



## **Public Interest Report**

# **Governance issues in relation to remuneration of Council officers for work as Directors of City of York Trading Ltd**

**City of York Council – audit of year ended 31 March 2015**

**February 2016**

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# 01 Context of our work and status of this report

## Context of our work

Mazars LLP is the independent appointed auditor of City of York Council (the Council)<sup>1</sup>.

We are required to carry out our work in accordance with the Audit Commission Act 1998 (the 1998 Act) and the Code of Audit Practice which is approved every 5 years by both Houses of Parliament. The Code of Audit Practice relating to the 2014/15 audit was approved by Parliament in 2010 and published in March 2010 (the 2010 Code). The 2010 Code prescribes the way that the auditor should discharge their functions under the 1998 Act and summarises the auditor's responsibilities and powers under the 1998 Act.

The Local Audit and Accountability Act 2014 introduces new arrangements for local audit, and a new Code of Audit Practice was approved by Parliament and published by the National Audit Office in March 2015, which applies to the 2015/16 financial year onwards. In relation to the 2014/15 audit, most of the requirements of the 1998 Act are transitionally saved and it is the 2010 Code which applies to this audit.

Under the 1998 Act and the 2010 Code we are required to consider:

- whether the accounts comply with all applicable statutory requirements and that proper practices have been followed in their preparation – this results in our audit opinion on the Council's financial statements; and
- whether proper arrangements have been made for securing economy, efficiency and effectiveness in the use of resources – this results in our Value for Money (VFM) conclusion.

## Status of this report

Section 8 of the 1998 Act requires that auditors should consider whether, in the public interest, they should report on any matter that comes to their attention in the course of the audit, so that it may be considered by the body concerned or brought to the attention of the public.

This report is a public interest report under Section 8 of the Audit Commission Act 1998 due to the nature and significance of our findings, the level of local public interest in this issue, and the further actions which are now needed to address the issues that have been identified. Whilst the total value of the payments that are the subject of this report is small in relation to the Council's overall expenditure, the payments relate to the sensitive issue of senior officer remuneration and our findings address important governance matters. We also consider that, in view of the increasing use of local authority trading companies by councils across the country, the report provides relevant learning that may be of value to those responsible for the governance of other local authorities.

The 1998 Act specifies requirements about how the Council should respond to a public interest report, including the time within which it must consider the report, the arrangements for publicising the meeting at which the Council will consider the report and publicising the Council's response to the report.

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<sup>1</sup> Note that we use the term 'Council' to refer to the statutory corporation as a whole. Where we refer to a Council decision therefore this includes decisions taken under Executive Arrangements

## 02 Executive summary

### Background to this issue

When we presented our Audit Completion Report for the 2014/15 audit to the Audit and Governance Committee on 23 September 2015, we indicated that we expected to issue an unqualified opinion, Value for Money (VFM) conclusion and audit certificate on 30 September 2015.

Between this meeting and our planned sign off date we were made aware of payments made in March 2015 by City of York Trading Ltd (a trading company specialising in the provision of temporary staff and wholly owned by the Council) to two of the company's executive directors who were also officers of the Council. Almost all of the company's trading income resulted from its supply of temporary staff to the Council and schools.

On 30 September 2015, we issued an unqualified audit opinion and an unqualified VFM conclusion, but we did not issue a certificate to close the 2014/15 audit. We explained why we had not formally concluded the 2014/15 audit in our audit report which is included in the statement of accounts on the Council's website.

*"The audit cannot be formally concluded and an audit certificate issued until we have completed our consideration of matters brought to our attention shortly before the date of this audit report. We are satisfied that these matters do not have a material effect on the financial statements."*

The matters we needed to consider were the governance arrangements relevant to our audit of the Council covering the payments by City of York Trading Ltd to two of the company's executive directors who were also officers of the Council. These payments are relevant to our audit because the company is wholly owned by the Council and the two executive directors receiving the payments are officers of the Council, one of them being the Council's Chief Finance Officer.

We have now concluded our review of these arrangements.

### Overall conclusions

We have reached the following key conclusions:

- we have identified failings in the governance of this issue by the Council;
- action is now needed by the Council to regularise the position in relation to remuneration in March 2015 made by City of York Trading Ltd (the company) to two of its executive directors who are also officers of the Council; and
- there are important lessons to be learnt and applied to ensure the future good governance of the Council's relationships with its trading companies.

The main failings we have identified are:

- the decision to pay the two executive directors was taken by the company's Board on the recommendation of the Shareholder Committee which did not however have the authority to take a decision on behalf of the Council or provide the written consent which was required by the Shareholder Agreement between the company and the Council;

- the required written consent of the Council to the remuneration was not obtained;
- the Council wrongly omitted to include the remuneration in the relevant related parties note to its 2014/15 financial statements;
- the effect of these omissions was that the process for approving the payments lacked transparency and was not subject to the usual scrutiny process for Council decisions;
- there was a lack of clarity over senior officer responsibility for (i) overseeing the advice to the company on the proposed director remuneration and (ii) protecting the Council's interests in relation to this issue;
- there was insufficient challenge to the initial proposal for remuneration prepared by the Director of Customer and Business Support Services (one of the direct beneficiaries of the proposal), resulting in the key elements of his original proposal being presented largely verbatim to the Shareholder Committee and the Board;
- legal advice given on the need for Council approval for the proposed remuneration was not followed;
- insufficient attention was paid to the increased conflict of interest risk created by the proposal to remunerate the two executive directors of the company, particularly as the proposal included a growth and profit related element and the Council and schools were the company's main customers; and
- no additional safeguards to protect the Council against the increased conflict of interest risk were implemented by the Council following the approval of the remuneration by the company's Board.

Our findings illustrate the need for complete clarity of process and decision-making when senior council officers with a statutory role to protect the Council's interests also take on directorships in Council-owned companies, especially when those directorships are paid. That clarity is essential in protecting both the Council and the individual officers involved.

Since September 2015, the Council has taken action to improve the governance of its relationship with City of York Trading Ltd. It should consider the findings set out in this report to ensure that the mistakes made on the issue of remuneration for company directors are not repeated, whether for City of York Trading Ltd or any other Council-owned company. We make recommendations to this effect at the end of the report.

## 03 Detailed findings

### The payments

In March 2015, City of York Trading Ltd made a payment of £6,000 to its Managing Director and £3,000 to its Operations Director as remuneration for their work for the company in 2013/14. The Managing Director was also the Council's Director of Customer and Business Support Services (and Chief Finance Officer) and the Operations Director was also the Council's Assistant Director of Customer and Business Support Services (Customers and Employees).

The payments were made following a recommendation by the Shareholder Committee which was approved by the City of York Trading Ltd Board.

We were not aware of these payments at the time they were made and they were not brought to our attention during the 2014/15 audit of the Council's accounts. If we had been made aware of these payments, our view would have been that they should have been disclosed in the notes to the Council's 2014/15 financial statements. Although the payments were not made by the Council (and were not material in size for the purposes of our audit), they were made by a related party to the Council and were therefore a relevant disclosure in the financial statements under the related parties note to the accounts, as the two company directors receiving the payments were also senior officers of the Council.

We have subsequently identified that these payments did not receive the proper authorisation required from the Council, and that there were failings in the governance arrangements leading to the payments being made.

In September 2015, both directors of the company voluntarily waived any further payments to be made to them as a result of the company's performance in 2014/15. We understand that no further remuneration payments are to be made in relation to the scheme considered as part of this report and more transparent arrangements for Council oversight have been put in place through revised arrangements for a Shareholder Group (previously a Shareholder Committee) which met for the first time on 30 September 2015.

The focus of this report is on the governance of the process which led to the payments being made. We make no comment on the operation or management of the company itself, which we have not reviewed for this report.

The issues highlighted in this report coincided with a period of significant political upheaval in the Council. In December 2014, there was a change in Leader of the Council, and after the May 2015 elections there was a change in political administration. In our view, this turbulence in the autumn and winter of 2014/15 contributed to the lack of clarity in the governance of the issue that is the subject of this report.

### Background to City of York Trading Ltd

In 2011 the Council set up City of York Trading Ltd as a local authority trading company.

The company's main activities are to provide temporary staff on an agency basis for the Council, schools and other customers. As the company was set up and developed, decisions were taken by the Cabinet. Initially, the company provided school agency staff only, but following a decision by Cabinet in June 2013, from 1 September 2013 the responsibility for supplying all of the Council's casual staff transferred to the company.

The company has grown in size over time, with turnover increasing in each year of operation:

- in the period from 18 November 2011 to 31 March 2013 turnover was £604,798;
- in the year ended 31 March 2014 turnover was £2,389,132; and
- in the year ended 31 March 2015 turnover was £5,368,618.

We understand that the company's turnover from Council activity increased more significantly than originally expected because of the nature of recruitment activity and the need for more casual and temporary staff. This trend is not expected to continue. Most of the company's work is for the Council and schools, but the future challenge for the company is to grow and develop its external business.

At its inception several Council officers became directors of the company. This was approved by the Cabinet in February 2011. These included:

- the Council's Director of Customer and Business Support Services who became Managing Director of the company; and
- the Council's Assistant Director of Customer and Business Support Services (Customers and Employees) who was also Operations Director of the company.

In his role for the Council, the Director of Customer and Business Support Services is also the Chief Finance Officer charged with the statutory duties of Section 151 of the Local Government Act 1972 to be responsible for the proper administration of the financial affairs of the Council.

The Assistant Director of Governance and ICT, who is also the Council's Monitoring Officer, also became a Director of the company.

There is nothing to prevent Council officers from becoming directors of a local authority trading company. In fact, this is quite common and can be advantageous as part of the Council's arrangements for getting a trading company established, keeping it on track and ensuring an appropriate level of Council oversight. Although it does create a potential conflict of interest, in normal circumstances potential conflicts of this nature can be managed by introducing appropriate safeguards. Where the Council officers appointed as company directors are also Statutory Officers of the Council (in this case, the s151 Chief Finance Officer and the Monitoring Officer), there is greater likelihood of conflicts arising with their statutory office and their primary duties to the Council.

We understand that in this case the safeguards included arrangements to ensure that work was commissioned from the company by the Council without the involvement of the Council officers holding office as directors of the company. Indeed, in June 2013, the Cabinet approved the transfer of all Council agency staff work to the company from 1 September 2013.

### **Corporate governance framework**

The Council's Constitution sets out its framework of corporate governance.

The Code of Corporate Governance, which is part of the Constitution, defines the corporate governance framework:

*“Corporate governance is the system by which local authorities direct and control their functions and relate to the communities they serve. This extends to how the organisation accounts to, engages with and, where appropriate, leads their community. Good corporate governance requires local authorities to carry out their functions in a way that demonstrates accountability, transparency, effectiveness, integrity and inclusivity.”*

Unlike the Members' Code of Conduct, there is no statutory basis for an Officers' Code of Conduct, but in common with most local authorities, the Council has adopted an Officers' Code of Conduct and this also forms part of the Constitution.

There are two key extracts from the Officers' Code of Conduct which are relevant to our considerations.

First, it highlights that the Code, like many aspects of the Council's Constitution, provides checks and balances designed to protect individuals from accusations of impropriety:

*"It is important that employees are protected from accusations of impropriety. Employees should declare in writing to their Chief Officer any financial or non-financial interests which they consider could conflict with the interests of the Council or adversely affect the performance of their duties."*

In this case, it was well known that the two Council officers were also directors of the company, this had been approved by Cabinet in February 2011 and declarations of interests were also made to this effect.

Second, it highlights that employees should not normally take a second employment, because of the potential impact on their role for the Council:

*"Full time employees should not normally take outside employment as this may have a detrimental effect on their job performance and health and safety. All employees graded above spinal column point 28 of the National Joint Council scheme of conditions of service need Chief Officer approval to take outside employment. All requests should be discussed with the appropriate Chief Officer, or the Directorate Human Resources Manager."*

In this case, we note that in February 2011 it was the Cabinet which approved the role of Council officers as directors when the company was being established. This was on the basis that the relevant officers remained solely employed by the Council. However, between this time and the later proposals for remuneration of company directors, the company had grown significantly, which was one of the key reasons put forward as the case for paying directors' remuneration. In our view, the Council could reasonably have been expected to revisit whether the directors' roles had exceeded what they could reasonably do whilst properly fulfilling their other employment duties to the Council or whether these roles now constituted a second employment that was appropriate for the officers to undertake in light of the changed circumstances. There is a reference to a need to consider this in the report presented to the Shareholder Committee on 20 October 2014 and to the Board on 19 February 2015. The appropriate time to consider this would have been alongside the remuneration proposals.

The Constitution also highlights the key roles of the Council's statutory officers:

- the Chief Executive, as the Head of Paid Service;
- the Director of Customer and Business Support Services, as the s151 Chief Finance Officer; and
- the Assistant Director of Governance and ICT as the Monitoring Officer.

The Constitution sets out the corporate governance framework and it is essential that the framework is applied in practice. The statutory officers have an important role in overseeing the proper application of the framework.



## Initial proposals for remuneration of company directors

The initial proposal for remuneration was generated within the Council rather than the company. We understand that the discussions around remuneration began when the Council's Director of Customer and Business Support Services had sought alternative employment. In discussing his reasons for seeking a new job with the then Chief Executive, he suggested that the growth in his responsibilities had not been matched by an increase in his remuneration. The Chief Executive invited him to share his thoughts on possible ways of addressing his concern.

On 28 November 2013, the Director of Customer and Business Support Services provided a proposal in relation to remuneration of City of York Trading Ltd executive directors to the Chief Executive. The proposal, which was written in a report format, was to pay two executive directors of the company, the Managing Director (i.e. himself) and the Operations Director. The proposal was for remuneration of £6,000 and £3,000 per annum respectively based on current operational levels plus a potential growth element based on company profits. If profits for the preceding financial year exceeded £300,000, the amounts payable would be increased by 100% and if profits exceeded £500,000 a further 100% (of the original amounts) would be payable.

In the covering e-mail to his proposal, the Director of Customer and Business Support Services stated that "I have not sought any additional advice (HR, legal) as clearly it's for the Council to consider and determine". The Director of Customer and Business Support Services has told us that his proposal was meant to be illustrative and that later he was concerned to find that it had been accepted without more scrutiny and challenge. In our view, he made an error of judgement in preparing an initial proposal for his own remuneration as a director of the company which included a mechanism for increasing the remuneration if certain growth and profit targets were met (when the Council and schools were overwhelmingly the company's main source of income). He should have recognised the heightened conflict of interest risk inherent in his draft proposal.

The Chief Executive sought input from the Head of Human Resources in December 2013. The Head of Human Resources consulted with legal colleagues and provided advice to the Chief Executive on 27 March 2014 and followed this up on 13 May 2014. The focus of the advice was around whether remuneration should be paid as part of Council employment or whether it should be a separate employment contract with City of York Trading Ltd, and whether there was anything preventing the Council's Director of Customer and Business Support Services from being paid as a Director of the company. The advice given, which included internal legal advice, was that any payments should be made by the company under separate employment contracts and that there was nothing preventing the Chief Finance Officer from being a director of the company and being paid for this.

The Head of Human Resources had seen the brief as primarily to address the issue of which organisation the contract of employment should be with, and not to question the basis for the proposed remuneration. The Head of Human Resources told us that he thought the amounts proposed were reasonable and he could see that additional work had been required of the two directors for their work on the company.

One concern about the growth and profit element of the proposals is that the basis for a growth in profits had already been put in place in June 2013, when the Cabinet approved the transfer of all Council agency staff work to the company from 1 September 2013. In our view, there was insufficient challenge of the remuneration proposed and the increased risks of the profit and growth element, or whether the triggers for additional payments were sufficiently challenging in the context of the company's current business performance, particularly as significant time elapsed between the original proposals and the point at which the decision was taken.

The Head of Human Resources was asked by the Chief Executive to approach and work with the Board of the company to take the remuneration proposals forward. The then Chief Executive's view was that it was reasonable for her to ask the Head of Human Resources to take this issue forward as he was experienced in dealing with matters relating to the employment of senior officers. The then Chief Executive had asked for appropriate legal advice to be taken and highlighted the potential conflicts of interest and unusual circumstances of this situation. She would have expected the Head of Human Resources to alert her if there were any concerns, but none were raised with her.

In our view, the Head of Human Resources would have benefited from a greater degree of supervision and support in taking forward these issues. In particular, a clear steer was needed that it was not appropriate to accept the level of and mechanism for calculating the remuneration originally proposed by the Director of Customer and Business Support Services himself without further scrutiny and challenge. This risk should have been addressed internally, but failing this, it could have been identified by seeking independent HR and legal advice.

### **Monitoring Officer Advice**

The Head of Human Resources shared the Director of Customer and Business Support Services' proposals with the Monitoring Officer on 23 June 2014. The Monitoring Officer later advised on the processes that should be followed in relation to the approval of remuneration, in particular, the need for the Board of the company to obtain the approval of the Council.

On 4 October 2011, the Cabinet agreed to the establishment of a Shareholder Committee "in order to properly exercise the Council's powers and responsibilities as the sole shareholder of the LATC [Local Authority Trading Company]."

A Shareholder Agreement was entered into between the Council and the company in 2012. Clause 8.2 of the Shareholder Agreement stated:

"The role of the Shareholder Committee shall not be operational and shall be the means by which the Council shall:

8.2.1 appoint all Directors, and approve best practice policies in relation to such appointments, the constitution of the Board and the employment and recruitment of staff;

8.2.5 exercise the functions flowing from its ownership of shares."

The Shareholder Agreement includes a number of corporate covenants. The corporate covenants in Part 1 of Schedule 2 set out a number of matters that the company shall not act on without the prior written consent of the Council. This included needing written prior consent of the Council to "vary the emoluments of any of its Directors or of any Shareholder or of any Associate of a Director or Shareholder" (paragraph 1.2.27 of Schedule 2).

The view the Monitoring Officer reached was that the intention of the Cabinet decision in October 2011 and the Shareholder Agreement was that the Shareholder Committee would provide the approval required from the Council in this case in relation to the remuneration of the directors.

However, for this to be effective the approval of the remuneration would need to amount to the Shareholder Committee exercising Council decision-making powers under the Council's executive arrangements. The Monitoring Officer explained how executive decision making could be exercised:

"The allocation of decision making responsibilities for executive functions is, by law, the responsibility of the Leader. The law identifies those to whom he is entitled to allocate

responsibilities and chief amongst these are the Executive [at that time named the Cabinet at York], individual executive Members and Officers. He is also entitled to exercise any function himself.

Importantly he cannot allocate functions to a politically balanced committee or even a non-politically balanced committee unless it consists wholly of members of the executive.”

The issue in this case, correctly identified by the Monitoring Officer, is that the composition of the Shareholder Committee did not fulfil these criteria. The Chair of the Shareholder Committee was the Leader, but the other two members of the Committee were non-executive Council members. Consequently, the Monitoring Officer advised that separate Council approval was needed for the remuneration of directors.

Subsequently, the Council has received advice that challenges the Monitoring Officer’s view and argues that the Shareholder Committee had fully delegated authority from the Cabinet to provide the written Council consent for the directors’ remuneration. In our view, the Monitoring Officer was correct and the evidence is clear that the Shareholder Committee had not been constituted in such a way that would allow it to take an executive decision on behalf of the Council and therefore provide the required consent.

### **Shareholder Committee approval on 20 October 2014**

The Head of Human Resources prepared a report to take to the Shareholder Committee of City of York Trading Ltd, and shared his draft report by e-mail with the then Leader of the Council and the Chief Executive on 10 October 2014, including a summary e-mail which was very clear about the proposal being made.

Much of the content of the draft report produced by the Head of Human Resources was taken verbatim from the draft proposal prepared by the Director of Customer and Business Support Services in November 2013. This included the remuneration considerations, the general case for remuneration, the amount of remuneration and the growth or profit related element.

The Director of Customer and Business Support Services has told us that he was surprised that so much of his original note had been used to prepare the report to the Shareholder Committee, but his understanding at that point was that a proper process had been followed in relation to the proposals. In particular, he took assurance from an e-mail from the Head of Human Resources on 24 October 2014, which stated:

*“I’m aware that this has been discussed with the Leader, the Chief Executive, HR and Legal and no concerns have been raised and as I have described in the paper there are already effective mechanisms to monitor the relationship going forward.”*

The report to the Shareholder Committee did not indicate who had prepared it. However, in circulating the report the Head of Human Resources did indicate that it was his report.

There were some differences from the original proposal prepared by the Director of Customer and Business Support Services.

The main point on which the report differed from the original proposal was in suggesting that the remuneration should be paid by the company. The report said:

“2) Who should pay the remuneration

HR and legal advice has been taken on this issue and it is recommended that the Directors should hold separate contracts of employment for their role with CYC [the Council] and as a Director of CYT [the company].”

The Director of Customer and Business Support Services' original proposal had been that the Council pay the remuneration as a separate contractual amount to reflect the two directors' roles for the company. We note that if this course of action had been taken, it would have needed Council or, under delegated authority, line manager (Chief Executive) approval, and also then that the remuneration is more likely to have been properly disclosed in the financial statements as part of the officers' Council remuneration, potentially with increased transparency about its payment.

The report also stated that:

“Both CYC and CYT would need to give consideration to whether there would be any implications upon their ability to fulfil their contracts with CYC or CYT and how to deal with any potential conflict of interest. This will require good governance, transparency and open dialogue between CYC and CYT. The mechanisms to ensure this happens are already well established and working effectively.”

In our view, the payment of remuneration created an additional conflict of interest, and this required measures above and beyond those already in place. These measures were all the more necessary with the addition of a potential growth or profit element to the remuneration, which could incentivise the directors to maximise company profits in a way that could be in conflict with their roles as Council officers (where for example, savings for the Council may have been a higher priority than profit for the company). Whether this actually created such a conflict is secondary to the perception that such a conflict was created. In our view, the Council did not take the actions necessary to either fully consider or effectively manage the potential conflicts of interest that arose from these proposals. An example of a potential measure that could have been considered might be a stipulation that the growth or profit element would only be triggered if the additional growth and profit could be shown to be attributable to sales to customers other than the Council.

The Head of Human Resources did not receive any feedback on the draft report from the then Leader of the Council and it became the report that was presented to the Shareholder Committee on 20 October 2014. The report was presented at the end of the meeting under 'any other business'.

Only two of the three Members of the Shareholder Committee attended the meeting, and the then Leader of the Council, who was the normal Chair for the meeting, was not present. Neither of the two Members who attended the Shareholder Committee were members of the Cabinet, and for the reasons outlined above the Shareholder Committee was unable to exercise an executive function for the Council and take a decision on the proposals.

The report was presented to the Shareholder Committee by the Head of Human Resources and the two potential recipients of the remuneration were not present when it was discussed.

The proposals were approved and the minutes of that meeting record that the Shareholder Committee recommended them to the company board. The Committee further noted that the Council 'should be formally consulted on this proposal'.

The agendas and minutes of the Shareholder Committee were not published or made widely available and the meetings were held in private. Since then, a decision has been taken to publish the papers of the Shareholder Committee (now the Shareholder Group) and the first minutes published for the new group were of the meeting on 30 September 2015.

We asked the then Leader of the Council (i.e. the Leader of the Council on 20 October 2014) about the report. He said that he was not aware of the report and if he had been aware of it, he would not have supported it. As he saw it, the Managing Director's role was part of his work for the Council and he did not agree with an additional remuneration. He said that copies of the report may have been e-mailed to him,

but he had no recollection of seeing those e-mails, and that at the time of the report he was involved in a difficult by-election and dealing with issues that subsequently led him to stand down from the Council.

He explained that when something so important was occurring, if he had inadvertently not managed to respond to such an e-mail, officers would normally speak to him directly about the paper before it was issued. He was therefore surprised this did not happen on this occasion.

The then Leader also said that if he was not attending a meeting he would normally sign off the agenda for the meeting, that he was not aware of a paper about remuneration for the directors, and if he had seen this as an agenda item, he would have queried it. As noted earlier, the report was considered under 'any other business' rather than being a separate item in its own right.

Finally, the then Leader told us that he was clear that whatever the Shareholder Committee decided, the decision to pay an additional remuneration would have still required Council approval.

The then Chief Executive of the Council has told us that in 2014 there was clear political support for the proposal to remunerate the two company directors, which explained why the report was produced and taken through the company's governance structures. The Director of Customer and Business Support Services also understood, from his discussions with the Chief Executive, that there was political support for the proposals provided that the payments were made by the company and not by the Council.

### **Approval by the company Board on 19 February 2015**

Following approval by the Shareholder Committee, there was a delay until the remuneration was approved by the Board of the company on 19 February 2015.

Between 20 October 2014 and 19 February 2015, there were significant changes at the Council, including a new Leader. The Shareholder Committee changed from being composed of Members of the majority political party to being politically balanced. The Shareholder Committee met once between these dates on 15 January 2015. The issue of directors' remuneration was not on the agenda although the minutes of the 15 January meeting show that the minutes of the previous meeting of the Shareholder Committee were approved. The previous meeting was the 20 October 2014 meeting which included the decision about directors' remuneration.

Prior to the Board meeting on 19 February 2015, the Head of Human Resources sent an e-mail to Board members on 16 February 2015 (excluding the two directors affected by the proposals) and this said:

"As the HR Advisor to CYT I was asked by the CYT shareholder committee to produce a report on the possible options for payment to the Executive Directors. The paper attached to this email is the report I produced and was considered by the shareholders committee in October 2014.

As you can see from the minutes of the shareholder committee the arrangements sent out in the report were agreed and recommended to the CYT Board for approval, with the intention being that the first payment would be made in 2014/15, based on the company performance in 2013/14."

Attached to this e-mail were the relevant minute from the 20 October 2014 Shareholder Committee meeting and the report that had been presented to that meeting in relation to the remuneration.

The minutes of City of York Trading Ltd Board meetings are published, which is unusual for a company. However, the minutes of the Board meeting on 19 February 2015 make only a very oblique reference to what was approved at the meeting, and the agenda items referred to are not published.

"Item Deferred from 12 February Board Meeting – Agenda Item 4 of the original decision - Shareholder recommendation (item 2 on the attached)

The motion was carried with AD [the Council’s Monitoring Officer] abstaining from the vote.”

This is the only public record that was made of the remuneration decision, and a reader would not know what had been agreed.

The minutes of the Board meeting record that the meeting lasted one minute. The matter had been scheduled to be considered on 12 February 2015, but was deferred because the Chair of the Board, the newly appointed Leader of the Council, had not been able to attend that meeting.

The two potential recipients of the remuneration were properly not present for this Board meeting.

We spoke to the then Leader of the Council who had taken office in December 2014 and chaired the 19 February 2015 Board meeting. He explained that although the Board meeting on that day was very short, he saw this as the end of a period of discussion. He had been Chair of the Board for two years and he had been aware of the proposals for the additional remuneration. He was aware that he wore two hats, one as the Leader of the Council and another as Chair of the Board. He fully understood that the Board decision needed to be ratified by the Council, and he intended to declare an interest and withdraw from the discussion when Council approval was sought.

### **Failure to obtain Council approval**

The report that had been prepared for the Shareholder Committee on 20 October 2014 and which was shared with the Board on 19 February 2015 stated that “the proposal also needs the approval of Council”.

The required Council approval was not obtained.

On 1 October 2014, the Monitoring Officer informed the Head of Human Resources that the Board would need the approval of the Council to vary the emoluments of any of its directors.

As noted earlier the Shareholder Agreement included a corporate covenant that the written prior consent of the Council was needed to “vary the emoluments of any of its Directors or of any Shareholder or of any Associate of a Director or Shareholder” (paragraph 1.2.27 of Schedule 2).

In our view, this corporate covenant was an appropriate measure to enable the Council to exercise reasonable control over the company, given that it is a local authority owned company. The requirement for Council approval would also have enabled the remuneration to be considered in an open and transparent way in accordance with the Council’s Constitution and Code of Corporate Governance.

As described earlier in this report, the Monitoring Officer advised that the decision was an executive function and could have been discharged by the Cabinet, the Leader or allocated to another Cabinet member to discharge. The Monitoring Officer also indicated that the decision could have been made by an officer such as the Chief Executive.

The Monitoring Officer has subsequently argued that the documentary evidence is clear that it was always intended that the Chief Executive would make this decision on behalf of the Council, and further that it was clear that the Chief Executive did support making the payments.

The then Chief Executive has told us that neither the Monitoring Officer nor the Head of Human Resources brought the requirement for Council approval to her attention or asked her to approve any payment. Further, she has indicated that she was unaware that the payments had been authorised.

Clearly, something went wrong in fully understanding that Council approval was required, in understanding what constituted Council approval and in ensuring that the required approval was obtained and recorded. Whatever the method chosen for the obtaining and recording Council approval, if this course of action had been followed, the decision would have been put on the public record, and it could then have been



scrutinised. As Council approval has not been given or recorded, the company is in breach of its agreement with the Council. The Council should seek to regularise the position.

Although the payments were made by the company, we considered whether these indirect payments could constitute unlawful expenditure by the Council. Having taken our own legal advice, we are satisfied that, despite the breach of the Shareholder Agreement by the company, the Council has not itself incurred unlawful expenditure on this matter. However, the Council still needs to rectify the lack of Council approval for the remuneration made by the company.

### **Making the payments**

On 24 October 2014, following approval of the proposals by the Shareholder Committee, the Head of Human Resources e-mailed the Managing Director and Operations Director of the company and said “When / if approved by the CYT board my advice would be that CYC [i.e. the Council] should be formally approached by CYT [i.e. the company] and asked whether there is any reason why you would not be able to take up a second contracted role.” This advice was not followed.

Following approval by the Board, the Managing Director of the company asked the Work With York Manager to action the payments in the light of the Board’s decision. The payments were made in March 2015. We understand that despite the recommendation that these be paid under the terms of separate employment contracts with the company, no separate employment contracts were issued.

To ensure the proper governance of the company, separate employment contracts should have been prepared setting out the basis for the remuneration.

The Director of Customer and Business Support Services has explained that he sought clarification on when the payments would start from and what ‘Council approval’ meant from the Head of Human Resources on 26 October 2014. The response he received indicated that the payments would start from the 2013/14 financial year’s performance and that ‘Council approval’ meant consultation with the then Chief Executive rather than formal approval. On 11 November 2014, the Head of Human Resources provided e-mail clarification:

“I’m clear that the shareholder committee were of the view that the payments should be made in 2014/15, based on the 2013/14 company performance. So a payment can be made any time after the 2013/14 accounts have been published (i.e. now).

The payment is dependent on board ratification, consultation with the Chief Executive (I’ve made that clearer in the draft minutes), and the company payroll being able to deliver.”

The Director of Customer and Business Support Services took the assurances he received from the Head of Human Resources as the authority for the payments to be made. In the circumstances, and as it related to his own remuneration, it would have been more appropriate to wait for others to request that payment be made, or if this did not happen because there was a lack of clarity on roles and responsibilities, to raise this with the Chair of the Board so that arrangements could be made to take the necessary steps to initiate the payments independently of the Director of Customer and Business Support Services.

In February 2015, before any payments were made, the Assistant Director of Customer and Business Support Services (Customers and Employees) e-mailed the Head of Human Resources to ask whether the payments would need to be included in the Council’s formal Pay Policy. The Head of Human Resources replied that this would not be necessary because the payments were to be made by the company under a separate employment contract and not by the Council.

## **Proposals for further remuneration that were subsequently not paid**

The company's financial results for 2014/15 would have triggered the growth/profit element payment of remuneration for that year. This would have led to a 100% increase in remuneration for the two directors under the remuneration framework that had been put in place:

- An increase in the Managing Director's remuneration from £6,000 to £12,000; and
- An increase in the Operations Director's remuneration from £3,000 to £6,000.

The Director of Customer and Business Support Services has told us that, from May 2015 onwards, it appeared that the financial performance of the company for 2014/15 might begin to trigger the profit related element in his remuneration from the company. This caused him some concern as he felt that it may result in potential comment. He has told us that he also considered over the months that followed whether he should continue in his role as Managing Director. The factors he was considering included whether he had taken the role as far as he could without it distracting from his primary role, his own career development, and the general direction of the new Administration of the Council. He intended to have discussions with the new Administration, and gather their thoughts on these matters.

The Director of Customer and Business Support Services also told us that during August and September 2015, there was significant discussion with Members on the matters of pay and future direction of the company, leading in September 2015 to the Managing Director (and Operations Director) declining any further remuneration. The Managing Director informed the Shareholder Group (and leading Members) that he would like to be removed from his company role in due course, but would stay on until the Board had appointed a replacement.

## **Disclosures in the officers' register of interests**

We asked to see the register of interests in relation to the two Council officers who received remuneration for their work for the company.

We were provided with the annual registration of interests form for each of these two officers for 2014/15. Both disclosed their roles for the company. The value of remuneration was not disclosed. We note that the form and guidance notes do not require the level of remuneration to be disclosed.

In our view, the officer register of interests form and guidance notes should be updated to require any remuneration to be disclosed in relation to any local authority trading company.

We asked for the register of interests forms for 2011/12, 2012/13 and 2013/14. These were not available for 2012/13 and 2013/14 in relation to the Director of Business and Customer Services. The Director of Customer and Business Support Services believes that he did complete returns for these years, and a consolidated record of officer interests for 2013/14 has been found which included his role as Managing Director of the company. The Director of Customer and Business Support Services also points out that his role was unchanged from 2011/12 and his returns for 2012/13 and 2013/14 would have been exactly the same as the previous year. It is also the case that his role on the company was approved by the Cabinet in February 2011.

The issue here is the importance of maintaining a complete record of interests, supported by individual declarations. It is important to ensure that all senior officers complete their annual register of interests form, and that where this is not the case or individual returns have not been received, that this is followed



up to ensure that records are complete. It is of course incumbent on all officers to update the register of interests whenever there is a change in circumstances and not to wait for the annual review process.

### **Action already taken by the Council and the company**

The company's Shareholder Group met on 30 September 2015 and improved arrangements for governance have been put in place.

It has been agreed that the Board structure of the company will be revised so that there are two elected Members providing cross-party representation, two external non-executive directors, one officer non-executive director and a full time Managing Director (externally recruited). The result of this will be that "no payment will be made by CYT in future to Board members other than to the full-time Managing Director and any agreed nominal amount paid to external Directors." If the officer non-executive director is to be considered for additional remuneration, this will be done through their contract of employment with the Council.

The company envisages that the Director of Customer and Business Support Services will remain as Managing Director on an unpaid basis until a new full-time Managing Director can be recruited by April 2016.

In addition, the Shareholder Group will meet in public, follow the Council's public participation arrangements and minutes will be published, although it is recognised that some items will be confidential or commercially sensitive and therefore considered privately.

The company is also to consider whether there is a need for internal audit and an Audit Committee.

## 04 Recommendations

We acknowledge that measures have been taken to improve the Council's oversight of the company and the transparency of relevant decisions. We make the following recommendations for further action.

### **Council approval of the payments**

R1 The Council should take steps to rectify the omission of Council approval for the payments made to the two directors of City of York Trading Ltd in March 2015 for work for the company in 2013/14.

### **Governance arrangements**

R2 Where the Council envisages a role for a committee within a Council-owned trading company to fulfil a Council function, as appears to have been the case with the Shareholder Committee of City of York Trading Ltd, the Council should ensure that the Constitution is amended to reflect this role and that the composition of the Committee is consistent with the Council's decision making and governance arrangements.

R3 The Council should review its approach to the establishment and governance of Council-owned companies to ensure that it fully reflects good practice and the lessons from this report.

R4 In the light of the conclusions of the review recommended in R3, the Council should prepare specific guidance to members and officers on their involvement in Council-owned companies.

R5 The guidance recommended in R4 should address the conflict of interest risks likely to arise where members and officers hold both Council and Council-owned company roles (unpaid and paid) and set out clear advice on how these should be managed. The guidance should also specifically address how the conflict of interest risks should be managed where the Council officers involved hold one of the three Statutory Officer roles of Head of Paid Service, Chief Finance Officer and Monitoring Officer.

R6 The Council should review its arrangements for ensuring that internal legal advice is followed, and that any instances where such advice is not followed are identified.

### **Disclosures in financial statements**

R7 Where there are unusual or sensitive transactions such as the remuneration paid to Council officers for their work for a Council-owned trading company, particularly where they take place for the first time, the Council should bring the matter to the auditor's attention during the audit.

R8 Where senior Council officers receive remuneration for their work for a Council-owned trading company, the Council should recognise this as a related-party transaction and disclose it in the notes to the financial statements.

## **Register of interests**

R9 The Council should update the officer register of interests form and guidance notes to require disclosure of the value of any remuneration received for an individual officer's role in a Council-owned trading company.

R10 The Council should review its system for ensuring that all annual returns are received for the officer register of interests.