52. Each institution will have its own risk management framework and processes. It should ensure that these processes cover all risks and opportunities (not just financial), and cover all the institution's activities (including those by related companies). Guidance to institutions on general risk management has been produced by HEFCE (HEFCE 2005/11).

53. The tables in this section therefore seeks to assist institutions in identifying and mapping the key risks and opportunities that typical of related companies and similar ventures.

### Using the tables

54. Each institution will be operating in a different risk environment and with differing objectives, so the risks to each institution achieving their objectives will not be the same. The common key risks in this guidance should therefore not be taken to be an exhaustive list of potential risks.

55. Table 1, the strategic risk matrix, outlines the common key strategic risks associated with related company activity, based upon examples of objectives from the sector. A risk assessment should in all cases begin with mapping the risks against an institution's agreed corporate objectives. Against each illustrated risk are the potential consequences, key risk activities and controls, and the typical risk owners and stakeholders. (Note that the stakeholders' job titles and role may differ from those used in your institution.)

56. For each of the strategic risks listed in Table 1, there is a more detailed operational risk matrix in Table 2. This details sub-risks and triggers to each strategic risk, and key controls, activities and assurances in place. Table 2 also supplies a checklist reference, cross-referencing risks to particularly relevant checklists in Section 5 or to the Appendices.

### 3 Table 1 - Strategic risk matrix

Risk	Related objective	Potential consequences	Key risk activities and controls	Risk owner	Stakeholders
<p><b>1. The institution may not have a clear strategy for the use and development of related companies and/or other entities.</b></p>	<p>Institution strategies and policies support the achievement of the institution's corporate plan</p>	<ul style="list-style-type: none"> <li>a) Corporate plan objectives are not delivered.</li> <li>b) Commercial opportunities are not developed in line with institution's agreed strategy.</li> <li>c) Resources are not efficiently and effectively directed towards the achievement of the strategy.</li> </ul>	<p>Strategic planning process ensures the alignment of supporting strategies to the corporate plan objectives through annual monitoring and periodic 'fit for purpose' review.</p> <p>Process of venture identification includes confirmation of alignment to strategy.</p> <p>Institutional strategy includes an assessment of resource mix and skills required to achieve identified objectives.</p>	<p>Head of institution</p>	<p>Governing body; finance committee; and senior management team.</p>

**Table 1 Strategic risk matrix (continued)**

Risk	Related objective	Potential consequences	Key risk activities and controls	Risk owner	Stakeholders
<p><b>2. The institution may not have due regard for the issue of public accountability.</b></p>	<p>The institution complies with the regulatory framework.</p>	<p>a) Non-compliance with regulatory framework, e.g. funding body, employment, tax, health and safety or other legal obligations.</p> <p>b) Inappropriate selection of entity leads to ineffective or inefficient exploitation of identified commercial or other opportunity.</p> <p>c) Inadequate audit and assurance framework to support the draw-down of agreed funding streams.</p> <p>(d) As a result of (a) or (c), unplanned or unknown financial and/or non-financial liability, including reputational damage, accrues to the institution.</p>	<p>a) Development process for the commercial venture includes consultation with regulatory advisors.</p> <p>b) Development process for the commercial venture includes evaluation of exploitation of opportunities.</p> <p>c) Process for company formation includes:</p> <p>(i) agreement of contract and service levels; and</p> <p>(ii) identification and agreement of audit and assurance framework.</p>	<p>Institution's secretary</p>	<p>Governing body; finance committee; audit committee; head of institution; and director of finance.</p>

**Table 1 Strategic risk matrix (continued)**

<b>Risk</b>	<b>Related objective</b>	<b>Potential consequences</b>	<b>Key risk activities and controls</b>	<b>Risk owner</b>	<b>Stakeholders</b>
<b>3. Institutional governance structures do not reflect the appropriate level of influence over related companies.</b>	The institution complies with the regulatory framework.	<p>a) Inefficient/ineffective commercial activity planning and review framework.</p> <p>b) Undue or insufficient influence, including through shadow directorships.</p> <p>c) Inefficient or ineffective use of resources.</p>	<p>(a) Institution's governance structure supports a balanced assessment of each commercial opportunity, which informs investment decisions.</p> <p>(b) Process of venture development includes the appointment, where appropriate, of Nominated Officer and company board.</p> <p>(c) Process for venture formation identifies company governance framework and investment by the institution.</p>	Institution's secretary	Governing Body; audit committee; head of institution; nominated officer; and company chief executive.
<b>4. The institution does not identify and evaluate all potential commercial opportunities in line with its agreed strategy.</b>	The institution's related company strategy supports the achievement of the institution's corporate plan.	<p>Commercial opportunities are not optimised based upon the institution's agreed strategy.</p> <p>Resources are not efficiently and effectively directed towards the achievement of the strategy.</p> <p>Unviable or high risk investments are progressed at unnecessary financial or reputation cost to the institution.</p>	<p>(a) Operational arrangements within the institution ensure the identification and balanced evaluation of commercial opportunities within the context of the agreed strategy.</p> <p>(b) Institutional strategy includes an assessment of the resource mix and skills required to achieve identified objectives.</p> <p>(c) Evaluation process for the commercial venture includes assessment of a possible exit strategy.</p>	Head of commercial activities	Governing body; finance committee; and head of institution.

**Table 1 Strategic risk matrix (continued)**

Risk	Related objective	Potential consequences	Key risk activities and controls	Risk Owner	Stakeholders
<p><b>5. Formation of the related company (or other commercial entity) formation may not be properly planned and controlled.</b></p>	<p>The institution complies with the regulatory framework.</p>	<p>a) Poor selection of investment opportunity.</p> <p>b) Inappropriate choice of commercial entity.</p> <p>c) Poor governance structures leading to: regulatory non-compliance; and/or professional or commercial conflicts of interest.</p> <p>(d) Unviable investments are sustained and/or exit strategies are not implemented on a timely basis.</p>	<p>(a) Operational arrangements within the institution ensure the identification and balanced evaluation of commercial opportunities within the context of the agreed strategy.</p> <p>(b) Development process for the commercial venture includes evaluation of choice of entity.</p> <p>(c) Commercial venture development process includes: consultation with regulatory advisors; and appointment, where appropriate, of Nominated Officer and company board.</p> <p>(d) Process for formation of commercial venture includes agreement of exit strategy.</p>	<p>Head of institution</p>	<p>Governing body; finance committee; head of institution; nominated officer; company secretary; and company chief executive.</p>

**Table 1 Strategic risk matrix (continued)**

Risk	Related objective	Potential consequences	Key risk activities and controls	Risk owner	Stakeholders
<p><b>6. The related company's performance may not meet its budget and objectives.</b></p>	<p>The institution achieves its planned financial performance.</p>	<p>a) Corporate plan objectives are not delivered.</p> <p>b) Planned financial contributions to the institution are not achieved.</p> <p>c) Ineffective use of institution's resources.</p>	<p>a) Process for forming the commercial venture includes agreement of:</p> <p>financial and non-financial performance targets;</p> <p>performance reporting methods;</p> <p>timetable for deliverables; and</p> <p>non-performance exit strategy.</p>	<p>Company chief executive</p>	<p>Governing body;</p> <p>finance committee;</p> <p>head of institution;</p> <p>nominated officer; and</p> <p>head of commercial activities/director of finance.</p>



## Table 2 - Operational Risk Matrix

Trigger	Risk management activities and controls	Sources of assurance	Checklist ref
<b>Strategic risk 1: The institution may not have a clear strategy for the use and development of related companies and/or other commercial entities.</b>			
Strategy has not been produced and approved by the governing body.	<p>Strategic lead appointed to drive the development of the strategy.</p> <p>Strategic planning process includes production and review of supporting strategies to the corporate plan.</p> <p>Board and committee annual timetable includes agenda items for the approval of the commercial development strategy.</p>	<p>Management structures, job descriptions, annual objectives and appraisals.</p> <p>Presentation of strategy to board.</p> <p>Timetable of board and committee business.</p>	A
Poor awareness of the strategy amongst relevant staff.	<p>Communication arrangements may include:</p> <ul style="list-style-type: none"> <li>dedicated resource</li> <li>embedding consideration of commercial opportunities into the planning cycle</li> <li>internal marketing</li> <li>intranet site</li> <li>training for relevant staff.</li> </ul>	<p>Staff feedback at planning cycle evidences awareness.</p> <p>Evidence of marketing material.</p> <p>Levels of use of intranet site.</p> <p>Training records.</p> <p>Annual commercial activity report to the governing body and the head of institution.</p> <p>Independent assurance reports.</p>	C
Resources are not available to support the implementation and achievement of the strategy.	Institutional strategy includes an assessment of resource mix and skills required to achieve identified objectives	Presentation of strategy to board.	A
The governing body does not periodically review, challenge or approve an institutional strategy for commercial opportunities.	Periodic management or independent review.	Annual commercial activity report to the governing body and the head of institution. Independent assurance reports.	C, D

**Table 2 - Operational risk matrix (continued)**

Trigger	Risk management activities and controls	Sources of assurance	Checklist ref
<b>Strategic risk 2: The institution may not have due regard for the issue of public accountability.</b>			
The institution is not aware of public accountability issues through a poor understanding of the regulatory framework, including funding council legislation, taxation, legal and other audit requirements.	Specialist advisors held on retainer. Relevant officers, for example Nominated Officer, are empowered to obtain necessary advice.	Outline and detailed business plans include consideration of public accountability issues and confirmation of consultations.	B  Appendix VI
Policies and procedures do not support compliance with regulatory framework.	Responsibility for production and control of policies and procedures clearly delegated to a named officer.	Ongoing review by management to the governing body.  Periodic independent assurance to the audit committee.	B, C, D  Appendix I
Insufficient skills are available to the institution to identify and evaluate identified opportunities in the context of: ethical responsibilities corporate and social responsibility issues statutes and other regulations, related to for example: – funding body – taxation – employment financial issues other academic priorities, for example research.	Institution policies and procedures require the need to consider these issues.  Relevant officers, for example Nominated Officer, are empowered to obtain necessary advice.	Outline and detailed business plans include consideration of public accountability issues and confirmation of consultations.	B  Appendices I, VI

**Table 2 – Operational Risk Matrix (continued)**

Trigger	Risk management activities and controls	Sources of assurance	Checklist ref
<b>Strategic risk 2: The institution may not have due regard for the issue of public accountability (continued).</b>			
<p>There is a poor understanding of the commercial entity options available, for example:</p> <ul style="list-style-type: none"> <li>related company</li> <li>joint venture</li> <li>partnership</li> <li>internal development</li> <li>spin out etc.</li> </ul>	<p>Training and guidance is available for relevant staff.</p> <p>Access to and membership of relevant peer groups and working parties.</p> <p>Institution policies and procedures require assessment of entity options.</p>	<p>Training records.</p> <p>Communication of outcomes and evidence of inclusion of issues on board and other reports.</p> <p>Outline and detailed business plans include evaluation of entity options.</p>	<p>A</p> <p>Appendix VI</p> <p>Section 2</p>
<p>The framework for decision making is unclear or inconsistently applied.</p>	<p>All opportunities are logged with the strategic lead.</p> <p>The evaluation process is clearly documented and predicated on key indicators, for example investment need, time to realisation, likely outcome, availability of funding, other potential uses.</p> <p>Evaluation reports and business cases must include key evaluation material to provide for balanced assessment.</p> <p>Decisions are documented and include the assumptions upon which the decision has been made.</p>	<p>Central tracker of options.</p> <p>Documented procedures.</p> <p>Evaluation reports and business case documents.</p> <p>Decision forms or other meeting minutes.</p>	<p>B, C</p>
<p>Arrangements are not in place to subcontract the provision of services back to the institution from the related company where appropriate, for example research deriving from consultancy work.</p>	<p>Policies and procedures detail the process for decision making.</p> <p>A cost benefit analysis is carried out.</p> <p>Appropriate contractual documentation is produced and signed by all relevant parties.</p>	<p>Decision forms or other meeting minutes.</p> <p>Completed documentation.</p>	<p>B</p>

**Table 2 - Operational risk matrix (continued)**

Trigger	Risk management activities and controls	Sources of assurance	Checklist ref
<b>Strategic Risk 2: The institution may not have due regard for the issue of public accountability (continued).</b>			
<p>Lack of control and monitoring of related company liabilities to the institution, for example:</p> <ul style="list-style-type: none"> <li>• profits not routed back on an effective basis</li> </ul> <p>possible tax or repayment exposure to the institution as a result of funding arrangements</p> <ul style="list-style-type: none"> <li>• other liabilities in respect of employees in related companies</li> <li>• related company compliance with the requirements of the taxation authorities.</li> </ul>	<p>Formation process requires identification of initial liabilities.</p> <p>Memorandum of agreement requires periodic management reports to be provided to the institution and, based on the level of investment and influence held, allows for institutional representation to review the company's accounts and financial records.</p>	<p>Nominated Officer and director of finance assurance at creation.</p> <p>Periodic Nominated Officer review.</p> <p>Director of finance confirmation.</p>	<p>B, C</p> <p>Appendices IV, V</p>

**Table 2 – Operational Risk Matrix (continued)**

Trigger	Risk management activities and controls	Sources of assurance	Checklist ref
<b>Strategic risk 3: Governance structures do not reflect the appropriate level of influence over related companies.</b>			
<p>The institution has not implemented a group framework to support commercial development in light of the potential mix of developments. Relevant to, for example:</p> <ul style="list-style-type: none"> <li>• governor forums</li> <li>• management structures</li> <li>• group structure.</li> </ul>	<p>Periodic review of governance structures to ensure they are fit for purpose.</p>	<p>Institution's company secretary; independent assurance reports.</p>	<p>B, C, D</p>
<p>Related company structure including board membership.</p>	<p>Institution policy defines board allocations.</p>	<p>Nominated Officer at creation.</p>	<p>A  Appendix I</p>
<p>Inappropriate board membership creates:</p> <ul style="list-style-type: none"> <li>• conflicts of interest</li> <li>• shadow directorship.</li> </ul>	<p>Nominations and appointment process. Training for all company directors. Declaration of interest processes include declarations for related company interests. Nominated Officer.</p>	<p>Board reporting. Training records. External auditor. Nominated Officer at creation and periodic review.</p>	<p>A, C  Appendix I</p>
<p>Inappropriate evaluation phase does not include robust assessment of institution's investment and its impact on the governance structure.</p>	<p>Evaluation procedures include consideration of investment level and consequential impact on board allocations.</p>	<p>Outline business case includes assessment. Nominated Officer at creation.</p>	<p>A, B  Appendices I, VI</p>

**Table 2 – Operational Risk Matrix (continued)**

Trigger	Risk management activities and controls	Sources of assurance	Checklist ref
<b>Strategic risk 3: Governance structures do not reflect the appropriate level of influence over related companies (continued).</b>			
Contractual or other service level agreement poorly defined	Memorandum and Articles and/or memorandum of understanding in place for all related companies and other relevant ventures.	Company secretary /Nominated Officer. Periodic independent review.	Appendices IV, V
Lack of awareness of audit and code of practice requirements.	Evaluation procedures require consultation with relevant officers and advisors to clarify audit and other assurance requirements.	Nominated Officer confirmation at creation. Periodic review by: external audit; internal audit; or other independent assurance reports (e.g. by funding council).	A, D  Appendix VI
The review of the institution's investment is inadequate by: <ul style="list-style-type: none"> <li>external auditors</li> <li>internal auditors.</li> </ul>	Funding body review. External auditor's annual plan and audit committee review of external auditor performance Internal auditor's annual plan and external auditor's review of internal auditor performance.	External audit management letter. Internal auditor reports and annual report. Audit committee annual report. Other independent assurance reports (e.g. by funding council).	D
The related company does not operate with due regard to the requirements of the shareholders.	Training. Nominated Officer. Periodic management reports, including performance reports. Operational issue escalation arrangements, including whistle-blowing procedures.	Training records. Nominated Officer periodic reports.	C  Appendices I, II, III

**Table 2 – Operational Risk Matrix (continued)**

Trigger	Risk management activities and controls	Sources of assurance	Checklist ref
<b>Strategic risk 4: The institution does not identify and evaluate all potential commercial opportunities in line with agreed strategy.</b>			
Academic staff are unaware or unable to identify opportunities available.	Business development manager or other dedicated support. Annual planning process. Intranet site and other marketing material provide: <ul style="list-style-type: none"> <li>• clear guidance; and</li> <li>• live examples of opportunities.</li> </ul> Enshrined within performance objectives and annual appraisal cycle.	Staff feedback at planning cycle evidences awareness. Evidence of marketing material. Levels of use of intranet site. Training records. Annual commercial activity report to the governing body and the head of institution. Independent assurance reports.	C, D
Business development staff are not in place or used effectively to facilitate the identification of opportunities.	Commercial development strategy identified specialist resource need. Effective recruitment and retention arrangements or development training. Management reporting arrangements support the alignment of business developers into academic areas. Job descriptions define roles and responsibilities. Periodic review of documented management structures and job descriptions.	Commercial strategy approved by the governing body. Vacancy levels reported in head of commercial activities' annual report. Ongoing review by management to the governing body.	A, B, C, D  Appendix III

**Table 2 – Operational Risk Matrix (continued)**

Trigger	Risk management activities and controls	Sources of assurance	Checklist ref
<b>Strategic risk 4: The institution does not identify and evaluate all potential commercial opportunities in line with agreed strategy (continued).</b>			
<p>The culture of the institution does not support academic staff in the development of opportunities (for example in terms of time and seed corn investment).</p>	<p>Corporate strategy defines institutional objectives.</p> <p>Annual planning cycle enables re-alignment of roles and responsibilities where appropriate.</p> <p>Budget allocations provide for development of identified opportunities.</p> <p>Skills sets are available to effectively leverage seed-corn and other funding to support commercial development opportunities.</p>	<p>Corporate plan approved by the governing body.</p> <p>Annual plan approved by senior management team and the governing body.</p> <p>Financial budget agreed between the head of commercial activities and the senior management team and approved by the finance committee.</p> <p>Commercial strategy approved the head of commercial activities before presentation to the governing body.</p>	C, D
<p>The identification and evaluation process is unclear or is not 'user friendly' to facilitate the decision making process.</p>	<p>Procedures are clearly documented and include reference to key responsibilities, deliverables and timescales.</p> <p>Business development or other support is available to academic staff identifying opportunities and developing business plans.</p>	<p>Procedures approved by the head of commercial activities and periodically reviewed by internal audit.</p> <p>Commercial strategy, including required resources, developed by head of commercial activities before approval by the governing body.</p>	B, D
<p>Undue influence over the prioritisation of opportunities, for example:</p> <ul style="list-style-type: none"> <li>• where a related company is used for the initial identification and assessment of commercial opportunities, its assessment may be biased as a result of overarching targets set for it by the institution, or</li> <li>• where an institution is developing commercial activity in-house one academic area may dominate over another because of existing skills and experience.</li> </ul>	<p>Procedures are clearly documented and include reference to key responsibilities, deliverables and timescales.</p> <p>All opportunities are logged with the strategic lead.</p> <p>The evaluation process is clearly documented and predicated on agreed indicators, for example investment need, time to realisation, likely outcome, availability of funding, other potential uses.</p>	<p>Procedures approved by the head of commercial activities and periodically reviewed by internal audit.</p> <p>Approval of evaluation process approved by strategic lead and summarised to the governing body annually.</p>	B, D



**Table 2 – Operational Risk Matrix (continued)**

Trigger	Risk management activities and controls	Sources of assurance	Checklist ref
<b>Strategic risk 4: The institution does not identify and evaluate all potential commercial opportunities in line with agreed strategy (continued).</b>			
Ineffective outline business planning	Business development or other specialist support. Procedures are clearly documented and include: <ul style="list-style-type: none"> <li>• reference to key responsibilities, deliverables and timescales;</li> <li>• minimum content standards for the business case, for example:               <ul style="list-style-type: none"> <li>– summary of the opportunity</li> <li>– SWOT analysis</li> <li>– indicative resource requirements</li> <li>– outcomes from initial consultation with regulatory and other advisors</li> <li>– initial commercial entity assessment.</li> </ul> </li> </ul>	Outline business case is approved by strategic lead before presentation to governors where appropriate.	B

Trigger	Risk management activities and controls	Sources of assurance	Checklist ref
<b>Strategic risk 4: The institution does not identify and evaluate all potential commercial opportunities in line with agreed strategy (continued).</b>			
Inefficient initial evaluation.	Business development or other specialist support. Procedures are clearly documented and include: <ul style="list-style-type: none"> <li>• delegated powers</li> <li>evaluation criteria and</li> <li>• an assessment of the availability of funds.</li> </ul> Outcomes of evaluation are documented.	Evaluation is confirmed and approved by strategic lead.  Periodic independent review by internal audit.	B, D
Assessment of commercial venture entity options.	Documented guidance is available for informed assessment.  Specialist advice is available in-house or obtained by sub-contract.	Outcomes documented in outline business case, which requires strategic lead authorisation.	A, B  Appendix VII Section 2

**Table 2 – Operational Risk Matrix (continued)**

Trigger	Risk management activities and controls	Sources of assurance	Checklist ref
<b>Strategic risk 5: The establishment of each related company (or other commercial entity) may not have been properly planned and controlled.</b>			
<p>A full business case is not developed and scrutinised to ensure a robust decision-making process.</p>	<p>Nominated Officer allocated.</p> <p>Business development or other specialist support.</p> <p>Procedures are clearly documented and include:</p> <ul style="list-style-type: none"> <li>• reference to key responsibilities, deliverables and timescales;</li> <li>• minimum content standards for the business case, for example: <ul style="list-style-type: none"> <li>– summary of the opportunity</li> <li>– SWOT analysis</li> <li>– full resource requirements</li> <li>– impact on other areas of the institution (opportunity cost of progression), e.g. impact of teaching and learning resources, RAE submissions.</li> <li>– full outcomes from consultation with regulatory and other advisors</li> <li>– final commercial entity assessment</li> <li>– exit/realisation strategy including timescales.</li> </ul> </li> </ul> <p>Clearly documented evaluation criteria based on institutional strategy and priorities.</p>	<p>Documented evaluation assessment forms.</p> <p>Detailed business case is approved by strategic lead before presentation to governors where appropriate.</p> <p>Nominated Officer formation approval.</p>	<p>B, E</p> <p>Appendices I, II</p>

**Table 2 – Operational Risk Matrix (continued)**

Trigger	Risk management activities and controls	Sources of assurance	Checklist ref
<b>Strategic risk 5: The establishment of each related company (or other commercial entity) may not have been properly planned and controlled (continued).</b>			
<p>Adequate resource is not allocated to ensuring the effective and timely planning and establishment of related companies.</p>	<p>Nominated Officer allocated.</p> <p>Commercial development strategy includes assessment of specialist skills requirements, and these are recruited.</p> <p>Business development or other specialist support.</p> <p>Resource modelling is carried based upon an agreed structure, to establish:</p> <ul style="list-style-type: none"> <li>• human resources</li> <li>• IT/IS</li> <li>• accommodation</li> <li>• financing</li> <li>• other specialist equipment needs etc.</li> </ul> <p>Procedures are clearly documented.</p>	<p>Nominated Officer annual report.</p> <p>Strategic lead annual report to governors.</p> <p>Director of finance approves resource modelling tool.</p> <p>Periodic management review of policies and procedures, the findings from which are reported via the strategic lead to governors.</p> <p>Periodic internal and external audit assurance.</p>	<p>A, C, D</p> <p>Appendices I, II</p>
<p>Appropriate specialist advice is not taken: for example legal, tax, regulatory or commercial.</p>	<p>Business case methods require full consultation.</p>	<p>Detailed business case is approved by strategic lead before presentation to governors where appropriate.</p>	<p>B</p> <p>Appendix VI</p>

**Table 2 – Operational Risk Matrix (continued)**

Trigger	Risk management activities and controls	Sources of assurance	Checklist ref
<b>Strategic risk 5: The establishment of each related company (or other commercial entity) may not have been properly planned and controlled (continued).</b>			
Inappropriate choice of commercial entity.	<p>Documented guidance is available for informed assessment.</p> <p>Specialist advice is available in-house or obtained by sub-contract.</p> <p>Where relevant and appropriate, arrangements ensure effective subcontracting of the provision of services back to the institution from the related company, for example research deriving from consultancy work.</p>	Outcomes documented in outline business case, which requires strategic lead authorisation.	B Section 2
The assignment of intellectual property is not appropriate or is not effectively carried out.	<p>Specialist advice is available in-house or obtained by sub-contract.</p> <p>Standard contract clauses are applied.</p>	<p>Outcomes documented in outline business case, which requires strategic lead authorisation.</p> <p>Use of standard contracts approved and periodically reviewed by the institution's company secretary.</p>	B, C  Appendix VII
Poorly defined realisation and/or exit strategy.	<p>Requirement of business plan.</p> <p>Annual planning cycle.</p>	<p>Outcomes documented in outline business case, which requires strategic lead authorisation.</p> <p>Nominated Officer creation and periodic review of performance management information.</p>	A, B, C, E  Appendix VI

**Table 2 – Operational Risk Matrix (continued)**

Trigger	Risk Management Activities and Controls	Sources of Assurance	Checklist Ref
<b>Strategic risk 6: The related company's performance may not meet its budget and objectives.</b>			
Management structures, for example boards and committees, do not effectively control the development process.	Board nomination and training. Policies and procedures.	Nominated Officer creation and periodic review. Completed nominations forms. Nominations Committee minutes. Training records. Completed declaration of interest forms.	A, B, C  Appendices I, III
Unclear targets and objectives for performance management purposes.	Requirement of business plan. Memorandum of understanding. Annual planning cycle. Documented guidance is available detailing minimum standards, suggested formats and timetable for reporting, for: <ul style="list-style-type: none"> <li>• financial reporting</li> <li>• non-financial targets, e.g. performance reporting arrangements.</li> </ul>	Outcomes documented in outline business case, which requires strategic lead authorisation.  Use of standard memorandum of understanding and contracts approved and periodically reviewed by the institution's company secretary.  Nominated Officer creation and periodic review of performance management information.	A, B, C  Appendices IV, V, VI
Inadequate audit arrangements	Funding body review.  External auditor's annual plan and audit committee review of external auditor performance.  Internal auditor's annual plan and external auditor review of internal auditor performance.	External audit management letter.  Internal auditor reports and annual report.  Audit committee annual report.  Independent assurance reports (e.g. by funding council).  Funding body reports.	D

## 4 Activities and entities for related company activity

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### Activities

<b>Subsidiary company</b>	
<i>Definition</i>	<p><b>HEI controls the company. Subsidiary generally has the same policy-making powers as any majority owner and can do such things as appoint directors and hire officers.</b></p> <p><b>Subsidiary is controlled by the parent through these powers.</b></p>
<i>Advantages</i>	<ul style="list-style-type: none"><li>• Scope to readjust the level of limited liability afforded to the group as a whole.</li><li>• Can provide a distinct focus to the activities undertaken.</li></ul>
<i>Disadvantages</i>	<ul style="list-style-type: none"><li>• Parent may be held liable for the acts of the subsidiary if the subsidiary is found to be an instrument of the parent.</li><li>• HEI is not permitted to exempt a director from any liability attaching to him/her in connection with any negligence, default, breach of duty or breach of trust by him/her in relation to the associated company (but can be insured against).</li></ul>
<i>Other comments</i>	<ul style="list-style-type: none"><li>• Used most commonly for tax efficiency purposes or for distinct trading activities.</li></ul>

<b>Spin out company</b>	
<b>Definition</b>	<b>A business set up by staff at an HEI to make use of the commercial applications of research.</b>
<b>Advantages</b>	<ul style="list-style-type: none"> <li>• A mechanism to enable institutions to realise the value of research activity and generate additional income.</li> <li>• Can enable third party investment to be obtained.</li> <li>• Limited liability can protect owners from creditors.</li> </ul>
<b>Disadvantages</b>	<ul style="list-style-type: none"> <li>• Directors may be personally liable for the activities of the spin-out.</li> <li>• Distraction from research activities.</li> <li>• Business and management skills may not be readily available.</li> <li>• Consent from the HEI may be required for a researcher to participate in the spin-out.</li> <li>• HEI may not give permission to its employees to take executive directorships in spin-out companies.</li> <li>• Onerous legal responsibilities attached to being a director of a limited company.</li> </ul>
<b>Other comments</b>	<ul style="list-style-type: none"> <li>• The approach to spin-outs and the success levels of spin-outs varies significantly from organisation to organisation.</li> </ul>



<b>Joint venture</b>	
<b>Definition</b>	<p><b>A joint venture is a venture by a partnership or conglomerate designed to share risk or expertise, created with a specific project in mind.</b></p> <p><b>It may not be a limited liability company.</b></p> <p><b>It generally dissolves once the project has been completed.</b></p>
<b>Advantages</b>	<ul style="list-style-type: none"> <li>• All parties agree to share in the profits and losses of the venture.</li> <li>• A joint venture is a good way for organisations to partner without merging.</li> </ul>
<b>Disadvantages</b>	<ul style="list-style-type: none"> <li>• Members of the joint venture are exposed to full legal liability, i.e. the liability extends to all liabilities of the venture and not only in proportion to the contributions by the joint venture parties.</li> </ul>
<b>Other comments</b>	<ul style="list-style-type: none"> <li>• Joint ventures can be a particularly complex entity, fraught with difficulties. Problems are most commonly encountered where the different parties have not fully considered the risks and rewards associated with the proposed partnership, or where there is no clear and transparent objective or exit strategy.</li> </ul>

<b>Licensing</b>	
<b>Definition</b>	<b>A contract involving the granting of permission, giving someone the legal right to use a patent, trademark or technology under defined conditions.</b>
<b>Advantages</b>	<ul style="list-style-type: none"> <li>• Licensing enables the retention of ownership, and therefore control, of intellectual property (IP) whilst at the same time generating royalty income from the use of IP by industry.</li> <li>• Licensing can be a source of significant income.</li> <li>• Offers risk-free income to an inventor, who does not need to devote further financial resources to its exploitation</li> </ul>
<b>Disadvantages</b>	<ul style="list-style-type: none"> <li>• Reduction of direct control.</li> <li>• Need for high tolerance level.</li> <li>• The inventor and/or HEI may have onerous obligations under the licensing arrangement (e.g. marketing, transferring updated research results etc).</li> </ul>
<b>Other comments</b>	<ul style="list-style-type: none"> <li>• Licensing can be an effective and efficient entity for releasing the potential of intellectual property.</li> </ul>

## Entities

57. The available legal entities for both a subsidiary and an associated company are a private company limited by shares, public company limited by shares, company limited by guarantee, an industrial and provident society, or a community interest company.

58. The most common entity used is a private company limited by shares or a company limited by guarantee. Sometimes a public company limited by shares is used.

59. A spin-out company is invariably a private or public company limited by shares although it is possible to use another legal form.

60. A joint venture can be any of the legal forms listed earlier, or could be an unincorporated arrangement (evidenced by contract).

61. A licensing deal is almost invariably by contractual arrangement only.

62. The main drivers behind the use of different forms of legal entity are the tax status, minimisation of risk, the exit route, funding, whether any aspects are overseas, third party interaction and other commercial factors, and the degree of management control. These are discussed in more detail below.

- **Tax status**

The tax status of the parties to the venture often drives its legal form. Some legal forms are fiscally transparent, which means that the underlying owners are taxed directly on any profits received and the legal entity itself does not pay tax. This is particularly true of limited partnerships, limited liability partnerships and European economic interest groupings. An industrial and provident society is automatically an exempt charity and is less constrained in some instances in what it can do, compared to other charities.

- **Minimisation of risk**

The parties always need to understand the nature of the risks they face in a venture and to put into place appropriate risk minimisation strategies consistent with relevant risk/reward ratios. For example, in a limited partnership structure, the limited partner is not allowed to take part in the management of the limited partnership and, therefore, that lowers the risk of a claim being made against a limited partner by an aggrieved third party. This is balanced against the lack of control that such an interest would have. A limited liability partnership gives both limited liability and an ability to take part in management.

Contracts can be used to minimise liability but their effectiveness can depend on the nature of the entity being used.

- **Exit route**

The method by which the institution seeks a return (i.e. by income, capital gain or both) dictates the legal form to be used. If one is looking for an exit route for a commercial venture on a public stock market then only a company limited by shares would normally be used in the early stages as the entity. This is because it is difficult to convert one legal form to another, and usually only companies limited by shares are listed on UK stock exchanges.

Institutions should also consider in advance their possible exit routes in the event of failure of the related company activity, whether it be failure to achieve its corporate objectives or financial failure.

- **Funding**

Sometimes funding is required in order to move the project forward. If substantial external funding is required then it is usually from venture capitalists or a bank. They generally fund a company limited by shares. The more unusual the legal entity, the more difficult and time consuming (and possibly expensive) it could be to raise the finance.

If the institution is seeking to raise funds to be used for a range of ventures (for example as a venture capital fund) then external funders will want to invest in a fiscally transparent entity such as a limited partnership or a limited liability partnership. This is the common method used for venture capital funds to be formed.

The availability of grants and other finance sometimes dictates the form of the legal entity. European economic interest groupings are often used to access EU funding (where there are participants from more than one EU member state).

- **Overseas**

Overseas legal entities are used where a partner of the HEI is based overseas or there is the possibility of an exit route on an overseas stock exchange. Numbers of British investors have invested in spin-out companies who are (normally Delaware) corporations which have gone onto a listing on the US Nasdaq or New York Stock Exchange.

- **Third party interaction and other commercial factors**

The method by which the related company will interact with commercial and other partners can be relevant to its legal form (e.g. if it needs to give a charge or mortgage or debenture). If it is operating in EU markets then there is likely to be increasing use of European companies (because of their common laws throughout the European Union.)

- **Management control**

The nature of management control dictates the legal form to be used. Limited partnerships do not allow limited partners to control them. Industrial and provident societies require at least seven members although they can be differing membership interests.

Expert advice should be taken on which type of legal entity to be used for a related company activity.

## 5 Checklists

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### Introduction

63. The following checklists should be studied and completed by officers of the institution and the company as appropriate. We recommend that the Nominated Officer should prepare a report for submission to the institution. We set out a suggested report structure at Appendix II.

### Completion cycle

64. The checklists are set out in five parts, each broadly corresponding to a stage in the life cycle of a company. We recommend that these checklists should be reviewed as follows:

<b>A - Preliminary considerations</b>	Before formation
<b>B - Company formation</b>	On formation
<b>C - Management</b>	To be completed at the formation stage and on a regular basis thereafter (we recommend at least annually)
<b>D – Review</b>	To be completed on a regular basis (we recommend at least annually)
<b>E - Exit/realisation of investment</b>	Pre-disposal/closure

65. Every institution that is considering creating a company should examine the issues in Checklist A.

66. Once it has been decided to proceed, every institution should consider the formation, management and review issues outlined in Checklists B, C and D respectively before taking a decision to implement.

67. Checklists C and D should be reviewed at regular predetermined points (or an ad hoc review if required by performance) by the institution or by the holding company (when different people may have responsibility). This should be agreed by the institution's Nominated Officer.

68. Checklist E should only be completed once the decision has been taken by the institution to dispose of its investment or wind up the company.

69. The checklists have been designed to allow the addition of relevant comments, or references to supplementary documents as appropriate.

## CHECKLIST A: PRELIMINARY CONSIDERATIONS

Checklist A should be considered and, where relevant, completed before a related company is established. It is intended to determine that a company is appropriate for the purpose and that the reason for formation is valid.

	Yes, No or N/A	Comments
A1	Have the governors approved the project? In particular, have they satisfied themselves as to the objectives in drawing up the business plan?	
A2	Has a Nominated Officer been appointed by the governors to oversee the formation of the company?	
A3	<p>Has a preliminary business plan been prepared? Does it include:</p> <ul style="list-style-type: none"> <li>i. consideration of the feasibility of the project;</li> <li>ii. the proposed objectives of the company;</li> <li>iii. details of the proposed management structure of the project and the company;</li> <li>iv. details of the proposed shareholding/ownership of the company;</li> <li>v. constraints (e.g. is the institution prepared to allow the proposed subsidiary to use its name and reputation?);</li> <li>vi. financing (from non-earmarked sources) and the need for guarantees;</li> <li>vii. assessment of risks and sensitivities;</li> <li>viii. exit strategy;</li> <li>ix. formation timetable?</li> </ul>	

	Yes, No or N/A	Comments
<p>A4 Has the form of legal entity to be used for the activity been considered? Is a company the most suitable entity for the proposed activity?</p> <p>Have alternatives been considered, including:</p> <ul style="list-style-type: none"> <li>(i) straightforward contractual agreement by the institution;</li> <li>(ii) joint venture not involving the formation of a company;</li> <li>(iii) partnership;</li> <li>(iv) franchising/licensing arrangements?</li> </ul>		
<p>A5 Has professional advice been taken as to whether a company is appropriate for the purposes and objectives of the proposed activity (and as to its proposed legal form)?</p> <p>In particular:</p> <ul style="list-style-type: none"> <li>(i) is the activity within the powers of the institution? What steps must be followed to ensure the validity of the arrangements?</li> <li>(ii) are there any implications in respect of the charitable status of the institution?</li> <li>(iii) what are the implications in respect of taxation (both direct and indirect) ?</li> <li>(iv) what are the legal implications of the proposed activity?</li> </ul>		
<p>A7 Have any restrictions within the constitution of the institution been considered and resolved in respect of the formation of a company?</p> <p>Have any legal or tax obstacles been resolved?</p>		
<p>A8 Is the company being set up to exploit the commercial potential of technology and/or intellectual property?</p> <p>If so, have the matters set out in Appendix VII been considered?</p>		

## CHECKLIST B: COMPANY FORMATION

Checklist B should be completed once the decision to set up a company has been approved by the governors. It is intended to ensure that the formation of the company has been properly planned and controlled.

	Yes, No or N/A	Comments
<p>B1 Has a comprehensive business plan been prepared by the proposed directors of the company? The following should be included:</p> <ul style="list-style-type: none"> <li>(i) the objectives of the company;</li> <li>(ii) management structure;</li> <li>(iii) management teams;</li> <li>(iv) detailed financial projections, including key assumptions and the working capital requirement;</li> <li>(v) risks and sensitivity analysis;</li> <li>(vi) the permanent capital required;</li> <li>(vii) an understanding of the true costs, contribution to overheads, and rates of return required;</li> <li>(viii) the return of profits to the institution;</li> <li>(ix) the intended exit;</li> <li>(x) the expectations of the institution in the event of any unexpected losses.</li> </ul>		
<p>B2 Has the institution validated the business plan? (This may be through independent professional advice or by suitably qualified personnel within the institution.)</p>		
<p>B3 Has the comprehensive business plan, together with the financial backing required (for example in equity, loan and guarantees), been approved by the governors?</p>		



		Yes, No or N/A	Comments
B4	<p>Has independent professional advice been taken on:</p> <ul style="list-style-type: none"> <li>(i) the company's constitution;</li> <li>(ii) the impact of the proposed company on the charitable status of the institution;</li> <li>(iii) the impact of taxation on the company and on the institution;</li> <li>(iv) loan agreements;</li> <li>(v) the impact of the proposed company on the financial position of the institution;</li> <li>(vi) the protection of assets, including intellectual property and copyright;</li> <li>(vii) potential risks to the institution and others for which the institution may become liable;</li> <li>(viii) the potential impact of product liability or other possible litigation, where the impact or cost of such litigation could flow through to the institution itself;</li> <li>(ix) the impact of any guarantees?</li> </ul>		
B5	<p>Are there formal loan agreements covering the following:</p> <ul style="list-style-type: none"> <li>(i) security of loans;</li> <li>(ii) rate of interest (which should be at a commercial rate);</li> <li>(iii) payment of interest;</li> <li>(iv) repayment of capital?</li> </ul>		
B6	Has the appointment of the directors or other senior managers been ratified by the governors?		
B7	Has a chairman of the board of directors or equivalent been appointed?		
B8	Has a company secretary been appointed?		
B9	Have external (and if appropriate) internal auditors been appointed?		

	Yes, No or N/A	Comments
B10	Has the year-end of the company been established and (if relevant) Companies House notified?	
B11	<p>Has a memorandum of understanding been prepared, setting out clearly defined and understood responsibilities and the scope within which the activities of the company can be carried out?</p> <p>Does the memorandum of understanding include the items set out in Appendix IV?</p> <p>Is the memorandum binding or non-binding?</p>	
B12	<p>Is the constitution of the board fit for purpose?</p> <p>Has it been well constituted, with an appropriate balance of executive directors, governors, executive officers of the institution and non-executive officers?</p>	
B13	Has the board of directors or equivalent set down written procedures and management structures for the conduct of its business?	
B14	Is there a need for appropriate written operating procedures?	
B15	<p>Are the directors or equivalent aware of their legal responsibility to act in the best interests of the company?</p> <p>Are any directors or equivalent of the company also officers of the institution? If so, is there a written requirement for the directors and other senior officials to report to the governors any conflicts which may arise from their duties to the board or to the institution?</p> <p>Is there a register of interests set up by the company to record any conflicts which may arise?</p> <p>Is this register of interests reviewed from time to time by the internal auditors?</p> <p>Has legal advice been taken in respect of any situation (such as the conflicts set out above) which may put at risk the institution's charitable status or directors as individuals?</p>	

	Yes, No or N/A	Comments
B15	Are there any other people attached to the company who are so closely involved that they might be considered shadow directors?	
B16	<p>Is there a suitable mechanism in place to remove directors or equivalent from office?</p> <p>If relevant is there a requirement in the articles for the directors to retire by rotation?</p> <p>Are there any other restrictions which should be imposed on the directors or equivalent? (For example, it may be appropriate for the institution to have a right to appoint and remove directors at will.)</p>	
B17	Has the issue of remuneration for directors or equivalents been considered?	
B18	<p>Are there laid down instructions in respect of the management information to be produced by the company?</p> <p>Does this management information include instructions to produce:</p> <p>(i) budgets and forecasts;</p> <p>(ii) management accounts?</p>	
B19	<p>Are there clearly defined approval procedures for the following:</p> <p>(i) strategic decisions;</p> <p>(ii) contracts of employment;</p> <p>(iii) subsidiary companies (of the company)?</p>	
B20	<p>Are the respective responsibilities of the following clearly defined:</p> <p>i) the board of directors or equivalent;</p> <p>ii) the institution's finance committee;</p> <p>iii) the institution's audit committee or equivalent;</p> <p>iv) the governors?</p> <p>These responsibilities should be clearly set out in the memorandum of understanding between the institution and the company.</p>	

		Yes, No or N/A	Comments
B21	Is there a mechanism in place for holding accountable key related company executives?		
B22	Are there suitable indemnities in favour of institutional officers or employees acting as directors of related companies?		
B23	<p>Are maximum authority limits set down in the memorandum of understanding, and clearly understood by officials both at the company and at the institution?</p> <p>Do these limits cover the following:</p> <ul style="list-style-type: none"> <li>(i) capital expenditure;</li> <li>(ii) resource planning;</li> <li>(iii) employment decisions;</li> <li>(iv) investment decisions;</li> <li>(v) sale of assets;</li> <li>(vi) external financing (involvement of third parties);</li> <li>(vii) alterations to the proposed activities of the company?</li> </ul>		
B24	Are the directors satisfied that there are no arrangements which may prevent the company carrying out its planned activity or proposed exit?		
B25	Has suitable liability insurance for directors and officers been taken out by the institution and by the company?		
B26	Has the company arranged suitable insurance cover?		
B27	Has an appropriate timetable of board meetings been established (including the annual general meeting)?		
B28	Has the company been given authority to disclose information to the institution's audit committee (i.e. has the institution right of access to the company's records)?		

	Yes, No or N/A	Comments
B29	Have the internal auditors been given instruction as to their responsibilities in respect of the company and given rights of access?	
B30	Has the institution considered whether it is appropriate for the company to adopt the recommendations of the Cadbury Committee, the Greenbury Committee on Corporate Governance, the Combined Code and Turnbull?	
B31	Has Checklist C in respect of management issues been reviewed and completed where appropriate?	
B32	Is the company a joint venture company? If so, have a shareholders' agreement and articles of association been prepared setting out the obligations and liabilities of the shareholders and the company to each other?  Do the shareholders' agreement and articles of association address the issues set out in Appendix V?	
B33	Is the company being set up to exploit the commercial potential of technology and intellectual property?  If so, have the matters set out in Appendix VII been addressed?	

## CHECKLIST C: MANAGEMENT

Checklist C should be completed once the company has been set up and has commenced trading. It is intended to ensure that management procedures are being adequately maintained, and that the business issues arising out of the performance of the company are understood by the institution.

		Yes, No or N/A	Comments
C1	Has Checklist B in respect of formation issues been completed and reviewed?		
C2	Have any profits arising been passed back to the institution in accordance with agreed procedure?		
C3	Are the protocols by which the directors conduct the business of the company in line with the law? In particular has each director, on appointment, been given sufficient information by the board to enable him/her to perform his/her duties?		
C4	Has the company suitable procedures in place to ensure that there are regular board meetings and that formal minutes are prepared and approved by the board which clearly detail:  (i) business which can only be conducted at board meetings by company law;  (ii) other relevant business issues?		
C5	Are decisions regarding the content of the agenda for individual meetings of the board, and the presentation of agenda items, taken by the chairman in consultation with the company secretary?		
C6	Do the directors monitor the executive management of the company?  Is this procedure subject to internal audit review?		
C7	Does the board of directors formally record its compliance with the written procedure for the conduct of its business?		

	Yes, No or N/A	Comments
<p>C8 Is appropriate financial and non-financial motivation given to key company personnel, to ensure that the performance of the company is optimised, where this is relevant?</p> <p>Advice on the use of the following might be sought:</p> <ul style="list-style-type: none"> <li>(i) remuneration packages;</li> <li>(ii) bonus schemes;</li> <li>(iii) share ownership schemes.</li> </ul>		

## CHECKLIST D: REVIEW

Checklist D should be completed at regular predetermined times once the company has been set up and has commenced trading and thereafter. It is intended to ensure that the performance of the company is subject to appropriate review procedures.

		Yes, No or N/A	Comment
D1	Has the Nominated Officer reviewed Checklist C in respect of management?		
D2	<p>Has the institution (the Nominated Officer in the first instance) reviewed on a regular basis the performance of the company and understood the results?</p> <p>In particular, the following factors should be included in this review:</p> <ul style="list-style-type: none"> <li>(i) the sharing of resources between the institution and the company, for example staff and premises;</li> <li>(ii) the contribution by the company to the institution's overheads;</li> <li>(iii) whether transactions between the institution and the company are carried out on a full cost basis;</li> <li>(iv) whether the level of profitability of the company and other performance criteria are meeting the agreed targets.</li> </ul> <p>The frequency of this review will depend on the specific circumstances of the company and the scale of its operations. In most cases a review of performance against budget at least quarterly would be appropriate.</p>		
D3	Has the lifespan of the company been predetermined in any formal documentation or contract? If so, consider the appropriate course of action, for example completion of Checklist E.		



		Yes, No or N/A	Comment
D4	<p>Does the institution's assessment of the company's performance give a clear understanding of its current and future financial exposure? In particular:</p> <p>(i) is there an approved business plan which is still appropriate to the operations and environment of the company?</p> <p>(ii) do the management accounts show that the company has operated in accordance with the approved business plan?</p> <p>(iii) is the risk exposure of the institution clearly defined and reported?</p> <p>(iv) has the value of the underlying net assets been ascertained?</p> <p>(v) what are the future financing requirements?</p> <p>(vi) will these future financing requirements be met?</p> <p>(vii) has the impact of the company's activities and performance on the institution been considered?</p>		
D5	Are sufficient reserves earmarked by the institution to cover any contingent liabilities which may exist?		
D6	Does the audit committee have clear terms of reference in respect of the company?		
D7	Do the external auditors formally report to the audit committee in respect of the company?		
D8	Do the internal auditors include the company in their cycle of work, and formally report to the audit committee?		

		Yes, No or N/A	Comment
D9	<p>Is there adequate disclosure in the institution's accounts of the following:</p> <ul style="list-style-type: none"> <li>(i) company activities;</li> <li>(ii) company performance;</li> <li>(iii) the financial position of the company;</li> <li>(iv) institutional liability for company debts;</li> <li>(v) related party transactions;</li> <li>(vi) any material relationships which may exist?</li> </ul>		
D10	<p>Has the company been consolidated into the institutional accounts?</p> <p>If not, have the governors received summary information on the company and the reason for non-consolidation?</p>		
D11	<p>Does the institution maintain a record of the related company profits to date, and contributions to the institution since formation?</p> <p>Note: a record may be maintained for internal purposes only - it will enable the institution to determine the level of reserves generated from commercial investment.</p>		
D12	<p>Do the institution and its related companies maintain adequate records of transactions with related parties, as required by Financial Reporting Standard 8 'Related Party Disclosures'?</p>		
D13	<p>Has the institution satisfied itself that the company has taken appropriate steps in respect of the following:</p> <ul style="list-style-type: none"> <li>(i) health and safety procedures;</li> <li>(ii) quality control procedures;</li> <li>(iii) environmental impacts?</li> </ul>		

	Yes, No or N/A	Comment
<p>D14 Has a review of the company been carried out by the institution to consider the:</p> <ul style="list-style-type: none"> <li>(i) financial performance;</li> <li>(ii) performance of management;</li> <li>(iii) future working capital requirements;</li> <li>(iv) assessment of risks?</li> </ul> <p>Has the institution committed to its ownership of the company for a further year? If not, then Checklist E should be completed.</p>		
<p>D15 Where the company is a joint venture company, have the provisions of the shareholders' agreement and articles of association been complied with by all relevant parties?</p>		

## CHECKLIST E: EXIT/REALISATION OF INVESTMENT

Checklist E should be completed once the decision has been taken by the institution to dispose of its investment or wind up the company.

		Yes, No or N/A	Comments
E1	Has the institution's decision to dispose of its investment in a related company been ratified by the governors?		
E2	Has the institution considered the potential costs in respect of: <ul style="list-style-type: none"> <li>(i) closure;</li> <li>(ii) redundancies;</li> <li>(iii) contingent liabilities;</li> <li>(iv) guarantees;</li> <li>(v) product liability?</li> </ul>		
E3	Has suitable independent professional advice been taken? <p>Such advice should cover:</p> <ul style="list-style-type: none"> <li>(i) tax planning (both corporate and capital taxes);</li> <li>(ii) valuation of the company;</li> <li>(iii) the terms of the disposal and any warranties or guarantees given;</li> <li>(iv) contractual matters, including rights of employees;</li> <li>(v) public relations/announcements.</li> </ul>		
E4	Is the institution satisfied that it has obtained the best price possible (in the context of its goals) for its investment?		
E5	In the event that the institution has determined to withdraw its financial support from a company, has this information been formally passed to the board of directors of the company?		

	Yes, No or N/A	Comments
<p>E6      Where the company is a joint venture company the disposal of a shareholders' investment or the winding up of the company will depend upon the terms of the joint venture, and in particular any shareholder agreement between the parties. Have these been considered and independent professional advice taken on them?</p>		

## Acknowledgements

We would like to take this opportunity to place on record our thanks to the following institutions and people who have contributed to this update:

### **Institutions included in telephone research**

- Arts Institute of Bournemouth;
- University of Bath;
- University of Birmingham;
- University of Cambridge;
- Cardiff University;
- University of Central England;
- University of Central Lancashire;
- University of Durham;
- Edge Hill College of Higher Education;
- University of Essex;
- Imperial College;
- University of Leeds;
- Loughborough University;
- Manchester Metropolitan University;
- University of Newcastle-Upon-Tyne;
- University College Northampton;
- University of Oxford;
- Queen's University Belfast;
- University of Reading;
- Southampton Institute of Higher Education;
- Surrey University;
- Teesside University; and
- University of Warwick.

### **Institutions included in site-visits research**

- University of Cambridge;
- University of Central England;
- University of Durham;
- Imperial College;
- Manchester Metropolitan University; and
- Oxford University.

### **Members of the Project Steering Committee**

- Richard Aveling – University College Northampton;
- Brian Baverstock – SHEFC;

- Professor Michael Brown – Liverpool John Moores University;
- Paul Greaves – HEFCE;
- Richard Hirst – HEFCW;
- James Hunt – University of Leicester;
- Clifford Shanbury – RSM Robson Rhodes; and
- Fraser Woodburn – Open University.

**Members of the Project Management Team**

- David Barnes – RSM Robson Rhodes;
- Nichola Crail – RSM Robson Rhodes;
- David McIntyre – RSM Robson Rhodes; and
- Ian Parry – HEFCE.

Our thanks also to Eversheds LLP who have reviewed the legal content of this guidance. They stress that institutions should take appropriate professional advice before proceeding with any related company activity or proceeding to act on this guidance. The law has been checked to 31 July 2005.

# Glossary of terms

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Term	Definition
<b>HEFCE</b>	- The Higher Education Funding Council for England
<b>SHEFC</b>	- Scottish Higher Education Funding Council, now the Scottish Funding Council
<b>HEFCW</b>	- Higher Education Funding Council for Wales
<b>DELNI</b>	- Department for Employment & Learning Northern Ireland
<b>Institution or HEI</b>	- University or higher education institution or college in England, Wales, Scotland or Northern Ireland
<b>Governor</b>	- Member of council, board, governing body or other body ultimately responsible for the affairs of the institution
<b>Related company or company</b>	- Any legal entity where the institution has control over, or exercises a substantial degree of influence over, that company's activities*
<b>Guidelines</b>	- Recommended practice guidelines issued to institutions from time to time by the relevant funding council
<b>Shadow director</b>	- A person (or a body corporate) in accordance with whose directions or instructions the directors are accustomed to act
<b>Risk</b>	- A potential event which may support or hinder an institution in the achievement of its strategic objectives

\* Under this definition the institution would in most cases have a controlling or majority interest in the company. However, there may be situations where a related company is not a subsidiary undertaking, as defined by accounting standards, but where the relationship between the institution and that company is such that the guidelines may still be applicable.