

NOT FOR PUBLICATION

Appendices A and B to this report contain exempt information as defined in Paragraph 3 of Part 1 of Schedule 12A to the Local Government Act 1972

Report to: **South Hams District Council Audit Committee**

Date: **12th January 2017**

Title: **Local Authority Controlled Company (LACC)
Risk and Governance**

Portfolio Area: **Leader of the Council - Strategic Vision**

Wards Affected: **All**

Relevant Scrutiny Committee:

Approval and clearance obtained: **No**

Urgent Decision: **N/A**

Date next steps can be taken:

Authors: **Neil Hawke**
Support Services Specialist Manager
neil.hawke@swdevon.gov.uk

RECOMMENDATION

That the progress of the Joint Steering Group in respect of Risk and Governance matters contained in this report be noted.

1.0 Executive Summary

- 1.1 The Council has been exploring the possibility of establishing a Local Authority Controlled Company (LACC) jointly with West Devon Borough Council. The matter was considered by Full Council on 28th July 2016.
- 1.2 At the July Council meeting, Members requested further detailed analysis to enable them to make a final decision on establishing a LACC. Members also agreed to establish a Joint Steering Group (JSG) consisting of members from both Councils. The purpose of the JSG is to consider the outstanding issues identified in the business case and report back to the Full Council.

- 1.3 The detailed information is currently being prepared for consideration by the Joint Steering Group at their meeting on 16 January 2017 following which the Joint Steering Group will make its recommendations to the Council on 9 February 2017. However, as part of the Council resolution, the Audit Committee were tasked to consider the Joint Steering Group's recommendations regarding risk and governance.
- 1.4 In view of the fact that the JSG is yet to make its recommendations, this report provides the Audit Committee with an overview of the current position for the key areas in respect of Risk and Governance.

2.0 Background

- 2.1 On 28th July 2016, a full meeting of South Hams District Council considered a detailed business case prepared by PricewaterhouseCoopers into the viability of establishing a Local Authority Controlled Company.
- 2.2 Officers commissioned Zurich Risk Management Services to undertake a risk diagnostic of the LACC proposal. This work involved discussions with Officers of the Council's Leadership Team including Executive Directors and Section 151 Officer to understand what the Council was aiming to achieve and in turn identify any risks to the successful operation of a LACC.
- 2.3 The team from Zurich consolidated the views of Officers into a draft risk register which was then considered by a working group consisting of SLT and the LACC Project Team. The working group considered each risk and potential mitigations were identified. This formed the initial register of risks which would need to be considered should the Council proceed to establishing a LACC.
- 2.4 The risk register was considered by this committee on 22 September 2016 with a request for a specific workshop to be planned to consider risk relating to the establishing of a LACC. The risk register has been regularly updated as the project has progressed with regular updates provided to the Joint Steering Group.
- 2.5 A workshop was held on 8 December 2016 to provide Members with an opportunity to explore the risks in more detail. This provided further opportunity for the project team to update the risk register.
- 2.6 This report now provides a more in-depth update on the key risk and governance matters that will be considered by the Joint Steering Group on 16 January 2017.

3.0 Outcomes/outputs

- 3.1 The positions set out in this report are subject to final consideration by the Joint Steering Group on 16 January 2017 but are based on expert advice from the Pension Actuaries (Barnett Waddingham) Bevan Brittan Solicitors, Grant Thornton Accountants and the Devon Pension Fund.
- 3.2 Currently work is being undertaken to prepare the final report for consideration by the Joint Steering Group however, the following

paragraphs set out the current position in respect of the key risk and governance matters.

Treatment of Pension liabilities

- 3.3 Effective treatment of Pensions is critical to ensuring that a LACC is financially viable. The Council has commissioned expert advice on the most suitable pension models with officers having discussions with the Actuaries, Devon Pensions, legal and financial advisors to ensure that the position presented to Members in the final report considers all issues on this matter.
- 3.4 A summary of the advice from Grant Thornton is set out in Appendix A to this report.
- 3.5 The current recommendation to the Joint Steering Group is that the LGPS be closed to new entrants – meaning that only transferring staff would have access to the scheme. Staff subsequently recruited to the LACC would be offered an alternative pension scheme.
- 3.6 There will be an initial increase in the employer's contribution rate by moving to a LACC, however there is an option to 'step' this increase over a number of years.
- 3.7 The LACC project team are currently undertaking financial modelling based on 8% turnover of staff, the alternative pension scheme with a 6% employers contribution rate and a number of scenarios in respect of stepping the increased contributions.
- 3.8 The Council will retain its historic LGPS liabilities/deficits and employees remaining with the Council will continue with access to the LGPS to ensure that the scheme does not 'close' which would trigger a requirement for repayment of the full pension deficit.
- 3.9 Full financial modelling is being prepared for the Joint Steering Group to consider in January 2017. This will include the impact on the LACC and the Council.

Regulatory compliance

- 3.10 The Council has commissioned expert advice from Grant Thornton in respect of Corporation Tax and VAT matters, and Bevan Brittan in respect of the TECKAL position. In addressing these matters at this stage, we can ensure that should a LACC be established, it will be compliant. Specialist advice has been sought on the following matters;

VAT

- 3.11 Grant Thornton undertook an assessment of the Councils and LACCs VAT positions. The LACC will need to register for VAT however based on the assessment, the conclusion is that there should be no irrecoverable VAT. Further details on the VAT position are as set out in Appendix A to this report.

Corporation Tax

3.12 The LACC should be exempt from corporation tax on any profits arising from transactions with the Council. In order to achieve this exemption the LACC would need to apply for Mutual Trading Exemption from HMRC. In the unlikely event that this is not granted, an alternative solution would be to establish two subsidiary companies – one to operate the activity of the two Councils and a separate one to operate the activity of third parties (where external business is won). This solution would also be required when external trading income exceeds the 20% required by the Teckal regulation,

Teckal exemption

3.13 The *Teckal* exemption applies where a contracting authority contracts with a legally distinct entity which it controls (award of contracts to controlled persons) – usually this will be a company that the authority has set up, either on its own or in concert with others to provide services. There are three key tests to apply in demonstrating Teckal compliance.

- Control – the Councils must demonstrate similar control over the LACC as it does with its in house departments. This will be managed through reserved matters and appointments to the LACC board.
- Essential Activities – the LACC can only deliver 20% of its overall turnover to 3rd parties and must be similar services to those provided back to the Council. This will be managed in considering bidding for future trading opportunities.
- No private capital – the LACC cannot have any private capital. This will be managed by the LACC board and is a governance consideration

3.14 Compliance with the Teckal exemption will all be managed through the drafting of the contract and governance documents of the LACC. It will also be a critical test to be applied to board decision-making

State Aid

3.15 The LACC and Councils will need to be mindful of State Aid Implications. State Aid means the giving of financial assistance or economic advantage by a body such as a local authority. Legal challenges can be made against both the Council and the LACC if the state aid rules are not followed; therefore Compliance with state aid regulations will be managed by the LACC and the Councils S151 officer to prevent breaching the regulations.

Governance and Shareholding

3.16 The Councils have sought expert advice from Bevan Brittan in respect of governance and shareholding matters to ensure that the model proposed is compliant with regulation and ensures that the Council retains overall control. These issues will be set out in both the LACC and Councils' governing documentation.

Company Structure

- 3.17 It is important that the form of company is established very early in the project. There are two key options available for the form of company – Company Limited by Shares or Company Limited by Guarantee.
- 3.18 Companies Limited by Guarantees are typically used as a vehicle for embedding “social” values and have a number of disadvantages (see below).
- 3.19 A Company Limited by Shares is a ‘tried and tested’ company vehicle for local authority companies and gives possibility for an income return to the shareholders, subject to there being sufficient profits available.
- 3.20 As such, a Company Limited by Shares is recommended as the most appropriate form of company for a LACC See Appendix C for the full benefits and risks to each option.

Board composition

- 3.21 The Board composition is important to ensuring a commercial direction for the LACC whilst demonstrating sufficient control over the LACC by the Council in order to comply with the Teckal exemption. It should be of a sufficient size to ensure an appropriate spread of skills and experience but not so large that it inhibits fast and flexible decision-making by the LACC.
- 3.22 Legal guidance from Bevan Brittan is that the LACC board should consist of 7 -9 board members. This matter has been considered by the JSG with the current position being 7 board members - an Independent Chair, 3 company directors (Senior LACC officers) and 3 Non-Executive Directors (Senior Officers of the Council, Members or Independent).
- 3.23 The advice from Bevan Brittan is that the JSG should think carefully about Councillors being members of the LACC board. While it is completely lawful for Councillors to be non-executive directors of Council companies, conflicts need to be carefully addressed. These considerations relate to both code of conduct issues and risks associated with councillor decisions where s/he is also a LACC director, being challenged on the basis of bias/predetermination. Directors must act with the best interest of the company at all times.
- 3.24 If it is decided that Members should not be directors Members will still be able (and in fact it is a requirement of Teckal), to influence the direction of the company through reserved matters and approval of the annual business plan for the LACC without being on the board.

Control over the LACC

- 3.25 A Joint Shareholder Committee will be formed consisting of Members of both South Hams District Council and West Devon Borough Council as the Shareholders. This Committee will be formally constituted as Joint Committee in order that it can make decisions in its own right and will oversee the implementation of the LACC and

once operational, and will consider and make decisions on Council reserved matters.

- 3.26 Reserved Matters will ensure that the Council retains control over the LACC. It is important that the Reserved Matters do not hold the company back from making timely decisions but are robust enough to demonstrate that the Council still controls the company sufficiently to comply with the Teckal exemption.
- 3.27 Workshops have been held with Members to consider possible matters which they would wish Council to retain control over.
- 3.28 Appendix D to this report sets out the matters which Members felt should be reserved but in summary the headline themes are:-
- Change of company name / registered office
 - Changing the issued share capital
 - Decision to wind up the LACC
 - Changes to the board composition
 - Appointments of independent persons to the board (including Chairman)
 - Admitting new organisations to the LACC
 - LGPS issues
- 3.29 Reserved Matters will need to be further considered during implementation of the LACC by the Joint Shareholder Committee.

4.0 Options available and consideration of risk

- 4.1. At the time of writing this report, positions are still being finalised for the Joint Steering Group's consideration in January 2017.
- 4.2. A final report into the issues will be prepared for the Joint Steering Groups January meeting on 16 January 2017)
- 4.3. The Joint Steering Group will consider in January its final recommendation to Executive and Full Council based on that report and the specialist advice it has received to date.
- 4.4. The project risk register will continue to be updated to reflect the most up to date position. The current version of this register is as set out in Appendix E.

5.0 Proposed Way Forward

- 5.1. The Final report into the LACC proposal is being prepared which will address the key matters on which Members requested for more information and detailed financial modelling. The report will be published in January along with the Joint Steering Groups final recommendation.

6.0 Implications

Implications	Relevant to proposals Y/N	Details and proposed measures to address
Legal/ Governance	Y	The LACC proposal will have significant Legal and Governance implications, on which the Council has received specialist legal advice from Bevan Brittan and to which officers and the JSG have had regard. The most significant matters are considered in this report. The detailed positions and recommendations will be provided in the final report considered by the Joint Steering Group In January.
Financial	Y	Detailed financial modelling is being undertaken with input from the Joint Steering Group. This will be considered by the January Joint Steering Group Meeting and included with their recommendation to Executive and Full Council.
Risk	Y	The project has a risk register which is regularly reviewed. This can be found in Appendix E to this report.
Comprehensive Impact Assessment Implications		
Equality and Diversity		N/A as no change to service delivery or policy
Safeguarding		N/A as no change to service delivery or policy
Community Safety, Crime and Disorder		N/A as no change to service delivery or policy
Health, Safety and Wellbeing		N/A as no change to service delivery or policy
Other implications		N/A as no change to service delivery or policy

Supporting Information

Appendices:

Appendix A – Financial advice from Grant Thornton (Exempt from publication)

Appendix B – Pensions Defined Benefit v Defined Contribution options (Exempt from Publication)

Appendix C – Options for company structures

Appendix D – Reserved matters workshop outputs

Appendix E – Risk Register