Cheshire East Council

Working for a brighter future together

## Finance Sub-Committee

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| **Date of Meeting:** | 7 September 2023 |
| **Report Title:** | Wholly-owned Companies Governance Review – Board Composition and Shareholder Agreement |
| **Report of:** | David Brown, Director of Governance and Compliance |
| **Report Reference No:** | FSC/35/23-24 |
| **Ward(s) Affected:** | ALL |

### 1. Purpose of Report

1.1 At its meeting on 7 September 2022, the Finance Sub Committee (as Shareholder Committee) agreed changes to the Council's current arrangements in respect of its wholly owned companies, to improve governance and ensure that the Finance Sub-Committee is properly informed, in accordance with its responsibility as the shareholder committee. The Committee also agreed to set up a Shareholder Working Group to undertake a full review of the structure and governance of the Council's wholly owned companies, in line with published guidance and the CIPFA toolkit.

1.2 This report sets out the recommendations of the Shareholder Working Group.

### 2. Executive Summary

This report sets out the key findings of the Shareholder Working Group, having regard to its review of compliance with the published CIPFA guidance and the company purpose for the wholly owned companies. Its conclusions regarding the most effective approach to designing the Council's longer term company governance, reporting and board arrangements are:

**(a)** There should be a revised Board structure to support good governance.

**(b)** There should be an observer appointed to the Board to report direct to the Shareholder committee.

**(c)** Immediate attention to be given to rectifying some areas, including the removal of the Cheshire East Residents First (the group structure) from the governance structure and relevant documentation.

**(d)** A further in-depth review of Shareholder documentation to be undertaken.

**(e)** The risk appetite of the Council in respect of company risk is overall rated as ‘Low’ and risks should be appropriately mitigated to this position.

**(f)** Risk mitigation and controls are to be improved

**(g)** The Wholly Owned Company Working Group should continue, to report on future proposals for improving governance.

## 3. Recommendations

**3.1.** That the Sub-Committee Agrees that:

**(a)** From 19 July 2023 (date of Full Council), the Board of Directors of each of the wholly owned companies will be comprised as follows:

- One elected Member on the Board of each company to support local knowledge and service user functions. The Member will be appointed by Finance Sub-Committee following an open expression of interest and a transparent process; and
- Two Council Officers be appointed to the Board of each company, being 1x Finance Officer (on the recommendation of the Chief Finance Officer) and 1x Service specific officer (on the recommendation of the Chief Executive); and
- The Managing Director of the wholly owned company
- At least one Director may be appointed through external advert, being an independent sector specialist appointed for their expertise by the Finance Sub-Committee, supported by the Council’s HR service.

**(b)** An Observer will continued to be appointed to the Board as the Shareholder representative by the Finance Sub-Committee from amongst its number. The Observer will have the right to access all information and documents, to attend all meetings and to ask questions of each Board.

**3.2** All current and future Director appointments will be subject to a Shareholder approved service contract, and all Directors will be required to enter into this contract as part of their new or continuing appointment.

**3.3** The amended shareholder agreements set out in appendices 1 and 2 are adopted from 19 July 2023.

**3.4** That Cheshire East Resident First (CERF) no longer forms part of the governance structure of any Council wholly owned companies and any shares it holds are transferred to Cheshire East Council.

**3.5** That the Shareholder Working Group be asked to continue to:-

(a) undertake a full detailed review of the Shareholder Agreements against the CIPFA guidance and other good practice,
(b) to ensure that companies support the Council's strategic objectives and decision-making
(c) an appropriate and proportionate mechanism for control and review of risk is developed.
(d) consider the purpose of Orbitas bereavement services and Tatton Park Enterprises
(e) consider the creation of a timely mechanism for seeking shareholder permissions between scheduled committee meetings
(f) develop a business planning template to be implemented across the wholly owned companies

**3.6** That company risk registers and strategic decisions made by the companies form part of the reporting and monitoring mechanisms

**3.7** Recommend to Corporate Policy Committee that companies risks should be a separate category on the strategic risk register.

**3.8** That the Council's risk appetite in respect of the companies is 'Low' and that the companies should maintain a low risk approach to business activity.

## 4. Reasons for Recommendations

**4.1** The governance of wholly owned local authority companies (WoC) has come under significant scrutiny following very public failures resulting in the publication of Public Interest Reports for a number of Councils. Those reports highlight those failings in the governance of those companies which resulted in "institutional blindness" and a failure to recognise, understand, and address commercial pressures and conflicts of interest. Those governance failings resulted in high profile financial losses and reputational damage to the Councils and in some cases external intervention from Government.

**4.2** Guidance was produced by Local Partnerships in 2021 and was a recommended outcome of the review of Nottingham City Council. It provides a toolkit for use when reviewing both the Council's governance arrangements for overseeing the entities and holding them to account and reviewing the governance arrangements of wholly owned companies. In the light of the high-profile company failures, CIPFA have also published guidance aimed at mitigating the risk to local authorities of company ownership. Whilst framed as guidance, its status is such that external audit work will take this into account when considering our control framework and level of assurance the Council is able to provide.

**4.3** The Shareholder Working Group has carried out a review in accordance with the guidance and accompanying checklist and is making some immediate recommendations and has identified areas for further consideration.

**4.4** The recommendations in this report, if adopted, will:

- Put in place arrangements to reduce identified risks in the current structure.
- Provide a transparent and clear line of accountability on the reporting of risk, business planning and performance to the Finance Sub Committee (as Shareholder committee).
- Give assurance to the Audit and Governance Committee and provide evidence for the Annual Governance Statement.
- Inform and advise senior officers on performance and allow timely instructions to be given to commissioning officers.
- Help to develop a long-term approach for the Council as Shareholder.
- Put in place governance arrangements which reflect good practice as set out in the guidance.
- Promote open and transparent decision making (both by the Council as shareholder and by the Boards of the companies), open to scrutiny and demonstrating value for money in the delivery of Council services, which play an important part in the delivery of the Council's environmental objectives.
- Create a governance structure that meets statutory requirements, mandatory guidance, recommended good practice, and reflects the approach to risk adopted by the Council.
- Be sustainable over the medium term, including the Medium-Term Financial Strategy (MTFS).

**4.5** The service criteria and detail of the service provision on an operational or day to day basis sit with commissioning arm of the Council. There will be an overlap with the Shareholder committee, in so far as changes to the service requirements may alter the financial viability of a wholly owned company, but in the main both the requirements of the commissioning arm and the Shareholder committee should align e.g. the commissioning arm will wish to be reassured there are sufficient well trained staff, and the Shareholder committee will wish to ensure that the Directors have a proper staff recruitment and retention policy.

**4.6** The purpose of this report is to ensure the Shareholder oversight and control is adequate.

## 5 Other Options Considered

The options considered are:

**OPTION 1 - Do Nothing**. This is not recommended, as the Council would not be able to demonstrate that it has considered best value and taken into account good practice recommendations.

**OPTION 2 – Company Self Assessment and Transparency.** No changes made to the company boards and they are required to self-assess risks and propose any mitigations, and report on company performance for scrutiny purposes, purpose and benefits of the structure and upon the qualities and effectiveness of the Board. This is not recommended, as the Council as Shareholder would not be taken a proactive approach to companies which are delivering statutory services and on which it relies.

**OPTION 3** – **Maintain the current position with a shareholder observer appointed**. This would provide for greater transparency but would mean that no action could be taken for some time, which is not considered to be appropriate in relation to the exposure of the Council and the need to improve the governance.

**OPTION 4 – Change and strengthen the governance in line with the recommendations of the Shareholder Working Party.** This is the recommended option as it presents the best opportunity for improving governance and transparency, for the reasons set out in this report.

## 6 Background

**6.1** The Working Group held two workshop sessions with officers, to discuss key issues in greater detail and to work through the checklist of issues to be considered. At its first workshop in November the issues of membership of company boards and the commissioning/shareholder functions were considered, and at its next workshop in December 2022 members considered risk and control of the wholly owned companies.

**6.2** The Council has two remaining wholly owned companies that are engaged in service delivery; ANSA Environmental Services Limited (TSS Transport Services Solutions Limited having divided between ANSA and the Council on 31 March 2022) and Orbitas Bereavement Services Limited (which remains a separate company acting as agent in the delivery of the Councils bereavement services).

**6.3** A third company, Tatton Park Enterprises Ltd, was also set up as a wholly owned company in order to supply catering services within Tatton Park. Its operations are limited to this function.

## 7 Membership of Boards

**7.1** A Councillor who is a Director of a wholly owned company has a whole set of duties and responsibilities they must comply with in law, under the Companies Act 2006. By way of example, they have a statutory duty to promote the success of the company for the benefit of its members (i.e. the Shareholder) as a whole. Any company director (whether or not a councillor) must comply with their director's responsibilities, as failure to do so could risk significant reputational damage, may result in disqualification of the Director, and could even possibly be a criminal offence. Conflicts of interest must therefore be identified at the earliest stage, and they are not always obvious. A Director's duties may at times cause a conflict between the role of Councillor and Company Director, where the best interests of the Council are not necessarily the same as the best interests of the Company.

**7.2** For example, there may be instances when the requirements of the Council will necessitate that the Company arrange its priorities or carry out delivery in a manner which is less than optimal when compared with the Company's overall objectives, or where a Councillor is on a Committee which is considering services provided by the Company. In such cases a Director/Councillor would be required to act in the best interest of the Company, which may conflict with the Councillor's role as an elected member, and the public interest.

**7.3** There is not, currently, a Council Conflicts of Interest policy in place. The standing exemption granted by Audit and Governance Committee to directors of companies must be renewed every four years. The purpose of the exemption is to ensure Councillors are able to participate in the democratic process, but it is currently phrased broadly, and it applies to all circumstances including those where a councillor would be obliged to vote on council business in accordance with the company's interests. As the number of 'member' directors is likely to be limited for the future, the need for such a wide exemption can be reconsidered to ensure it is still appropriate.

**7.4** The Working Group considered the statutory requirements and responsibilities placed on Directors and felt that it was necessary to ensure a balance between member oversight and knowledge, while having the support of officers and independent directors with industry expertise to bring specialist knowledge of the subject area. The working group felt that the inclusion of a member as director ensured that the Council retained a strong voice on the Board and when considering non delegable duties and core services such as waste collection members have unique insight through their role as elected representative. The inclusion of a sector specialist not only provided a specialist skill set but also an industry perspective and a proportionate degree of challenge to mitigate against the risk that the Board became inward looking.

**7.5** Their recommendation was that all members of a company board should have a service contract in place, approved by the Shareholder committee, and that the composition of the board should be as follows:-

a) One elected Member as a Director. That Member to be appointed on merit (where possible) by the Finance Sub Committee following an open expression of interest/appointment process;

b) Two Council Officers; one Finance Officer (on the recommendation of the Chief Finance Officer) and one Service specific officer (on the recommendation of the Chief Executive) to provide expertise and challenge;

c) Not less than one independent Director, selected and appointed by the Finance Sub-Committee on the grounds of their sector specialism and expertise. There would be an open and transparent recruitment process for these appointments, supported by the Council's HR service.

d) Managing Director of the company

In addition, there would be one Member of the Finance Sub Committee as an Observer (as opposed to a Director) to challenge and ask question from the Shareholder perspective. The Observer should be entitled to all documents and supporting papers they require to carry out their role, as well as being invited to all meetings. The inclusion of a member of the Finance Sub-Committee as an Observer provides an open and transparent way for the Shareholder to understand the management and operation of the Council's wholly owned company at Board level.

**7.6** The Working Group felt that all directors' appointments should be subject to review and that there should be some form of performance management in place. The company should ensure that all Directors are provided with sufficient and appropriate training, updated periodically, and which should be demonstrated via a structured training programme and performance review.

**7.7** An agreed programme of training (for both Directors and Observers) for all existing Directors and new Directors was requested by the Shareholder Committee This has not yet been achieved.

## 8 Purpose of the Companies

**8.1** The Working Group was invited to consider the purpose of each of the companies as it is important to ensure that the purposes for which they were set up still remain relevant. Members were reminded that the 'Teckal

Exemption' had been used to award the contracts to the wholly owned companies, and of the criteria for this:-

- the contracting authority exercises control over that economic entity that is similar to that which it exercises over its own departments (known as the "control test"); and
- the economic entity carries out the essential part of its activities with the contracting authority (known as the "function test").

Members agreed to recommend that the companies continue to operate on a 'Teckal' basis as they considered that the criteria were still being met, and this would mean that the current contractual relationship (direct award of a contract for operation of services) can remain in place. Members asked for further work to be considered on the merits of using a wholly owned company structure to provide statutory service and this is considered further under risk.

## 9. Shareholder Function

**9.1** The Council makes decisions as Shareholder through the Finance Sub Committee, whose terms of reference include the following:-

*"making decisions as Shareholder, reviewing and approving Business plans, including risk registers and commissioning services and functions from the Council's ASDVs"*

**9.2** The Council's original governance arrangements were predicated on a group structure being in place with Cheshire East Residents First (CERF - a group structure) taking an active role in the arrangements, however this is no longer the case. The Council's Shareholder function is now discharged through the Finance Sub-Committee, which (through the Shareholder Working Group) reviews the business cases of the wholly owned companies and communicates with the Boards. CERF does not play an active role and is in the process of being dissolved, and therefore the Shareholder Agreements have been revised on an interim basis to remove the existing anomalies and they should be immediately adopted to reflect the current position. A Shareholder Agreement sets out the respective roles of the Board and the Shareholder and sets out the powers of the Board and the reserved matters i.e., those decisions for which the approval of the Shareholder is needed. It is necessary to undertake a further detailed review of to the Shareholder Agreements to reflect both the Council's new style of governance, members recommendations and guidance and other good practice.

## 9 Risk

**9.1** The Working Group considered its risk profile in respect of ANSA, which the Council uses to provide statutory services. If ANSA begins to fail in any way then the Council will need to step into ensure continuity of a statutory service. As the service is essentially underwritten by the Council and it cannot be allowed to fail, then the limitation of liability by creating a company structure is largely illusory as the Council must, in any event, ensure that the services to residents continue. The Council, through the Shareholder, needs to have a clear understanding at all times of the financial position of ANSA and the level of risk to which the Council is exposed. Key risks relate to residual liability, and minimum controls in place must include guarantees, indemnity statements, subsidy controls, improved financial oversight, incentivisation of behaviours and clearer distinction between Shareholder and commissioner. Recent events also highlight the issues around non-delegable duties and of appropriate control, oversight, and instructions on the activity of the contractor/company.

**9.2** In the event of any further expansion or increase in traded services for ANSA or the other wholly owned companies, there needs to be a clear understanding of how the Shareholder retains oversight of the associated risk and who agrees to accept that risk (bearing in mind that ultimately the Shareholder will have to step in if there is a prospective failure of the wholly owned company. Shareholder risk is different from service committee risk, as the Council has direct control over the services it directly provides.

**9.3** The Working Group was invited to consider the risks present as a consequence of operating a company, both in terms of its non-delegable statutory functions and the drive to make profit/reduce the management fee and the mechanisms by which the Council exercises control over its companies. It was asked to consider any further arrangements it felt should be put in place to support good governance and it recommended that, in view of the level of risk appropriate controls should be put in place during the further review of the Shareholder Agreement, to ensure that a low level of risk is maintained.

## 10 Control of Companies

**10.1** Business plans have been reviewed on an annual basis and recent changes to reporting and monitoring processes have been introduced to ensure that that the financial positions of the companies are scrutinised by the Council, but it is not clear whether the Council has had sight of the companies strategic risk registers and reviewed the risk/levels of risks they (and by extension the Council) are exposed to, so as to be clear of the impact of any financial or other pressure on the company and thereby the Council as Shareholder.

**10.2** The review of the risk registers and strategic decisions made by the wholly owned companies should now form part of the regular reporting and monitoring mechanisms**.** The Shareholder having already required quarterly reporting to take place. The Working Group recommended that Corporate Policy Committee may wish to ensure the Council's strategic risk register reflects risks relating to wholly owned companies.

**10.3** The Working Group recommended that a Council-led business planning template be developed and implemented across the wholly owned companies to ensure the Shareholder is fully appraised of all relevant information and is able to hold each Company and its Directors to account against the agreed business case, in order to assess if outcomes are achieved.

**10.4** The Shareholder Agreement is an agreement which sets out the rules by which the Shareholder and the wholly owned company decide their rights and obligations and sets out how the company should be managed. It is currently set out as a series of limitations on the Directors' powers to do things, rather than setting up a framework for the operation of the comapny and specifying the parameters within which they should be operating. For instance, it limits the wholly owned company's ability to seek legal advice in contemplation of legal proceedings without the Shareholders permission, but it does not set a framework for how and where the wholly owned companies can obtain their legal advice.

The other control mechanisms are specific e.g. guarantees but as the Shareholder will be keen to limit liability falling on the Council in any circumstances a restricted definition is not particularly relevant. This in part reflects the previous governance with a group company arrangement through CERF. These matters all need to be addressed in the revised Shareholder Agreements for the future review.

## 11 Consultation and Engagement

This report will be shared with the Directors of the current wholly owned companies.

## 12 Legal Implications

**12.1** The legal implications are set out in the body of this report. There are significant liability issues relating to the functioning of wholly owned companies. Some are a direct function of ownership whilst others relate to how services would be provided in the event of default of the wholly owned company. Other issues relate to conflicts of interest, overlapping liabilities or non-delegable duties etc. It is important that issues are identified and essential to hold timely reviews to ensure compliance with the most recent standards in good governance.

**12.2** There has been significant public interest in this area following the high-profile company failures in other local authorities. CIPFA Guidance on Council Owned Companies formally sets out requirements for audit purposes. Taking immediate steps and putting in place arrangements for review in the longer term will demonstrate that the Council is taking a proactive approach in reviewing and amending its governance processes

## 13. Finance Implications

13.1 There are significant financial risks involved in failure of wholly owned company governance. For example, a failure of statutory services through a wholly owned company will result in urgent funding and if the wholly owned company has provided indemnities or entered into third party agreements the liability can escalate significantly.

13.2 The Council must ensure the value for money criteria remains at the forefront of its thinking and that the Annual Governance Statement properly reflects the risk profile of the Council's holdings.

13.3 Officers are not remunerated as any directorship is considered to be part of their role.

13.4 The directors remuneration is paid by the company and will in the future be subject to a formal agreement. This is also reported on the Member remuneration disclosure.

## 14. Policy Implications

Good corporate governance is at the heart of the Council's core values, and this report supports the priority of 'Open and Fair'. It also supports our financial priorities in ensuring that the Council's finances are well managed.

## 15. Equality

There are no direct equality impacts arising from this report.

## 16. Human Resources

16.1 Each wholly owned company will be required to have a shareholder approved service agreement in relation to each director and that agreement will set out the company's obligations to each Director. The wholly owned companies have a difference in approach to staffing matters, whistleblowing etc., and it will be necessary to consider if the HR and other policies of each wholly owned company align with those of the Council or whether these need to be reconsidered.

16.2 The recruitment of external independent Directors will require the support of HR services to ensure the Council's processes are followed.

## 17. Risk Management

The overall risk profile of the Council cannot be separated from any potential wholly owned company failure either in terms of statutory service provision or financial liability. The proposals are designed to properly understand the Council's risk exposure and where possible reduce risk. The Working Group also recommends that clearly identified risks should be placed on the strategic risk register to enable the Council to have an overall view of risk across all its areas.

## 18. Rural Communities

The governance of wholly owned companies has no direct implications for residents. All residents will be directly impacted if companies are not able to provide services and evidence value for money.

## 19. Children and Young People/Cared for Children

The governance of wholly owned companies has no direct implications for Children and Young People.

## 20. Public Health

The governance of wholly owned companies has no direct implications for Public Health

## 21. Climate Change

The governance of wholly owned companies has no direct implications for climate change. However, the Councils' policies on a sustainable approach can be strengthened through ensuring it influences its wholly owned companies to deliver within the Council's policy framework where possible.

| **Access to Information** | |
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| Contact Officer: | David Brown |
| Appendices: | Appendix 1 & 2 - shareholder agreements<br>Appendix 3 minutes from the working group |
| Background Papers: | NIL |