

CHESHIRE EAST COUNCIL

REPORT TO: AUDIT and GOVERNANCE COMMITTEE

Date of meeting: 19 March 2015

Report of: Head of Corporate Resources and Stewardship

Title: ASDV Governance Review

Portfolio Holder: Councillor Peter Raynes

1.0 Introduction and Summary

1.1 This report provides the Committee with an update on the governance arrangements for Council's Alternative Service Delivery Vehicles (ASDVs). It follows the earlier report of 27 March 2014 setting out the governance structures under which Cheshire East Residents First Ltd and its subsidiary companies will operate; and the governance arrangements for other ASDVs.

1.2 While over £50m of services are now provided by ASDVs and almost 1250 staff, (685 fte), have been TUPE transferred the Council remains responsible for ensuring that it uses public funds properly and that it can demonstrate value for money. Maintaining accountability to residents, service users, businesses and local councillors is vital. The governance arrangements introduced in April 2014 sought to ensure this.

1.3 The Council's group of companies are structured under its wholly owned holding company, Cheshire East Residents First Ltd. The following companies are included in the group:

- Engine of the North - EoTN;
- Ansa, Environmental Services;
- Orbitas, Bereavement Services; and
- Transport Services Solutions - TSS.

The Council, Cheshire East Residents First and its subsidiaries will sign a formal shareholders agreement in March 2015. This agreement enables the shareholding to be formally split between the Council and its holding company from 1 April 2015.

1.4 Cheshire East Residents First is a wholly owned Council company that will hold the majority interest, (80%), in all of its subsidiaries; with the Council holding the remaining minority interest, (20%). Through this shareholding arrangement the Council can retain decisive control over important decisions – this is a key requirement of *Teckal*. (The *Teckal* exemption enables the Council to award contracts directly to its companies without going through a public procurement process.)

1.5 Everybody Sport and Leisure is a charitable trust and, as such, is not part of the group. CoSocius, a company owned jointly with Cheshire West and Chester Council, is also not part of the group. Tatton Park Enterprises is also not part of the group; it reports to the Tatton Board.

The Council expects to have a new company – Civicance - in place from early 2015/16 providing planning support and building control.

- 1.6 The Council has shared its work on ASDV governance with its external auditors, Grant Thornton, at regular stages throughout the year. That open and regular dialogue helped shape and develop these arrangements in a positive and constructive way.
- 1.7 The Head of Corporate Resources and Stewardship and the Head of Legal Services have reviewed the governance arrangements set out in the 24 March 2014 report to Cabinet - Group Structure and Governance Arrangements. This report sets out their findings from that review.

2.0 Recommendation

- 2.1 That the Committee consider and note the contents of this report.

3.0 Reasons for Recommendations

- 3.1 It is important that the Committee is reassured that the governance arrangements for the ASDVs, and the role of the Audit & Governance Committee, in respect of those arrangements, is reviewed and remains fit for purpose.
- 3.2 The Committee's Terms of Reference includes: "overseeing the Council's roles and responsibilities in respect of Corporate Governance and Audit" and "...to undertake as appropriate an assessment of wider governance issues".
- 3.3 The recommendations fit with the Council's aim of becoming a strategic commissioning council.

4.0 Wards Affected

- 4.1 All

5.0 Local Wards Affected

- 5.1 Not applicable.

6.0 Policy Implications

- 6.1 The move towards more innovative, less traditional approaches to managing Council services is an exciting and necessary change in thinking to respond to a new era of public sector delivery and financial constraint. It is essential to get the balance right between effective delivery mechanisms and transparent and democratic governance linked to our Resident's First approach.

7.0 Financial Implications (authorised by the Chief Operating Officer)

- 7.1 There are no additional financial implications, other than those highlighted in this report.

8.0 Legal Implications (authorised by the Head of Legal Services)

- 8.1 The legal implications regarding the establishment of the companies were considered in reports to Cabinet in 2013 and specifically in February and March 2014.
- 8.2 The Council has the power to set up the companies under the general power of competence laid down by section 1 of the Localism Act 2011. Detailed considerations in respect of the requirements of the Companies Act 2006 were a key part of the decision making process.

9.1 Risk Management

- 9.1 The content of this report is part of the key risk that the Council fails to ensure the adequacy of governance and risk management arrangements over its commercial relationships and other service delivery arrangements, such that it is unable to account for the stewardship of public money and demonstrate its priority of ensuring quality and value of public services, in delivering its planned community outcomes.
- 9.2 Other risks recognised and being managed around governance and stewardship arrangements includes appropriate training for Members that are appointed as Non-Executive Directors of the new vehicles. In addition the establishment of a scrutiny committee with specific responsibility for the ASDVs enhances the member involvement and transparency of the company structure and delivery.

10.0 Background

Governance

- 10.1 The Council's overriding principle for the governance, stewardship and control arrangements for its ASDVs is to be resident and business led, and to ensure accountability to residents, service users, businesses and local councillors. However, the Council remains responsible for ensuring that it uses public funds properly and that it can demonstrate value for money.
- 10.2 The detailed governance and stewardship for all the council owned companies is set out below. Cabinet's control over the parent company and its subsidiaries is exercised through a number of key documents:
- articles of association;
 - directors' mandate; and
 - shareholder agreement.
- 10.3 The **articles of association** set out the objectives of each company and what its directors can and cannot do. They also include specific powers reserved for shareholders.
- 10.4 The **directors' mandate** sets out the more detailed 'set of rules' under which the company board can operate. These are particularly helpful in the context of local authority companies where the over-riding objective is to retain transparency and openness. They also have a key role in ensuring each company continues to benefit from the *Teckal* exemption

- at least initially. The directors' mandate will be signed by each director in March 2015.

- 10.5 **Cheshire East Residents First**, (CERF), held its first Board meeting in September 2014. Since then it has met regularly along with the Chairs of its subsidiaries. As the holding company its primary purpose is to hold shares in the subsidiaries that it controls. Its regular Board meetings focus on receiving and considering performance and business planning updates from each company.
- 10.6 CERF is Chaired by Cllr David Brown; Cllr David Topping and the Executive Director Strategic Commissioning are also directors. In line with expectations set out by Cabinet in March 2014 CERF met in public in December 2014 and will do so again on 20 March 2015. Cllr Peter Raynes also attends as Finance Portfolio Holder; Anita Bradley, Head of Legal Services, is the Company Secretary.
- 10.7 During this first year one of CERF's key objectives was to agree an appropriate **shareholder agreement** across the group of companies and with the Council. All parties recognised the importance of getting this key document right; this has involved detailed discussions with the boards of each company, their professional advisors and with Cabinet. The shareholder agreement is the key document between the holding company, Cabinet and the companies. It sets out, in some detail, how the shareholders will exercise control and influence over the group. The CERF Board holds the directors to account and has the key role in providing regular reports to Cabinet to ensure quality delivery and proper use of public money.
- 10.8 The shareholder agreement is particularly important for a council owned company operating under *Teckal*. It sets out how the shareholders and each company will work together to ensure that the Council exercises a decisive influence over both the strategic objectives and significant decisions of that company. This is usually done in a similar way to that which the Council exercises over its own departments - but only to the extent that this is necessary to protect the *Teckal* exemption.
- 10.9 The agreement sets out the governance principles agreed in March 2014 and includes a range of issues which are subject to prior approval by the shareholder before a decision can be made by the company boards. These include, but are not restricted to:
 - changing the name or nature of the company;
 - any changes to the Articles of Association;
 - approval of business plan;
 - appointment and removal of directors and auditors;
 - remuneration of directors;
 - issuing or allotting shares;
 - borrowing money;
 - declaring or paying a dividend;
 - requirement to meet in public;
 - changes to terms and conditions;
 - acquiring or disposing of assets.

- 10.10 The agreement will be signed by each company in March 2015 and is the key mechanism for ensuring that the Council - through the parent company, Cabinet, or via appropriate delegations - exercises decisive control over its companies and continues to approve significant decisions.
- 10.11 The governance arrangements for ESAR, Tatton Park Enterprises and CoSocius are different. In each case there is scope to develop the way in which these ASDVs provide regular updates and/or reports to Cabinet.
- **ESAR:** As an independent charitable trust the Council's relationship with ESAR is, essentially, contractual. A detailed contract and performance specification is in place. The contract protects the Council's interest and ensures that its significant investment in ESAR plays an important role in achieving its key strategic outcomes.
 - To provide additional protection, the freehold of the assets used by ESAR remain with the Council. ESAR operate/access these assets through a series of leases and licences.
 - Performance monitoring against the contract is led by the Council's Executive Director of Strategic Commissioning. Regular contract monitoring and reporting is done through the Council's client management arrangements, including discussions with finance and legal colleagues to review performance and delivery. Cabinet receives regular updates through the quarterly performance monitoring processes.
 - **Tatton Park Enterprises:** a company wholly owned by Cheshire East Council. Tatton Park Enterprises, (TPE), has a very limited function solely related to Tatton Park – to provide and manage catering staff and services on a 'non-profit' basis. Following the recent review of the role of the Tatton Board the Cabinet agreed that TPE should remain accountable to that board. As a result the Tatton Board now exercise the rights of the shareholder on behalf of Cabinet as well as monitoring TPE performance against the contract. Cabinet receives regular updates through the quarterly performance monitoring processes.
 - **CoSocius:** a company owned jointly with Cheshire West and Chester Council providing mainly back office services - ICT, finance and HR. The Council together with Cheshire West and Chester Council are the sole shareholders. The overarching objective of the shareholders is to ensure a well managed company with clear strategic direction which supports each council to deliver its outcomes.
 - The councils' shared services joint committee set out and refined the governance arrangements for CoSocius, its relationship with, and between, its shareholders over a number of its meetings from 29 November 2013 and to 27 February 2015. The committee agreed to the operational transfer of contracts and staff effective from 1 May 2014. Following a nine month initial term, on

27 February 2015 the committee approved the roll forward of the contract for the full five year term, to March 2019, on 27 February 2015.

- The Council exercises its powers as shareholder in CoSocius through the Shareholder Board. Each Council has appointed a shareholder representative to act in this capacity:
 - Cllr David Brown, Deputy Leader Cheshire East Council
 - Cllr Margaret Parker, Executive Member for Governance Cheshire West and Chester Council.

The other Board members are:

- Cheshire East Council: Peter Bates, Chief Operating Officer; and Anita Bradley, Head of Legal Services
- Cheshire West and Chester Council: Mark Wynn, Head of Finance; Karen McIlwaine, Head of Governance.
- The role of the shareholder is distinct from that of the shared services joint committee. The Joint Committee is the commissioner of services from CoSocius Ltd on behalf of the councils. When the company went live in May 2014 the committee set up a Transition Board responsible for overseeing and developing a tailored project plan and for reporting back to the Joint Committee. Between May 2014 and February 2015 the Transition Board met on a number of occasions and also held workshops with relevant members to both develop and monitor delivery the agreed work programme. The Transition Board will continue to meet during 2015/16 to review the outcome of the planned service reviews and make suitable recommendations to the joint committee. Cheshire East is represented on the Transition Board by Cllr David Brown; Mike Suarez, Chief Executive and Peter Bates, Chief Operating Officer.
- At present the company directors are – David Hudson, Interim Managing Director and nominated officers from Cheshire East and Cheshire West and Chester councils. Now that the full contract is in place the company will appoint a chairman and review its board membership.
- Performance monitoring against the contract is reported to the joint committee. Regular contract monitoring and reporting is done through the Council's client management arrangements, including discussions with finance and legal colleagues to review performance and delivery. Cabinet receives regular updates through the quarterly performance monitoring processes.

10.12 The Council has entered into a formal **contract** with all of its ASDVs. While the detail of each contract is specific to the service being commissioned, in general the contract sets out what, and how, services will be delivered. The contract is the primary document through which the Council commissions services and holds the service provider to account. The contracts are divided into four key elements:

- Contract Terms
- Output Specification
- Method Statements
- Performance Monitoring

- 10.13 **Contract Terms:** This is the main part of the contract and sets out the respective obligations of the contractor and the Council. They also set out the consequences of failure to comply with an obligation. In addition, the contract terms deal with issues such as how disagreements between the parties may be resolved. Each contract includes the arrangements for reviewing and agreeing the management fee due in each year.
- 10.14 The **output specification** sets out what the Council wishes the ASDV to do. Best practice is for the specification to set out the outcomes required by the client but not to specify how the contractor is to deliver those outcomes.
- 10.15 **Method Statements:** in this section the contractor sets out in detail how it will deliver the Council's required outcomes. The contract terms make it clear that the contractor is to deliver both the specified outcomes and what is set out in the method statements.
- 10.16 **Performance Monitoring:** in this section a number of key performance indicators are set to measure the extent to which the contractor is or is not delivering the desired outcomes. It is the responsibility of the Council to monitor the contractor's performance by reference to those key indicators.
- 10.17 Each contract includes appropriate provision in case of default by either party. These provisions depend upon the nature of the default; they include, for example, withholding or deduction of monies. Before any such provision is activated there is a full and proper dialogue with the company's managing director and the lead commissioner.

Reporting

- 10.18 Regular performance monitoring against each contract is led by the Executive Director of Strategic Commissioning through the Council's client management arrangements. This includes discussions with finance and legal colleagues to review performance and delivery. Cabinet receives regular updates through the quarterly performance monitoring processes. During 2014/15 the Executive Director of Strategic Commissioning has also provided regular reports and updates to the relevant scrutiny committee. CERF's role is limited to reviewing the performance of its subsidiaries in overall terms and not in relation to individual contracts.
- 10.19 In this first year the Council and its ASDVs have continued to learn and reflect upon the governance and stewardship of these new arrangements as well as contract monitoring and reporting on performance. There is scope to improve these arrangements to ensure that effective client and contract management is in place to deliver the best possible services to Cheshire East residents alongside effective reporting into Cabinet, Scrutiny and the Corporate Leadership Board.

- 10.20 While Cabinet has received regular updates through the Council's established quarterly performance monitoring processes this needs to be more explicit and cover all of the ASDVs. The Chief Operating Officer and Executive Director of Strategic Commissioning will discuss and agree improvements in reporting processes with Cabinet. These will then be shared with the ASDVs and appropriate mechanisms put in place for 2015/16.
- 10.21 The accounts of ANSA, Orbitas, EoTN and TSS will be consolidated into the Council's Financial Statements. From 2015/16 onwards the CERF Board's intention is that it will prepare and publish group accounts; these will then be consolidated into the Council's financial statements along with the disclosures required for any other Council owned companies.

Audit

- 10.22 The Council's external and internal auditors both have the right to inspect the accounts, books and records of all Council owned companies and the power to visit and inspect at any time.
- 10.23 The Council's internal auditors also provide services on request including routine audit work, advice and special investigations. The work planned for 2015/16 is included in the Council's internal audit plan that is also presented to this committee in March 2015.
- 10.24 All of the companies in the CERF Group are also subject to external audit – each company has appointed Grant Thornton. The audits will be conducted by the firm's commercial team. The Council and its companies are working with the Grant Thornton to ensure that the requirements of international financial reporting standards relating to consolidated financial statements are met.

Learning

- 10.25 The Council set up its first company, Tatton Park Enterprises in late 2012. That was followed by Engine of the North in May 2013 and others from April 2014 onwards. In most instances the Council adopted a 'lift and shift' approach transferring services and staff to provide the services set out in each contract. This initial phase has been very much a learning opportunity for both the ASDVs and the Council and as a result a number of changes have been made. This is in line with expectations and has enabled both the Council and its ASDVs to ensure that any early learning is reflected in an agile, practical and better way to meet the residents' needs.
- 10.26 This learning has been achieved through an open and transparent approach and includes the development of the parent company and group structure. There have been regular meetings between client managers and the officers of the companies as well as between the parent company, the various chairmen and relevant portfolio holders.
- 10.27 In May 2014, the lead officers in both the companies and the Council held a workshop to identify the learning and update the ASDV framework handbook. That workshop, together with the learning from drafting and agreeing the contract documentation for Ansa and Orbitas, enabled the Council to progress the Transport Solutions and Civcance,

(the Planning Support and Building Control company), proposals in a more efficient way.

- 10.28 More recently the client officers have been negotiating the management fees for 2015/16. This process, including the ongoing reviews of support service buy back, has also been done through open dialogue and engagement with the ASDVs. This has enabled any issues and concerns to be resolved in a pragmatic way. In future years that dialogue will start even earlier to ensure that there is adequate time for full engagement and better alignment to both the Council and the ASDVs business planning and budget setting processes.
- 10.29 The governance arrangements set out in this report will continue to be reviewed to ensure an appropriate balance between the proper governance and stewardship of public money alongside *doing things differently* and using innovative new approaches to service delivery. The Head of Legal Services and the Head of Corporate Resources and Stewardship have commissioned an independent peer review of the Council's governance of its ASDVs. The outcome of that review will also be reported to this committee.
- 10.30 The Council's external auditors are also considering the governance of ASDVs as part of their 2014/15 value for money work. The outcome of their work will be reported to this committee in September 2015.

11.0 Access to Information

- 11.1 The background papers relating to this report are:
Cheshire East Ltd – Group Structure and Governance Arrangements; Cabinet Report 24 March 2014
<http://moderngov.cheshireeast.gov.uk/ecminutes/documents/s33670/Group%20Structure%20and%20Governance%20Arrangements%20-%20report%20final.pdf>

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