CHESHIRE EAST COUNCIL
CHESHIRE WEST & CHESTER COUNCIL

SHARED SERVICES JOINT COMMITTEE

Date of Meeting:	28 March 2014
Report of:	Cheshire East – Chief Operating Officer Cheshire West & Chester – Director of Resources
Subject/Title:	CoSocius Limited Go-Live Decision

1.0 Report Summary

1.1 The purpose of this report is to seek approval to transition CoSocius Limited, which is currently operating in 'shadow mode', into a fully operational, arms-length, trading company.

1.2 In considering readiness for go- live the report addresses the following:

- The financial viability of the company as a stand-alone trading entity.
- The company's five year financial model and projected shareholder returns.
- The financial, legal and risk implications of the future operating model for the Councils and the company.
- The governance, contractual and performance framework for the new company.
- The transition and benefit realisation plans.
- Programme assurance evidence.

1.3 The overall conclusion is that all essential pre-requisites for go-live are in place.

2.0 Recommendations

The report recommends that the Shared Services Joint Committee:

2.1 approves the transition of CoSocius Limited to become a trading entity from 1st April 2014, with planned operational transfers of contracts and staff effective on 1st May 2014.

2.2 authorises the Head of Legal and Democratic Services for each authority in consultation with the Section 151 Officers for each authority to finalise the detailed terms and conditions for, and enter into, all necessary legal documentation required to give effect to recommendation (2.1) including but not limited to the:

- Contract for Services;
- Shareholder agreement;
- IT Systems and Services agreement;
- Support Services Agreement;
- Leases of Goldsmith House and Kelly House;
- Working Capital Agreement;
- Data processing and Data Sharing Agreement;

referred to in section 10 of this report;

2.2.1 Approves the provision of a joint working capital facility to the Company of £7m on terms to be agreed by the Head of Finance (CWaC) and Chief Operating Officer (CEC);

2.2.2 Agrees the provision of a joint guarantee by the two Councils in respect of pension liabilities for the duration of the contract for services in respect of transferring staff with an estimated value of £7.3m;

2.2.3 Agrees to the provision, by the two Councils, of such financial guarantees as the Company may reasonably require for the duration of the Contract for Services subject to the approval of the Head of Finance (CWaC) and Chief Operating Officer (CEC) on a case by case basis including parent company guarantees up to £50k;

2.2.4 Endorses the 5 year financial model, on the understanding that regular reports are submitted to the Shareholder Board and appropriate Council governance committees.

2.3 Endorses the cost reduction activity outlined in Section 5.2.4 that proposes to displace a proportion of contractor staff with fixed term contracts.

2.4 Endorses the Transition Improvement Plan included in Appendix 7.

2.5 Agrees that the Programme Board prepares for a formal ‘Closure’ of the delivery programme, focusing on the cut-over to transitional activity and produces a final closure report including lessons learned.

3.0 Reasons for Recommendations

3.1 The Councils set out on a journey to create a limited company that would deliver value to shareholders and the public and develop an innovative and sustainable business model which builds on the success of the existing shared service arrangement and the savings, in excess of £6.7m, that have already been achieved since 2009.

3.2 CWaC Executive and CEC Cabinet members[1] have agreed to transfer the existing ICT and HR & Finance Shared Services into a Teckal compliant company wholly owned and controlled by both Councils, now called CoSocius Ltd. CoSocius was established as a company limited by shares in September 2013. As a company it is a legal entity, capable of making its own decisions. It can enter into contracts, employ staff, own property and bring court proceedings in its own name. The company currently has three directors, Chris Mann (CEC) and Mark Wynn (CWaC) and Dominic Whelan (Managing Director).

3.3 Whilst CoSocius is registered as a limited company, it is currently operating in "shadow mode". It is therefore not formally trading and no assets, staff or business has been formally transferred from the Councils.

3.4 In line with agreed programme management and governance procedures this report has been prepared to assess the readiness of the new company to operate independently from its shareholding Councils and to take on the transferred functions and associated assets.

3.5 The assessment is based on consideration of the following issues:

Financial viability: the net operating costs of the company are analysed in **Section 5** below. These are affordable within the current levels of budget provision in both Councils. The inflation, income generation and efficiency savings targets assumed in projections for future years are considered reasonable.

Projected Shareholder returns: the 5 year financial model set out in **Section 6** demonstrates how the original business case savings targets will be achieved, and potentially exceeded over the medium term. This is based on generating new trading income, but also attracting additional shareholding partners.

Financial and, Legal Implications & Risk Management considerations: Sections 7, 8 and 9 of the report set out the specific financial and legal implications for the Councils of the new company arrangements. The governance model proposed will allow these to be managed and controlled so that the wider interests of local tax payers and business are not compromised.

The proposed contractual and governance arrangements: set out in **Section 10**, they provide a robust framework for future management and direction of the company and a basis to drive forward culture change in both the company and the client Councils in a spirit of mutual co-operation and shared success.

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[1] *Report to CWaC Executive 9th January 2013 and report to CEC Cabinet 2nd April 2013 – which includes the approved high level business case.*

The Transition Improvement and Benefit Realisation Plans: **Sections 11 and 12** of the report outline the work required beyond go-live to ensure that CoSocius remains a sustainable and viable commercial entity which delivers a return to its shareholders.

Programme Board Assurance & Independent verification: **Section 13** describes the evidence that has been used by the Programme Team to support the go-live recommendation and the positive outcome of independent verification undertaken by the Internal Audit teams of both Councils.

4.0 Background

In December 2009 the Shared Service Joint Committee articulated a vision that would see key shared back office functions operating on a more commercial footing and delivering significant benefits for both partners. This report sees the culmination of four years' work to make that vision a reality by transitioning of the ICT and HR and Finance Shared Services to a separate legal entity – CoSocius Limited – a wholly owned company owned by Cheshire East and Cheshire West and Chester Councils.

The following section provides a brief overview of the Programme Board Governance & Delivery phases which have led to the recommendations in 2.0.

4.1 Programme Governance

A Programme Board was established in June 2013 comprising seven workstreams to ensure a safe implementation of the company. The Programme Board Senior Responsible Owners (SRO's) are Chris Mann (CEC) and Mark Wynn (CWaC) and the governance of the Board is provided by the Joint Officer Board jointly chaired by Peter Bates, Chief Operating Officer (CEC) and Julie Gill, Director of Resources (CWaC) and the Shared Services Joint Committee, chaired by Cllr David Brown (CEC) and deputy chair Cllr Les Ford (CWaC).

The Programme Delivery Plan includes a significant amount of work which changes the way the Councils will operate with CoSocius in the future.

4.2 Programme Delivery

The Programme Delivery Plan has had two significant phases. The Phase 2 Programme Delivery Plan is attached at Appendix 1.

4.2.1 Delivery Phase 1:

The first 100 days (June – Nov) focussed on tasks relating to the governance and formation of the company, culminating in the Shared Services Joint Committee approval on 29th November 2013 of the following:

- Articles of Association
- Decisions reserved to the Councils as shareholders
- Proposals for the establishment of, composition and terms of reference for the shareholder board
- Heads of terms for the shareholder agreement, contract for services, working capital facility and support services
- Proposed structure of the CoSocius company Board of Directors and company organisation design
- Key operating principles recommended in order for CoSocius to be established on a commercially viable basis, covering:

    - Staff remuneration and pensions
    - The Councils commitment (including any new separate legal entities) to purchase from the company
    - The treatment and ownership of assets
    - Management of contracts
    - Council funding and guarantees to the company
    - Basis of charging for services

4.2.2 **Delivery Phase 2:**

The final 100 days (from Dec 13 to the formal Closure of the Programme): focussing on tasks relating to the re-baselining of the service budget to reflect the true costs of CoSocius (as described in detail in Section 5) and all contractual matters between CoSocius and the Councils as Shareholders (as described in detail in Section 10).

Whilst CoSocius is registered as a limited company, it is currently operating in "shadow mode". It is therefore not formally trading. No assets have been transferred, staff have not formally TUPE transferred from the Councils to CoSocius, no formal contract for services has been signed & sealed nor have any financial guarantees been approved by either Council.

In line with good programme management and CEC & CWaC Council's governance procedures this report has been prepared following a robust assessment of the readiness of the new company to operate independently from its shareholding Councils. The Phase 2 Programme Delivery Plan is attached at Appendix 1.

From 1st April 2014 the focus of the Programme Board will be:

- to initiate formal closure processes, executing cut-over activity, completing final due-diligence of programme deliverable,
- preparing for the deliverability of the Transition Plan activities; and
- the production of a formal Closure report including lessons learned.

The sections to follow address the key factors in determining whether CoSocius is ready to move to the natural next step to Go-Live from 1st April 2014.

5 The Financial Business Case

As previously referenced the case for creating CoSocius was to harness the benefits that a more commercial operation can potentially deliver through increased trading, securing greater economies of scale and business development and growth.

This section focuses on the financial affordability & future viability of CoSocius and assesses the case for change which delivers the financial benefits that will accrue.

5.1 Original business case

5.1.1 The original high level business case was based on the Cheshire Shared Services cost base as at October 2012. Over the past 18 months a significant amount of work has been undertaken to establish the full cost of operation as an arms-length company, and inevitably there have been some changes to the original assumptions. The largest single change is that the assumed increase in the future service contribution rate for the LGPS (cost was projected to cost £168k in 2014/15 rising to £503k 2018/19) which has not materialised following the latest advice from the pension fund actuary. Therefore the revised consolidated position is improved compared to the original business case.

5.1.2 Spending in 2013/14 in respect of one-off set up costs and business start- up is broadly in line with the original business case estimates of £395k and £250k respectively. All on-going costs have been included in the financial model set out in Appendix 3 along with revised and updated income and savings projections. Whilst these are based on similar assumptions to those included in the original business case, they have been updated and re-phased to reflect current views on market opportunities and a better understanding of potential cost and savings associated with on-boarding new partners.

5.1.3 It is important to note that the original business case included estimates for income from a new ‘factory’. The current CoSocius financial model and scenarios referred to in this paper do not include any assumptions for a new ‘factory’ at this stage because the business plan has been based on existing services and functionality that is transferring to the Company. The Councils may choose to further review the services offered by the Company which may increase efficiencies and offer more market opportunities.

5.1.4 It is therefore proposed that the updated financial model set out in Appendix 3 is approved as a basis for monitoring future delivery and performance and that the estimates included in the original business case are deemed superseded, and are used for comparative purposes only.

5.2. The Cost Base for CoSocius

5.2.1 In order to transition the existing shared services, hosted by CWaC and recharged to CEC on largely a 50/50 basis, a baseline trading account has been established to identify the total net operating cost of the business. This is detailed in Appendix 3 and shows a baseline net operating cost of £13.7m, as compared to the historic service cost of £10.1m. The difference reflects the adjustments required to move from a traditional "in-house" cost base (which normally only includes direct costs), to a full cost accounting basis, including all business operating costs and overheads. The adjustments required are summarised in the table below:

Re-baselining details:	£m
Current base budget as an "in-house" services	10.1
Additional funding approved in the business case to cover additional ongoing set up costs such as new corporate staffing and to cover costs of ongoing support services (e.g.: legal, finance, audit etc.)	+0.4
Transfers of existing support service budget (mainly running cost of Goldsmith House (rent, business rates, utilities), but also includes legal, finance, insurance etc.)	+1.0
Access charge for use of Council owned asset by the company (mainly the Oracle platform)	+2.3
Interest on working capital loans provided by the Councils	+0.3
Budget reduction for the historic pensions deficit retained by the Councils	-0.4
Restated Cost Base	**13.7**

5.2.2 To implement the above changes, there will be a number of corporate budget transfers which will ensure that the services provided by the company are still affordable within planned budget resources. ***Therefore the new cost base for CoSocius results in no new additional budget requirement for either Council***.

5.2.3 In November 2013 the fixed / variable cost ratio was calculated as 70/30%. Following the re-baselining exercise the percentage split of fixed / variable cost has been recalculated and the fixed costs are now moving in a downward direction. The Transition Improvement Plan will address the further restructuring of the cost base required to enable CoSocius to respond more flexibly as both Councils move towards a commissioning model of service delivery. This will be facilitated by exploitation of developments such as the implementation of PSN in 2014/15, and through further review of staffing, contract and corporate fixed costs

5.2.4 An example of how CoSocius is seeking to realise cost reduction benefits can be demonstrated in the following approach being taken to change the current capacity & capability model:

Moving forward the company wishes to use the option to employ more people on temporary contracts in lieu of contractors, likely to be between 12 months to 2 years in length but dependent on customer demand. Initial assessment of the cost reductions, based on 25 roles over a 2 year period, is in the region of £600k - £900k and it will have a direct impact of reducing the overall cost reflected in the rate card[2].

6. The 5 year Financial Business Plan

6.1 The Company Financial Plan includes a five year financial model that is based upon an agreed financial budget and forecast for 2014/15. It then builds up over the following four years to give a forecast based on the medium term business strategy. A detailed financial spreadsheet is available: a summary of this is attached at Appendix 3 providing detail on the 2014/15 financial budget and the forecast for the financial position at the five year point, based on achievement of three potential scenarios. Further detail on these scenarios is included below.

6.2 The 2014/15 Financial Plan.

6.2.1 The start point for the five year plan is the setting of the detailed 2014/15 financial budget based upon the following:

- the baseline 2013/14 Budget for Cheshire Shared Services
- plus additional funding allocated in the SLE Business Case
- minus 2014/15 efficiency targets
- plus the addition of the company operating overheads (previously within Council departments)

6.2.2 The CoSocius 2014/15 baseline Budget summarised by operating area is:

Staff and People	11,144
Premises and Facilities	1,105
Corporate Operations (incl Buy Back)	3,733
Technical Services	4,631
Projects	7,808
Gross Cost	**28,421**

Current Income	6,940
Current Income Projects	7,808
Total Current Income	14,748
Net Cost to both Councils	**13,673**

[2] Rate Card refers to the daily rates of charging for provision of Project and Change activity.

6.3 Five Year Financial Model with Scenarios (Revised Company Business Plan)

6.3.1 The five year financial model is based upon the base line costs set at 2014/15 (as per table at 6.2.2) uplifted for pay awards (1% per annum) and non-pay inflation (2.5% per annum). It also includes efficiency savings and income from sales and a new partner.

6.3.2 The following scenarios are used in the financial tables illustrate how the Company can deliver savings against the baseline (section 6.3.6 – 6.3.9):

- **Scenario 1** – focuses on the Company achieving the savings targets illustrated in section 6.3.3 and with the current level of income for schools and councils being maintained; but with no further income from new business or any income from a new partner.
- **Scenario 2** – builds upon the savings in Scenario 1 and also includes income from new business as illustrated in section 6.3.4
- **Scenario 3** – builds upon the savings and income in Scenario 2 and includes financial benefits from the successful on-boarding of a new partner in 2016/17 and a further partner in 2018/19.

6.3.3 The savings targets are based upon assumptions that savings will be achieved through a mix of the following:

- 2014/15 – staffing efficiencies (£0.2m); utility costs (introduction of energy saving measures - £0.025m) and reduction in operating costs (postage and stationary - £0.1m) and technical (reduction in circuits - £0.2m)
- 2015/16 – focus on licencing models; 3rd party contracts and reduction in applications – total savings £0.5m;
- 2016/17 – staffing and technical savings achievable due to increase in scale following new partner (focus on applications, service desk and customer contact areas) and costs of capital – total savings £0.48m;
- 2017/18 and 2018/19 – technical savings (focus on new licencing and cheaper service provision of core platform and applications) and support service costs (review of 3rd party support contracts) – total savings £0.4m per annum.

6.3.4 **New Business Targets** – The marketing strategy includes a focus on increasing sales within the Education sector, Blue Light and Health and Public Sector Network (PSN). The creation of the new Commercial Director and supporting Business Development Manager posts will provide capacity to develop this pipeline and future bid opportunities.

- Education: The intention is to build upon the successful service currently provided to Academies and Schools and reach out towards the independent sector. To aid this strategy, the Company is creating a dedicated Business Relationship Manager for Education. The targets for new business in this area assume that we achieve new contracts from 2014/15 onwards.

- Blue Light and Health: To operate in these sectors, we will be able to leverage the benefits of the PSN and the associated secure network provision as well as existing service provision for ICT and Employee Services. The Managing Director has experience in Blue Light sector and the new Commercial Director has experience in the Health sector. Blue Light services are being encouraged to look at new ways of delivering services and sharing across Local Authorities. Recognising that this is a new area, the target for new business commences in 2015/16.

- Public Sector Network. Both Councils have invested in PSN which will deliver savings to existing councils and schools and provide greater flexibility and a more stable and resilient network. CoSocius will aim to develop this as a product to sell onward. This should achieve benefits to the Councils by sharing the fixed costs across a wider PSN client base. It will also allow CoSocius an opportunity to gain a small revenue from provision of the 'wrap around services' such as internet and firewall provision, email and internet filtering. Targets for this commence in 2015/16 to allow for the new network to be established.

6.3.5 The income targets used in the model have been based upon the following assumptions, including:

- operating margin for new sales of 12%;
- financial information for a new partner is based upon detail previously developed from conversations with other councils;
- financial information for payroll and ICT services for smaller contracts (i.e.: academies and blue light) is based upon existing tender assessments;
- PSN sales based upon the existing costing work for provision of CoSocius 'wrap around' services such as firewall, internet and email filtering and management charges.

6.3.6 **Scenario 1 – Achievement of Savings Targets**. The following table shows the baseline cost (as at 2014/15) with an updated Year 1 forecast for 2014/15 onwards including indexation applied and achievement of savings targets.

Savings targets achieved but no new business or new partner	**Baseline Costs**	**Year 1 2014/15**	**Year 2 2015/16**	**Year 3 2016/17**	**Year 4 2017/18**	**Year 5 2018/19**
	£'000					
Gross Cost	28,421	28,548	27,653	27,328	27,162	26,788
Net Cost	**13,673**	**13,673**	**13,132**	**12,726**	**12,356**	**12,040**
Total Savings from Baseline	**0**	**0**	**541**	**947**	**1,317**	**1,633**

6.3.7 **Scenario 2 – Achievement of Savings Targets <u>and New Business Targets</u>**. The following table shows the baseline costs as per the table above including the savings targets. It now also includes the impact from income and costs of sales for new business (Section 6.3.6).

Savings, new business targets achieved but no new partner	Baseline Costs	Year 1 2014/15	Year 2 2015/16	Year 3 2016/17	Year 4 2017/18	Year 5 2018/19
	£'000					
Gross Cost	28,421	28,898	29,094	29,838	30,741	31,436
Net Cost	**13,673**	**13,673**	**12,949**	**12,397**	**11,881**	**11,396**
Total Savings from Baseline	**0**	**0**	**724**	**1,276**	**1,792**	**2,277**

6.3.8 **Scenario 3 – Achievement of Savings Targets, New Business Targets <u>and New Partners.</u>** The following table shows the baseline costs as per the table above (Section 6.3.7) including the savings targets and new business targets. It now also includes the impact from income and costs of sales for new partners.

It assumes that CoSocius gains a new Local Authority partner in 2016/17 that achieves additional savings to existing shareholders and it also targets an additional smaller Local Authority organisation in 2018/19. The detailed financial modelling for a new partner has been based upon the previous work completed for a potential partner project. Using that model the contract value of approximately £7.8m pa of income, would deliver approximately £1m savings pa to the new third partner and an additional £1.8m savings pa to CoSocius existing shareholders

Savings, new business targets achieved and new partners on-board	Baseline Costs	Year 1 2014/15	Year 2 2015/16	Year 3 2016/17	Year 4 2017/18	Year 5 2018/19
	£'000					
Gross Cost	28,421	28,898	29,094	35,912	36,815	40,874
Net Cost	**13,673**	**13,673**	**12,949**	**10,581**	**10,295**	**9,404**
Total Savings from Baseline	**0**	**0**	**724**	**3,092**	**3,378**	**4,269**

6.3.9 **Comparison against original business case**. The original business case for the separate company made assumptions on potential income from three elements: new business, new partner and a new 'business unit'. The table on below (row 1) shows the predictions from the initial business case assuming the income from all three elements was achieved. The following rows provide the summary detail for each of the three CoSocius scenarios outlined above.

	Year 1 2014/15	Year 2 2015/16	Year 3 2016/17	Year 4 2017/18	Year 5 2018/19
Total Savings – Original Business case	(830)	1,230	1,190	1,110	no data
Total Savings – CoSocius 5 year model (Scenario 1)	0	541	947	1,317	1,633
Total Savings – CoSocius 5 year model (Scenario 2)	0	724	1,276	1,792	2,277
Total Savings – CoSocius 5 year model (Scenario 3)	0	724	3,092	3,378	4,269

6.4. Summary of the Financial Case

The savings identified in Scenario 1 were not included in the original business case and many will be achievable without necessarily setting up the Company. However, Scenario 2 and 3 demonstrate the potential savings that may be achieved if the Company is established. Scenario 1 therefore acts as the secure base line to build upon for these future potential benefits. If the Company pursues the new business opportunities then the financial model indicates that it will out-perform the revenue savings targets in the original business case by 2016/17 without needing to gain a third partner. However, the business strategy seeks a third partner and potentially a fourth. This would enhance the savings further as shown in Scenario 3.

7.0 Financial Implications – The Councils Financial Commitments

7.1 The following section sets out the financial implications for the two Councils arising from the recommendations set out in Section 2.

7.2 ***Contract for Services***

Both CEC & CWaC will have their own contract for services with CoSocius. Both clients have specified their Service Requirements and CoSocius has responded with a priced offer. The cost of the contract for 2014/15 with both authorities is £13.7m. The basis of the contract price, this year, for both partner authorities is full cost recovery including the cost of overheads but no profit margin. Income generated by new business, outside of the Councils, will be charged with appropriate margins including profit but taking account of the limitations placed by Teckal. CoSocius will need to move to a more mature and commercial pricing model in the medium term and this is captured as a key outcome in the Transition Improvement Plan, referred to in Section 12.

7.3 ***CoSocius Cashflow forecast***

The Councils will provide a working capital loan facility from Day 1. The cashflow modelling has identified that the maximum working capital requirement is expected to be £7m but this will fluctuate during the year depending on actual cashflows. The maximum anticipated exposure for each council is £3.5m. This will be closely monitored – at least monthly - by the Company Board of Directors and by the company financial controller (a role to be filled initially on a buy-back basis from CWaC). Specific draw-downs from the loan will be done in agreement with the Councils. A copy of the initial cashflow forecast is attached at Appendix 2.

Interest on the loan will be initially be charged at 4.85%. This equates to a market rate of interest and is sufficient to ensure the Council complies with State Aid guidance (based on advice obtained directly from DCLG). It is assumed in the financial forecasting that the interest rate will reduce as the Company trades and begins to improve its credit worthiness. The Company will review its credit score using an appropriate rating agency such as Dunn & Bradstreet or Experian on at least a six monthly basis.

7.4 ***Parent Company Guarantees (PCG's)***

For PCG's relating to CoSocius the Councils will act as the "parent" company. At present the Councils are not giving any PCG's other than the Pension Guarantee – detailed in Section 7.5. However for CoSocius to win business from other Public Sector bodies it is likely that PCG's may be required in the future. If they are required, approval will be sought on a case by case basis. It is proposed that authority be delegated to Head of Finance (CWaC) and the Chief Operating Officer (CEC) to approve individual guarantees with a value of up to £50k each on a case by case basis. Shareholder approval above this limit will be required.

In addition to PCG's the Councils may need to provide supplier guarantees. As part of the programme delivery plan we have contacted all suppliers to advise them that their contract will be transferring to CoSocius (either Novated or as managing agent). It is possible that some suppliers may require a guarantee from the Councils as CoSocius does not have the same credit standing as the Councils. To date we are not aware of any such request.

7.5 ***Pensions***

The Cheshire Pension Fund will require the Councils to guarantee the LGPS pensions liabilities of CoSocius in order to protect the interests of other Scheme employers. On a normal outsourcing, the Councils would pass this risk to a 3rd party usually by requiring the company to either purchase a pensions bond (a form of insurance) or provide a Parent Company Guarantee (PCG). For a new company such as CoSocius with no financial reserves and no financial track record, purchasing a bond could be a significant cost. The estimated cost is between £146k a to £292k pa based on a bond amount of £7.3m. However, over the longer term as the company becomes more financially secure and has its own credit record, this cost should fall.

The Councils will provide the equivalent of the PCG as they already carry the funding risk relating to the staff who will transfer to CoSocius and they will retain significant control over the operation of the company. It is anticipated that as the company evolves through the incubation period and moves towards commercial independence, it will reduce the potential liability of the Councils PCG. Reducing reliance on Council support has been identified as a key success criterion in the Transition Improvement Plan.

There is a risk that provision of a parent company guarantee could be challenged as unlawful state aid. However the Councils have taken expert advice and consider that the provision of a PCG is justifiable in the circumstances and the risk of a challenge is considered to be small.

7.6 ***Insurances***

The contract requires the Company to insure against the following risks:

- Public Liability Insurance – £10m
- Employers Liability Insurance - £10m
- Professional Indemnity Insurance - £2m
- Computer Insurance (Kelly House) - £5m
- Cover as required by the leases - various

In addition the company will maintain Directors and Officers professional indemnity cover for £2m for the Board of Directors.

The company may have a higher level of cover especially whilst it is buying as part of the Councils policy. The company may also choose to take out other cover such as business interruption.

7.7 ***Capital Budget***

Included in the contract is a requirement for the Councils to keep oracle and related systems platforms up to date. The estimated projected total cost of meeting this obligation over the next 5 years is £9.1m shared between the 2 Councils. This amount has been used to calculate the access payment of £2.1m which the Councils will charge CoSocius for the use the Oracle platform.

The estimated total of £9.1m comprises £5.4m for the regular updates and minor upgrades, and approximately £3.7m for a major upgrade that is expected towards the end of the initial 5 year contract period in around 2018/19. Current capital programme provision is sufficient to meet the expected cost of £5.4m for the regular updates/minor upgrades, but is not sufficient to fund the cost of the major upgrade. Therefore a further business case and approval would be required before this major upgrade could commence. This restriction will be reflected in the contract.

8.0 Legal Implications

8.1 The legal aspects of the decision to externalise services to a company were documented in detail in the reports to Executive and Cabinet in January 2013 and April 2013 respectively including consideration of legal powers, trading requirements, the application of the Teckal procurement exemption and TUPE/pensions. Further legal implications are included within the body of the report as appropriate.

8.2 The Councils have taken specialist legal advice in relation to state aid (which is unlawful) and taken necessary steps to mitigate the risk of a state aid challenge by ensuring the company is charged commercial rates for the leases of Kelly House and Goldsmith House, market rates of interest in relation to working capital requirements and the inclusion of leasing charges for access to IT systems. As noted in section 7.5 there is a small risk in relation to the provision of a parent company guarantee by way of a pension bond, however the Councils consider the approach taken is justified.

8.3. Certain information referred to in the appendices to this report, namely appendices 2, 3, 4 and 7, is exempt information within the meaning of paragraph 3 to Schedule 12A of the Local Government Act 1972 as it contains information relating to the financial and business affairs of the Councils and Company. Due to the commercial sensitivity of this information, the public interest in maintaining the exemption outweighs the public interest in disclosing it.

9.0 Risk Management

9.1 The Top 12 programme risks as previously endorsed by the Shared Services Joint Committee, is attached in Appendix 6.

9.2 All risks have been regularly reviewed by the Programme Board. The majority of risks are still relevant as the CoSocius transitions to a separate trading company. Therefore appropriate risks will continue to be monitored by the Board of Directors and its management team through the company Risk Management Strategy and progress reported to the Shareholder Board at agreed intervals

10 Proposed Contractual Arrangements & Governance

10.1. In November 2013 the Shared Services Joint Committee approved the recommended governance and management structure for CoSocius [3]. This included the Matters Reserved for Shareholders. Some elements of these arrangements are still to be implemented, for example the appointment of non- Executive Directors and the Company Chairman. It is proposed that the Shared Services Joint Committee delegate to the Section 151 Officers of each authority, in consultation with the Chair & Vice Chair and the respective Heads of Legal Services the implementation of the final governance structure.

[3] Shared Services Joint Committee report 29 November 2013: Governance arrangements – CoSocius Limited; and Company Board of Directors structure - CoSocius Limited.

10.2. The Contract Documentation between the Councils and CoSocius has been prepared and details are listed below. The contracts and agreement are in the process of being agreed between CEC and CWaC lead officers and legal representatives. This is supplemented by additional external expert advice of complex matters such as State Aid. CoSocius has appointed an independent legal firm (Anthony Collins LLP) to review the legal documentation of behalf of the Board of Directors.

10.2.1 ***The Contract for Services***

The contract for services sets out the overarching terms and conditions such as payment arrangements, service default provisions and termination. Attached to it are a number of key schedules;

- **Service specification, KPI's and Charging Schedule** (CWAC and CEC) - form a key component of this document and set out what the company will provide to what level of service and at what cost;
- **Business Transfer agreement** – deals with the transfer of office equipment, personal IT and novation of existing customer contracts
- **Property Leases** - The form of leases for Goldsmith House and Kelly; House;
- **Contracts –** details of all contracts to be managed by the company on behalf of the Councils together with those to be novated to the Company;
- **Staffing and Pensions** - detailed provisions for dealing with the transfer of staff, the apportionment of liabilities, pension arrangements including continued access to the LGPS and the list of transferring staff;
- **Change control** – mechanism for dealing with changes to the service during the contract period;
- **Benchmarking** – provides for the services that may be benchmarked by the Councils and the process to be followed;
- **Data processing and data sharing –** Arrangements for the processing of data by the Company on behalf of the councils and for sharing data between the Councils and the company;
- **Support Services agreement –** sets out the terms on which support services are to be provided by the Councils to the Company, such as HR, Finance and company secretarial. Initially these services will be provided by CWAC with a review initiated if key personnel, the nature of the services or volumes change. The provision of support services is for a period of 3 years. For year one, charges will be £497k.
- **Working Capital and contingency agreements -** As referred to in Section 7.3, the Councils will each provide a revolving working capital facility to the company.

10.2.2 IT Systems and Services Agreement

The Councils are making the Oracle platform, network and infrastructure available to the company to enable it to:

- provide the contracted services back to the Councils,
- to support the business of the company – for example to enable it to run its own payroll, and
- provide services to third parties. A leasing charge will be made to the company and the company will be responsible for maintaining the systems and services to a specified level.

10.2.3 Shareholder Agreement

This agreement sets out the relationship between the two Councils and the company and includes provisions for management of the company and approval of the business plan, access to company records, transfer of shares, admission of new shareholders and termination arrangements.

10.2.4. Property Leases

The Company will enter into leases in respect of Kelly House and Goldsmith House for a term of 5 years with break clauses at the end of the 3rd year (12 months' notice). It should be noted that Kelly House will be granted a sub-lease subject to landlords consent.

10.3 Contractual & Operational activation

To enable cut-over activity, the contract for services will commence on 1st May 2014 which will trigger a transfer of staff under TUPE and will be the effective date for all other legal documentation. The revised Articles of Association approved by the Shared Services Joint Committee on 29th November 2014 will be formally adopted in early April.

10.4 Company Governance Manual

As part of its governance arrangements the company will have its own set of Finance and Contract Procedure Rules (FCPRs) which set out a framework for managing decisions and the related financial implications, including defining who is authorised to make these decisions. These are broadly in line with those of the two Councils.

The critical elements of a robust governance framework will be in place for Go-live date. These include:

- Financial & Contract Procedure Rules
- Financial Scheme of Delegation
- HR Scheme of Delegation
- Health & Safety Policy

The remainder of the governance policies are in development and will be completed post 1st April 2014; these include elements such as:

- Equality Policy
- Sustainability Policy
- Risk Management Framework
- Data Protection Policy, HR Policies and Procedures (e.g. Discipline, Grievance, Capability etc.)

11.0 Expected Benefits

11.1 The original business case and decision papers included benefits (both financial and non-financial) as follows:

Deliver savings**:** through sharing overheads, bringing on new partners, developing a more commercial business approach and streamlining governance arrangements.

Improve quality & performance**:** by responding quickly to changing technology and customer requirements and developing a strong, customer orientated performance culture.

Respond to change**:** by developing a cost effective and attractive back office offering for new providers.

Create value**:** by capitalising on existing assets and intellectual property and trading goods and services to generate financial returns and scale economies.

11.2 The key tasks undertaken by the Programme Team will ensure there is a solid platform on which to create a sustainable and viable commercial trading company. It is recognised that in order to achieve commercial success a significant change in culture and behaviours is required by both CoSocius and the Councils. To ensure that continued improvement and change is delivered the Transition Improvement Plan in Appendix 7 will ensure that focus is placed in the areas that will deliver the optimum positive impact.

11.3 The consolidated Benefit Realisation Plan is detailed in Appendix 4. This will evolve further with input from the full Board of Directors and the Shareholder Board in order to allow all stakeholders to influence the direction of travel. The realisation plan currently incorporates the planned financial benefits over the next 5 years together with the key areas:

- Building Value (Financial Management & Growth)
- Quality & Performance (Commercialisation & Culture)
- Innovation & Competitive Advantage (Technology & Capability)

12 Transition Improvement Plan

12.1 The development of the CoSocius programme has introduced a more business minded approach to these ex-council services. However further work is still needed to allow the company to meet its future aspirations.

12.2 The Shareholder Agreement will include a schedule of Guiding Principles and a Transition Improvement Plan to shape the future direction of travel and ongoing development of the company and the contractual relationship between the Councils and CoSocius. It recognises that the contractual relationship must be managed in the spirit of shared success but that significant cultural and business process challenges need to be addressed.

12.3 The Transition plan sets out the key tasks that whilst not critical for "go-live", are essential in order for CoSocius to remain viable and become a sustainable commercial trading company capable of generating new income streams and generating value and return on investment for its shareholders.

12.4 The Transition Improvement Plan seeks to deliver swift business improvements and shareholder benefits in the short to medium term. This is attached at Appendix 7 and covers key improvement themes of:

12.4.1 ***Governance***: Including appointments to the company Board and finalisation of Shareholder Board arrangements. There are also some legal formalities and supporting governance processes that need to be completed;

12.4.2 ***Operational Structure & Key Business Processes***: Some requirements within the plan to review and improve business processes with a more commercial mind-set. The structure will also need to be reviewed to ensure the optimum delivery vehicle for the company;

12.4.3 ***Contract Pricing / Commercialisation***: The current contract (based on full cost recovery) will need to evolve in order to become more sensitive to changing customer demands and to reflect a more commercial pricing approach;

12.4.4 ***Customer Focus***: Further focus needs to be given to developing improved customer understanding and more responsive and flexible engagement models; and

12.4.5 **Business Plan**: Delivery of the financial business plan which will inevitably develop over the course of the contract life, subject to Shareholder Approval.

12.5 In order to emphasise the importance of the outcomes to be addressed by the Transition Improvement Plan and their significance in terms of wider benefits realisation, and to attach appropriate priority to their delivery, the Transition

Improvement Plan will be included in the Shareholder Agreement thereby, securing contractual obligation for delivery on all parties.

13 Review of Readiness for Go-Live

The following section sets out the Programme Board review of Delivery outcomes, the independent verification of the readiness for go-live and the transition of inflight and outstanding programme deliverables into a Transition Improvement Plan as described in Section 12.

13.1 *Programme Board Summary of Delivery*

The Programme Delivery Plan summary is attached in Appendix 5. It provides a Programme Board view of:

- progress against deliverables & outcomes
- a status of readiness for go live
- outstanding tasks – the interim position and the risks & controls in place to ensure that outstanding tasks are not critical to a go-live decision

13.1.2 At the time of writing this report there is one Amber status. This relates to current “inflight” activity relating to the preparation, negotiation and agreement of the legal contractual documentation which is currently with both Client side legal representatives and appointed CoSocius lawyers. It is therefore felt prudent to award an amber status until such time agreement has been reached. An update on the current position will be tabled on the day of the decision to ensure that members have up-to-date facts to enable an informed decision.

The Programme Board endorses a positive Go-Live decision.

13.2 *Independent Governance & Review*

In order to provide a consistent, comprehensive controls framework that protects the client Council, or Councils; Cheshire West and Chester’s Internal Audit team developed an externalisation toolkit for use by the project team.

As part of the assurance process the Audit team were asked to provide an independent review of the completed toolkit as at week ending 21 February. The review assessed the information provided within the toolkit together with the available evidence that had been provided by the project team.

The review did not identify any major issues, risks or omissions from the toolkit and the Audit Team were able to provide a degree of assurance that risks associated with the overall process had been identified and managed.

That said, the review did identify a number of issues that have either been addressed in full or incorporated into the Transition Improvement Plan, which forms part of the Shareholder Agreement. There is no evidence to suggest that any of these items will have an impact on a positive go live decision.

On the basis of the completed toolkit, its subsequent review by Audit in CWaC and CEC, the completion and monitoring of the transition plan and ultimately the right of each Section 151 Officer to, collectively or independently, instruct internal audit involvement in future areas of concern, Internal Audit supports a 'Go Live' recommendation.

14.0 Wards Affected

14.1 This report relates to Shared Services that operate across both Cheshire East and Cheshire West and Chester so all wards are affected in both Councils.

15.0 Local Ward Members

15.1 Not applicable.

16.0 Policy Implications including - Climate change
- Health

16.1 None.

17.0 Other Options

17.1 Should the Shared Services Joint Committee decide not to approve CoSocius' transition to the next stage, the Committee should consider alternative delivery models as documented in the Options Appraisal & High Level Business Case – December 2012.[4]

18.0 Conclusion

18.1 On the basis of the assessment set out above, the overall conclusion of the Programme Board, is that all the essential pre-requisites for go-live are in place and that this can be effected from 1st April 2014, in line with the original business case target.

18.2 To summarise:

- CoSocius is financially viable from Day 1 with a 2014/15 budget that has been approved by the Councils. This includes the full and complete operating costs for a standalone company taking account of all of the associated corporate overheads and financial obligations.

- The financial case for CoSocius projects an achievement of the original business case by 2016/17 without a third partner and with an expectation to outperform the original savings.

- A robust framework is in place to manage contract and performance complimented by a detailed transition improvement plan that will deliver improvements in customer centric and commercial delivery.

[4] *Report to CWaC Executive 9th January 2013 and report to CEC Cabinet 2nd April 2013 – Options Appraisal & High Level Business Case.*

- Expert legal & financial advice has been sought to support decision making and contractual terms. The programme of delivery to prepare CoSocius for the transition has sought independent assurance of the readiness for go-live.

18.3 The Programme Board supports the recommendations in this paper.

19.0 Access to Information

The background papers relating to this report can be inspected by contacting the report writers:

Officer: Peter Bates, Chief Operating Officer – Cheshire East Council /
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Background Documents:

Cheshire East Cabinet Report – Shared Services – 7th October 2008
Cheshire West and Chester Executive Report – Joint Liaison Committee Recommendations: Caretaker and Nominated Councils; Shared Services: Service Delivery Option; Shared Back Office Services – 15th October 2009
Cheshire East Cabinet Report – Shared Services – 3rd March 2009
Cheshire West and Chester Executive Report – Shared Services – 18th March 2009
Cheshire East Cabinet Report – Shared Services – 23rd March 2009
Cheshire Shared Services Joint Committee Report –10th June 2009
Cheshire Shared Services Joint Committee Report – 13th July 2009
Cheshire Shared Services Joint Committee Report – 3rd September 2009
Cheshire Shared Services Joint Committee Report – 30th September 2009
Cheshire Shared Services Joint Committee Report – 26th October 2009
Cheshire Shared Services Joint Committee Report – 26th November 2009
Cheshire Shared Services Joint Committee Report – 3rd February 2010
Cheshire Shared Services Joint Committee Report – 12th March 2010
Cheshire Shared Services Joint Committee Report – 31st March 2010
Cheshire Shared Services Joint Committee Report – 28th May 2010
Cheshire Shared Services Joint Committee Report – 16th July 2010
Cheshire Shared Services Joint Committee Report – 17 September 2010
Cheshire Shared Services Joint Committee Report – 29 October 2010
Cheshire Shared Services Joint Committee Report – 26th November 2010
Cheshire Shared Services Joint Committee Report – 7th January 2011
Cheshire Shared Services Joint Committee Report – 25th February 2011
Cheshire Shared Services Joint Committee Report – 18th March 2011
Cheshire Shared Services Joint Committee Report – 29th July 2011
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Cheshire Shared Services Joint Committee Report – 26th April 2013
Cheshire Shared Services Joint Committee Report – 28th June 2013
Cheshire Shared Services Joint Committee Report – 26th July 2013
Cheshire Shared Services Joint Committee Report – 13th September 2013
Cheshire Shared Services Joint Committee Report – 29th November 2013
Cheshire Shared Services Joint Committee Report – 10th January 2014

Documents are available for inspection at:
Cheshire East Democratic Services
Westfields
Middlewich Road
Sandbach
CW11 1HZ
or:
Cheshire West & Chester Democratic Services
HQ Building,
Nicholas Street,
Chester,
CH1 2NP