Appendix A

Report to the November Companies Governance Committee

From: Bipon Bhakri
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Subject: Nottingham City Council Group Companies Financial Governance Framework

1. Introduction

The purpose of this Group Financial Governance framework is to provide a guidelines for the Council in relation to its group of companies and the principles to be followed to enable effective assurance of the financial and business position of the companies.

2. What is financial governance?

Financial governance refers to the way a company collects, manages, monitors and controls financial information. Financial governance includes how companies track financial transactions, manage performance and control data, compliance, operations, and disclosures.

2a. What is good financial and business governance?

Good financial governance means that the company is collecting, calculating and presenting financial data according to regulatory rules. Good business governance is the implementation and reporting of performance against agreed plans and managing identifiable risks which could prevent the delivery of those plans.

2b. Why governance and control is important?

While discussions around governance and control may not be the most exciting part of a company's activity, it is something that organisations must get right. Successful delivery of governance and control can make a huge long-term difference in a company's viability and plays a big role in how it competes and succeeds in the market place.

2c. What are the risks of poor financial governance?

What are the risks of poor financial governance? The risks of poor financial governance include fraud, misappropriation, material errors, regulatory penalties, poor decision making and reduced stakeholder confidence. Where a company fails, then it has significant negative consequences for its staff, customers, suppliers and shareholders.

3. Background

The Council has 9 operating companies in its group arrangements. In most instances, it is the parent organisation with 100% ownership of the company, but it also has joint venture and majority arrangements.

The financial and governance implications of these arrangements mean that the Council is responsible for meeting the financial obligations of these companies, as with the recent example of Robin Hood Energy.

Given that the council's own finances are tight and there is enormous pressure to achieve efficiencies. This briefing highlights the key themes that tend to emerge when there are governance weaknesses, identifies some of the early warning signs to look out for, and sets out the key steps to take to strengthen financial governance arrangements.

4. Early Warning Indicators for Inadequate Financial Governance

Where companies are struggling financially, then a common issue has been one relating to inadequate financial governance. There are five key themes that are often seen where financial governance is weak:

a. Over-optimistic outlook
- Financial plans are expected to be met because they always have been historically, and so they are not scrutinised sufficiently.
- Reliance on a few set of contracts/customers to provide bulk of revenue stream
- Failure to provide for adequate costs in previous years has stored up a problem, which is now becoming visible

b. Poor financial planning

• The starting point for the financial plan is often not realistic and/ or accurate.

• Finances are not signed off before start the financial year

• An over-reliance on perceived external scrutiny of plans by auditors, non-executive directors (NEDs) - it is the responsibility of each company to ensure that their plans are robust

c. Inadequate financial information

• Board reports are backward looking, with limited information on expected future trends or early warning indicators.

• Reports fail to highlight the key issues and actions, and instead provide excessive detail with little or no focus.

• There is a lack of reporting of the underlying financial position, meaning that the board is not properly sighted on underlying financial gaps.

• Monthly budget reports are static without the ability to easily drill down into data and understand variances.

d. Unclear ownership and accountability

• The financial challenge is not owned or seen as important by all board– it's left to the chief finance officer/ director of finance.

e. Lack of escalation of risks and exceptions

• There is limited exception reporting provided to the company board

• Risks are recorded but little is done with them and the escalation process is weak.

5. Implementing an effective Group financial governance framework

5a. Using the 3 lines of Defence Model

The three lines of defence is a model commonly used in relation to risk management and the assurance framework in an organisation. For the Companies Governance Executive Sub Committee, the application of this model will improve the financial governance arrangements. Each line plays an important role and can help identify the early warning signs that financial governance is deteriorating:

Companies Governance Executive Sub Committee

Financial Management	Business Management	Risk Management
First	**Second**	**Third**
• Monthly Financial Reporting • Medium Term Financial Strategy • Annual Financial Management Refresher Training	• Group Business Plan Objectives Performance • Quarterly Shareholder Reports • Monthly Companies Presentations	• Annual Review of appropriateness of financial scrutiny arrangements • Companies Audit Findings Report • Quarterly Audit Actions Progress Updates • Monthly Companies Risk Register reports • Implementation of Group Risk Plan & Appetite • Risk Mgmt Advice & Training

- **First line of defence**

The first line focuses on providing key financial information to the committee so it is sighted on the key financials for the Company, as a key risk for the Council in relation to its Companies is its financial exposure.

The use of forecasting tools for revenue, cash balances and loan repayments are controls for the Council to recognise at an early point if the companies will be in financial distress and who may require Council support in the form of cash injection or loan. These financial tools will also help infer to the likelihood of the company requesting a financial comfort support letter.

- **Second line of defence**

The second line focuses on providing the business context of the Companies and is a useful connector to the Companies' financial performance. The second line is a critical defence line as it includes the assurance provided by the shareholder representative that the company is delivering on its business strategies and highlights issues and opportunities around company-council governance.

The monthly companies presentations to the committee enable appropriate scrutiny of the companies chief officers and their activities in delivering against agreed objectives, to provide the necessary assurance around financial, business and risk strategies. These presentations also act as a feedback/feedforward loop to both Council and Company on potential issues arising functions that oversee or specialise in risk management, compliance and quality.

- **Third line of defence**

The third line acts as a check on the first two line, that risks which will affect strategies are not being managed appropriately in terms of impact on achievement of business objective nor reflected in the financial reporting.

The risk register, appetite and control framework enable the committee to be sighted on areas of concern such as a lack of management response to audit findings and delays to mitigation plans being actioned.

The annual testing of the committee's scrutiny processes act as an important improvement tool to enable good company governance to be delivered.

6. Recommendations

For the CGSC to note the principles of an Effective Group Financial Governance Framework and how it strengthens the scrutiny of the group companies financial arrangements.

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