

## **APPENDIX 2**

### Finance Sub Committee Working Group

#### TERMS OF REFERENCE

#### **1. Purpose of the Finance Sub Committee Working Group (“the Group”):**

- 1.1. The Group will carry out a Governance Review of Cheshire East Council Wholly Owned Companies (“WOCs”) and report back to the Finance Sub-Committee (“the Sub-Committee”) who may make further recommendations to Corporate Policy Committee.
- 1.2. The Group will:
  - 1.2.1. Review current governance arrangements in place for the WOCs against the Local Authority Review Guidance and toolkit, and CIPFA Guidance.
  - 1.2.2. Report its findings including any risks apparent from this review and as part of its report offer up suggestions as to any revisions to the current governance arrangements in order to mitigate any such risks.

#### **2. Membership**

- 2.1. The Group shall normally consist of 5 persons:
  - 2.1.1.3 elected members, drawn from the Finance Sub-Committee, the chair of the group shall be appointed by the Sub Committee.
  - 2.1.2.1 Officer representing Finance
  - 2.1.3.1 Officer representing legal.

#### **3. In Attendance**

- 3.1. To support the work of the Group the Chair may invite additional individuals to attend each meeting as follows
  - 3.1.1. Officers representing the Commissioning in services; depending on the WOC being reviewed.
  - 3.1.2. Directors from the respective WOCs.
  - 3.1.3. The Shareholder Representative who attends the respective WOC Board.

#### **4. Functions**

- 4.1. The core function of the Group is to:
  - 4.1.1. Follow best practice and learning from other Councils and recently published guidance and include:
    - the company governance in relation to the shareholder requirements as set out in the shareholder agreement which must be update following merger of companies and the advent of the committee system. It will consider reserved matters, control and reporting to the shareholder committee.
    - The selection, training, number of and skills of directors.
    - shareholder representation on the Boards.

- the role of the Council as shareholder in holding the company to account on its business plan objectives and the adequacy of the plans.
- Transparency, publication and reporting.
- The governance and reporting structure to the Committee and Finance Sub Committee in the varied roles of a) a committee of the Council b) as shareholder, c) appropriate scrutiny function and holding directors to account.
- Clear separation of roles between the council as shareholder and the company.
- Minimising the scope for conflicts of interest, proper consideration to a conflict of interest policy;
- Role of the Audit and Governance Committee in overseeing the effectiveness of the governance arrangements and giving assurance in the annual governance statement
- The Special Areas for Consideration (included as an appendix this Terms of Reference).

4.1.2. Provide assurance that the governance arrangements are legally and CIPFA compliant

4.2. The Group shall provide advice to the Sub-Committee on any potential risks to Cheshire East Council associated with the current arrangements

## **5. Frequency of Meetings**

5.1. The Group will meet during the period September to November 2022. The number of meetings will be determined by the Group.

5.2. The Chair of the Group will report the Group's observations and suggestions back to the Sub-Committee in accordance with the Sub-Committee Work Programme.

## **6. Administration**

6.1. Minutes and agendas will be distributed no later than 5 clear working days prior to the meeting.

## **7. Principal Information needs**

- Special Interest Reports (Contained in the appendices and links to the Report to Finance Sub-Committee 7 September 2022).
- Local Authority Review Guidance and Toolkit (September 2021).
- CIPFA Guidance (Local Authority Companies: a good practice guide, 2022)
- Articles of Association of the respective WOCs
- Shareholder Agreements for the respective WOCs
- Suggested Areas for Consideration

## **“SUGGESTED AREAS FOR DETAILED CONSIDERATION”**

1. The company governance in relation to the shareholder requirements as set out in the shareholder agreement.

In order to consider whether the shareholder’s requirements are being met (as set out in the shareholder agreement), it is helpful first to define what is meant by company or corporate, governance.

The definition adopted by the Institute of Chartered Secretaries and Administrators (ICSA), the professional body for company secretaries, is:

‘Corporate governance is the system by which companies are directed and controlled. Boards of directors are responsible for the governance of their companies. The shareholders’ role in governance is to appoint the directors and the auditors and to satisfy themselves that an appropriate governance structure is in place.

The responsibilities of the board include setting the company’s strategic aims, providing the leadership to put them into effect, supervising the management of the business and reporting to shareholders on their stewardship. The board’s actions are subject to laws, regulations and the shareholders in general meeting.’ (This is from the Cadbury Report (1992) page 14.)

### **Current Position**

The Council as shareholder must undertake a review of the shareholder agreement. The Council system of governance has changed, and the documentation no longer reflects current structures of the council or roles and responsibilities. The minimum is to update references to cabinet and portfolio holders.

#### **a) Shareholder agreements.**

The Council should seek further specialist legal advice in the redrafting of the Shareholder agreements to provide appropriate safeguards for the Council as shareholder. It is thought this will be the first review of their appropriateness since inception.

#### **b) Control**

The separate legal entity that a company enjoys, raises issues of control. The Council is the shareholder and funder of the companies, and should, pursuant to the Shareholder Agreements, have a high level of control. This needs testing against current activities to assess if the level of control is and if this remains appropriate.

#### **c) Risk**

The Council is taking the risk with the activity of the companies. This is particularly acute when the companies provide statutory services and undertake non delegable duties on behalf of the council. In these situations, companies (often irrespective of cost) can not be permitted to fail. This limits the perceived benefits of a limited liability undertaking or commercial risk taking.

The Council appoints the Directors, who deliver against their Business Plans and are (since the change in governance) accountable to the Finance Sub Committee. The Council funds the activity of the companies, through contractual or service agreements using taxpayers money.

The Council also provides some 'traded services' to the companies. Significantly, these services **do not** include the company secretary role, legal, financial or other roles.

The review should compare current business plan submission with other business in these sectors and other council owned business.

2. A clear process for decisions, performance and risk reporting from the companies through to Members in the Finance Sub-Committee and Audit and Governance Committee. To Officers through reporting to the corporate leadership team.

### **Current Position**

There is no formal reporting to CLT, in the last year Finance sub committee have been undertaking significant engagement as shareholder. Consideration should be given to how this may link together to improve Council and company planning.

3. The role of the Council as shareholder in holding the company to account on its business plan objectives

The Council has the role of holding the companies to account for delivery against their business plan objectives. The professional body for local authority lawyers, Lawyers in Local Government (LLG) issued a Code of Practice for the Governance of Council Interests in Companies in (2018). It refers to the option of a Shareholder Group to hold the Board to account with the inclusion of commercial expertise if necessary. The Shareholder Group is currently Finance Sub Committee and consideration should/could be given to enhanced their role through bespoke training and the adding of some external commercial expertise to the Shareholder Group, as a non-voting co-optee. (Local Government Act 1972 S.102)

4. Shareholder representation on the Boards

There is currently no definitive advice of the makeup of the Boards of Council owned companies. The Committee system has no executive leadership (Cabinet) and the best mechanism for providing direction to companies in the absence of an elected executive should be carefully reviewed. There are currently no professional officers (save for the shell remnants) or non-executive directors with industry expertise in any Cheshire East Company and consideration should be given to reviewing the expertise available to both the council and the company.

A director of a company has a legal duty to promote the best interests of that company. This can conflict with their other roles. Cheshire East Council has no conflict-of-interest policy, but members have a duty to resolve any such conflicts. This has implications for councillors who have links to the shareholder, or a political group, or a service committee that benefits from service provided by the company. Recent examples include service committees asking companies to undertake activities on behalf of the council.

The LLG Code of Practice is clear, that although conflicts of interest can be waived by the company, as a matter of law they cannot in a local authority setting. A Councillor & Director would always have to resolve a conflict of interest in favour of the company. That is because they have a legal duty at all times to act in the best interests of the company. The LLG Code of Practice therefore counsels against Councillor Directors being appointed, which is consistent with previous Government guidance on the same issue.

This is echoed in some of the recent public interest reports issued for considering some of the problems that Council companies have encountered, including Nottingham, Croydon and Liverpool.

The Robin Hood Energy (RHE) Ltd public interest report into the governance arrangements by Grant Thornton (<https://www.nottinghamcity.gov.uk/media/2835756/report-in-the-public-interest-rhe.pdf>) focused amongst other things on the role of councillors on the board.

There is no Corporate Leadership Team (CLT) representation on the Board. Best practice suggests that if appointing a senior officer to the Board of a Council owned company, that should not be the Chief Executive, the Section 151 Officer or the Monitoring Officer so as not to conflict with their statutory roles.

A full detail review should be undertaken to ensure the company board structure properly reflects the current best practice and the best outcomes for the residents of Cheshire East.

#### 5. Clear separation of roles.

It is appropriate for the council to look at the relationship with the companies through the traded service and insurance provision. These should be reviewed considering the guidance and conflicts of interest identified and where appropriate resolved.

#### 6. Role of the Audit and Governance Committee

During the last 12 months of Committee cycle there has been no proposals for Audit & Governance to consider the governance arrangements or to seek assurance they remain fit for purpose. The review should give consideration supporting and defining an effective role for A&G and the annual governance statement.

This may include consideration of the company finances when considering the council's accounts

There have been some high-profile Council company failures, e.g. Nottingham City Council's Robin Hood Energy which will cost the local taxpayers an estimated £38 million in losses.

Audit and governance issues have a role to ensure the correct structure is in place. This review could be used to provide assurance around the governance and the audit framework.

#### 7. Role of Scrutiny.

The current changes in governance structure has changed the mechanism of the scrutiny function. Finance Sub Committee is the primary committee as shareholder and is responsible to the initial scrutiny of the company. Local government scrutiny function is not found in a commercial environment and the potential to create tension with the shareholder function exists. It is suggested any review should give careful thought to value and positioning of Scrutiny as a check and balance to the risks from company/commercial approach.

This could be coupled with regular performance reporting against the Business Plans to either a Task Group or Sub-Committee.

### References

Cadbury Report (1992) (The Committee on the Financial Aspects of Corporate Governance)

LLG Code of Practice for Local Authority Companies (2018)

House of Commons Briefing Paper (2019) Local Government Alternative models of service delivery

Performance of municipally owned corporations: Determinants and mechanisms (2019) Voorn, B. et al

Organizational Publicness and Mortality: Explaining the Dissolution of Local Authority

Companies (2020) Andrews, R.

Public Interest Reports London Borough of Croydon, Liverpool City Council and Nottingham City Council.

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