

AUDIT COMMITTEE – 27 April 2018

Title of paper:		BEST PRACTICE FOR THE GOVERNANCE OF CITY COUNCIL COMPANIES	
Director(s)/ Corporate Director(s):		Strategic Finance Director	Wards affected:
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Other colleagues who have provided input:			
Recommendation(s):			
1	Consider and comment on the proposed Code of Best Practice for Governance of Companies.		

1 REASONS FOR RECOMMENDATIONS

- 1.1 Good governance of those companies in which the Council has an interest is an integral part of the governance arrangements of the Council as these ventures involve the expenditure of public money and the stewardship of public resources.
- 1.2 The timing of this review reflects the change in strategic context.

2 BACKGROUND

- 2.1 The City Council has 7 main subsidiaries – a trust and 6 companies, and a further 2 joint ventures included in its group accounts. These 8 group subsidiary companies have been created over many years, but
 - the pace of creation has increased recently as a result of imperatives for alternative delivery models and a commercial approach.
 - the potential size of these companies in relation to the Council as parent is increasing as the Council's funding is restricted by measures introduced by the UK government.
 - the Council's appetite for risk has increased and this should be reflected in the related control environment – mechanisms will be required to ensure commercial risk taking matches strategic requirements.
- 2.2 At the 14th July 2017 meeting of this committee councillors asked for Internal Audit to identify best practice in local authority company governance with a view to proposing a framework for City Council owned companies.
- 2.3 Suggested terms of reference for the review were prepared and approved at the 22nd September 2017 meeting of this committee.
- 2.4 Evidence gathering and a literature review were completed in November 2017 and proposals formulated for consultation with key stakeholders in NCC and its companies. The proposals in this report are the result of this process.

Concepts

Types of Company

- 2.5 The companies owned by Nottingham City Council are
- Private company limited by guarantee. The liability of the owners (members) on winding up the company is limited to the (usually nominal) amount stated in the company's articles. It is commonly used for not-for-profit companies;
 - Private company limited by shares. The liability of its owners (the shareholders) is limited to the amount, if any, unpaid on the shares which cannot be publicly traded.

Ownership and Control

- 2.6 Companies wholly or partially owned are generally companies limited by shares where Nottingham City Council owns all or some of the shares. The Council is able to exert control by
- being able to appoint, approve or remove directors;
 - providing funding, with rights of control over how that funding is spent;
 - owning a share conferring special rights; or
 - being able to set or constrain corporate policy.

Definition of a company

- 2.7 A company is a voluntary association of individuals incorporated by registration, usually created to conduct business, to become a separate legal entity from its owners. It has the full legal powers of an individual, for example to enter into contracts, raise funds, incur liabilities and employ staff. It is accountable to its owners but their liability for what the company does is limited.

Power to Trade

- 2.8 Under both the Local Government Act 2003 and Localism Act 2011, the power to trade must be exercised through a company.
- 2.9 Section 95 of the 2003 Act can be used to trade in any ordinary function of the authority including well-being (as long as the primary purpose is not revenue raising and no charges are made for mandatory services). A business case and risk analysis is required.
- 2.10 The General Power of Competence (GPC) within the Localism Act 2011 states that: "A local authority has power to do anything that individuals generally may do" without reference to its ordinary functions. It enables local authorities to do things:
- anywhere in the UK or elsewhere
 - for a commercial purpose or otherwise, or for a charge or without charge
 - for, or otherwise than for, the benefit of the authority, its area or persons resident or present in its area.
- But does not
- provide local authorities with any new power to raise tax or precepts, or to borrow
 - enable councils to set charges for services where the authority has a statutory duty to provide the service to that individual,

- enable councils to impose fines or create offences or byelaws affecting the rights of others, over and above existing powers to do so.

Formation and NCC constitution

2.11 The Council's constitution requires as part of Financial Regulations that

B.10 The Chief Finance Officer is responsible for providing guidance on setting up Companies.

B.11 Corporate Directors and the Director for Public Health are responsible for seeking approval from the Chief Finance Officer and Head of Legal before setting up a company or establishing formal relationships with any external organisation.

2.12 There is no current standard guidance for setting up companies. It is proposed that the Chief Finance Officer will from time to time set out and communicate updates and amendments to the key requirements for setting up companies.

Principles

2.13 The principles set out in the proposed Code of Best Practice for Governance of Companies (the Code) are as follows:

- The Company will be provided with the freedoms to achieve its commercial and operational objectives.
- The Council will retain controls which enable it to protect its investment and ensure that its objectives are met.
- Information will flow between the Council and the Company to ensure that mutual understanding and shareholder / company objectives are maintained.
- Appropriate business ethics will be enforced so that decisions are taken for the benefit of the company and the Nottingham City Council Group (the Group), with directors acting for their company, and a designated officer acting for the Group respectively.
- Any interests (including competing interests between the Council and Company, or between Group companies) will be formally recognised and controlled according to the Code of Conduct and Company rules.

2.14 These principles will provide for:

- Stewardship of assets
- Upholding legal duties
- Understanding Company performance
- Understanding of the external environment
- Effective governance of the Company
- Effective governance of the Nottingham City Council Group

2.15 As a shareholder, the Council's role is not to directly manage the business. That is a matter for the company's Board and the company's senior managers. Grant Thornton in its report "Spreading their wings" has noted the overriding determinant of a company's success is the drive and ambition of the people running the business. Company Boards must therefore be allowed sufficient freedom to deliver the strategic and operational priorities of the Company.

- 2.16 As outlined in Grant Thornton's "The Board: creating and protecting value" the company's Board of Directors must have the right skills to be able to manage the business of the company. This will enable Executive Directors to make decisions aligned with the company's purpose, and Non-Executive Directors (NEDs) to guide and support the Executive Directors in achieving the company's purpose. NEDs should ensure that the board has the right information to provide assurance on outcomes and progress, and acts appropriately on it. Executive Directors should have a clear view and control of resource use, plans and outcomes so that they can ensure that resources are deployed to meet strategic aims.
- 2.17 The Council in forming or financing a company should set in place controls to enable it to protect its investment and achieve its objectives. The following are suggested approaches from the review:
- The Council is required to consider a business case and risk analysis in deciding whether the Company should be established and proceed to trade.
 - The Council has the right to appoint board members.
 - A shareholder's agreement can be used to set out decisions which the company directors can only make with approval of the shareholder (the Council).
 - Birmingham, Bristol and York City Councils have the right to approve substantial changes in the company's business plan.
 - Norfolk (Norse Group), Birmingham, Bristol and York operate a shareholder board to advise companies and the council executive, in order to do so they monitor and evaluate company reporting.
 - Financial agreements are commercial agreements that set out assistance provided to the Company and on what terms. These would include resourcing including loans, services and staff, and may require regular detailed access to information and financial reporting.
- 2.18 Suggested terms of reference for a Nottingham City Council shareholder board are attached at Appendix 1 to the Code.
- 2.19 The form of a model shareholder agreement is set out at Appendix 2 to the Code.
- 2.20 Consultations with stakeholders have been particularly useful for identifying the necessary features of relationships between the Council and its companies, contributing to the review. Information flow should be two-way enabling the Council and the Company to work together effectively for mutual benefit. In particular the Council
- will set out its objectives and priorities at the outset – any changes will be timely, proportionate, commercially realistic and part of the annual review
 - will define and communicate clear roles for its representatives who meet with the Company and these meetings will have an agenda and be minuted;
 - will engage with the Company to understand, record and analyse the unit costs of the Company's deliverables as key performance indicators (KPIs) and its effect on Council and Group Company KPIs (incorporating factors such as interest payments, tax savings, business rates, savings/contributions on connected council activities and effect on the economy), companies will be reviewed annually – these reviews together with triennial reviews will be a mechanism for considering change in investment and funding.
 - will engage with the Company to understand and support it in relation to resourcing, including staffing (a commercial pay model), working capital, the investment cycle, cashflow, and retained profits.

- will maintain a joint risk register to ensure risks are managed across the Group, and engage with the Company to plan assurance requirements.
- will set out clear and consistent processes with commercial timescales for key decisions such as loans.
- will ensure that commercial confidentiality of sensitive information is maintained and agree a non-disclosure agreement where appropriate.

And the Company

- will engage with the Council in a timely fashion, keeping it well informed, where it requires funding or other support from the Council
- will communicate any commercial timescales and sensitivities
- will provide the information required in its agreements with the Council as part of its normal reporting cycle
- will engage effectively with the Council's assurance providers

- 2.21 Directors of the Company must act for the company, declaring and avoiding any actual or apparent conflict of interest. The Company Board should have skills appropriate to the sector and roles. To ensure this is achieved the Board should have mandatory training including induction and an annual training programme. An annual skills audit and triennial independent review should be used to support the Board and identify appropriate external expertise including NEDs.
- 2.22 A Grant Thornton recommendation to Birmingham City Council was that its company board chairs should all be independent NEDs and responsible for appointing other board members, selecting those with the relevant skills from the wider business community. This was identified as important to ensure that commerciality was promoted and it was suggested that councillors would retain directorships in each company board to represent the Council as shareholder.
- 2.23 Our consultations have identified that NEDs help to improve prioritisation by the board and that the role and impact of councillors on boards can be unclear. The following suggestions are made to address improvement of prioritisation by boards and improve clarity for companies and councillors regarding the roles and scope of councillor directorships.
- Managed progress towards more NED board chairs
 - Councillor directors limited in each company (with appropriate voting arrangements to maintain Teckal exemptions if necessary)
 - An assessed councillor development programme including commercial board skills. Councillors with the assessed skill to be eligible to be placed on company boards
- 2.24 A guidance note for Directors of Council owned companies is set out at appendix 3 to the Code which follows practice identified by Birmingham and Solihull LEP.
- 2.25 The Best Practice for Governance of Companies proposals set out in appendix 1 analyse the findings of the literature review and consultations across key activities to provide a summary of requirements for the Council and the Company. Appendix 4 provides an example of how the Council's Chief Finance Officer might request information from City Council owned companies
- 2.26 The following list of Appendices to the proposed Code of Best Practice for Governance of Companies is provided for reference

Appendix	Appendix Title
1	Proposed NCC Shareholder Board Terms of Reference
2	Proposed Form of a Model Shareholders' Agreement
3	Proposed Guidance note for Councillor Directors
4	Proposed Template Letter from Chief Finance Officer to NCC Company

3 BACKGROUND PAPERS OTHER THAN PUBLISHED WORKS OR THOSE DISCLOSING EXEMPT OR CONFIDENTIAL INFORMATION

3.1 None

4 PUBLISHED DOCUMENTS REFERRED TO IN COMPILING THIS REPORT

4.1 Financial Reporting Council: UK Corporate Governance Code (Apr 2016)
UK Stewardship Code (Jan 2012)

4.2 National Audit Office: Companies in Government (Dec 2015)

4.3 Grant Thornton: Alternative Service Delivery Models In Local Government: Spreading their wings - Building a successful local authority trading company (2015)

4.4 The Board: creating & protecting value A cross-sector review (2017)

4.5 The Future of Governance: one small step... (2016)

4.6 LGA: Enterprising councils - Getting the most from trading and charging (2012 edition)