KENT COUNTY COUNCIL

Governance Review of Kent Commercial Services

BDO

September 30th 2011 DRAFT

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SECTION 1: EXECUTIVE SUMMARY

A Look under the Bonnet

During the course of the 'MOT' on the Commercial Services we discovered an organisation which was originally designed as a small vehicle with specific journeys to make in Kent. Over time, it has transformed into a coach, regularly picking up new passengers (Business units) and opportunistically motoring up new roads with no specific final destination, and an undefined route. The Council has stopped checking its oil, tyre pressure and water levels and lost track of its location. Whilst there is a coach driver in place, there are no two way communications with the depot and the satnav is broken.

Scope of the Review

In July 2011, Eversheds and BDO were jointly commissioned to undertake a high level strategic review into the governance arrangements of Kent Commercial Services (CS), to cover the following areas:

- the current governance and assurance arrangements of the whole CS entity
- the legality of the current operating and governance arrangements in CS against Companies Act and Local Government legislative requirements
- the financial relationship between CS and Kent County Council (KCC), including an assessment as to the level of effective subsidy (if any) that KCC provides to CS
- how well KCC has specified the purpose of CS, how this aligns with the strategic requirements of KCC, and how precisely this is interpreted and delivered by CS.

Background to Commercial Services

CS, a trading arm of Kent County Council has grown organically and the motivation for business has evolved over time from market moderation to profit generator. An opportunistic approach has been taken to development rather than a strategic one in order to meet these imposed financial targets and consequently, the organisation has become untethered from the Council in both governance terms and policy direction.

Market moderation is a three stage process which should be achieved by entering, moderating and withdrawal. The organisation should now be planning the withdrawal process from certain markets.

In terms of structure, there is inherent risk in running a business of this size and scale without adequate investment in an effective executive. The vast majority of financial risk to Kent County Council is associated with one of the business units, LASER.

Within the last 18 months there has been a change of leadership at both CS and KCC and a significant reorganisation and cultural shift has occurred in order to create more collaborative ways of working within the Council. To date, CS has been outside of the scope of these changes. Wider events have also lead to an increased appetite to regain control of the CS vehicle and ensure that it is set a new, more focused direction in harmony with the aims of the Council.

As a direct consequence of an external report into LASER, the energy procurement consortium, CS have already started to address areas of governance such as the inadequate coverage of the audit programme for CS, a business with an annual turnover of £400m pa. It has been agreed that two commercial auditors will be recruited to rectify this with a professional line to the Head of Audit at Kent County Council (KCC).

Similarly, credit must also be given for the work undertaken to write a number of papers on governance and the role of

Commercial Services (the ' CS Trading Board' and 'CS as the Enabler for KCC Trading') which have been submitted to the Corporate Management Team of KCC for their review and action. The ideals behind the two reports are commendable and the desired outcomes will arise from the reorganisation of CS into an appropriate vehicle. This report takes those papers into account.

Strategic Overview (Commerciality)

Kent Commercial Services (CS) does not follow a common model for Local Government Purchasing Consortia. Most consortia are multi-based, governed and funded by management committees representing more than one Local Authority. The exceptions to this are few and are much more limited in their scope of services. CS however, is wholly owned by Kent County Council (KCC) and has a thorough mix of service provision and a turnover of over £400m pa.

CS constitutes 5 limited companies and approximately 26 business units, however, just four of these business units represent 88% of turnover, with LASER, the energy procurement consortium itself representing 62%. Over 25 business units make up 18% of the business which is far too dispersed and numerous for effective management and efficient use of capital and resources. In the short term, the move towards managing these diverse businesses as 6 streams or divisions must be applauded.

We also commend the move towards a local authority partnership with Hertfordshire to establish a robust and sustainable county supplies operating unit with the aim of zero stock turn.

We have refrained from comment on individual business units in this report in accordance with the specific guidance given to us for this commission. The organic and untethered growth of the organisation without adequate investment in an effective Executive puts the business at an indeterminate level of risk.

Governance and Assurance

The governance structure and internal control mechanisms in place such as risk management and audit are inadequate for a £400m commercial enterprise. Governance has two aspects; strategic direction and secondly, monitoring and control. The monitoring and control function is already being addressed by the future recruitment of two commercial auditors solely focused on CS however, the absence of strategic direction and decision making should be immediately addressed by establishing a Governing Board with appropriate membership (including non executive members with appropriate commercial and market sector expertise) the Chair of which will be the Deputy Managing Director of KCC. Furthermore, this will be supported by an Advisory Board for Commercial Services both of which will plug into existing governance structures within the Council. (These are described in more detail in Section 5)

Financial Relationship between CS and KCC

The financial relationship between the Council and CS whilst distinguished by its separate accounting systems and clear blue water in this respect leaves room for improvement where greater clarity and transparency could be achieved. The areas that would benefit from greater clarification are:

- Pensions liabilities
- Premises arrangements
- KCC recharges (what is and is not included)
- Mandated services (rationale and review)
- Insurances (whether KCC truly insure for the full risk)

KCC plays a dual role that of governor and customer, however there is little evidence of KCC exerting the role of intelligent customer e.g. through its appropriate use of SLAs.

Assessment of legality of operations

At present the arrangements are not sufficiently transparent to demonstrate the commerciality of the arrangements between the Council and the corporate trading entities. This raises questions about CS as a whole delivering to both the public and private sector simultaneously.

Recommendations

1. **Structure:** Create a stand alone, *formally* constituted Arms Length Organisation (ALO) with two discrete operating units one Teckal compliant the other in open competition under the auspices of the Local Government Act.

2. **Reporting Lines:** CS should be realigned to report to the Deputy Managing Director to whom it should be responsible for meeting KCC targets.

3. **Governance:** **i)**Create an appropriate Governing Board chaired by the Deputy Managing Director constituted with responsibility to the Cabinet & Scrutiny. **ii)**Create an Advisory Board with external advice in the guise of Non-Executive Directors, drawn from relevant sectors of the market that match those delivered by CS.

4. **Executive:** It is vital that a new executive should be formed, to mitigate risk and in recognition of the need to run CS as a commercially viable and sustainable business. The Executive should consist of the following roles:

- Director of CS
- Head of Finance
- Head of Commercial
- Head of Operations
- Head of Personnel
- Head of Teckal company
- Head of Market company.

5. **Relationship with other public sector bodies:** Appoint the new Head of Procurement to manage the relationship with other PS bodies on behalf of KCC, which must be discrete from the affiliation with CS.

6. **EU and Regulatory Compliance:** Director of CS should be held to account by the Head of Procurement at KCC for adherence to EU and internal regulations.

7. **Service Level Agreements:** That the Council fully adopts the role of Intelligent Customer and appropriate, balanced and agreed SLAs are drafted and implemented.

8. **Business Relationships:** Rebates to Directorates are applied based upon sales.

9. **Financial Relationship between CS and KCC:** Clarity must be obtained as early as possible.

10. **Risk:** CS to draft an appropriate risk policy which should be communicated to all staff.

11. **Audit:** CS must adopt a fit for purpose Audit function following the industry (Turnbull) best practice.

12. **Legal:** Simplify the organisational structure and put in place a clear vision, mission and objectives for the corporate entity and individual business units.

13. **Legal:** Any financial arrangements should be properly documented at the earliest opportunity and commercialised.

14. **Detailed review of Commercial Services:** Conduct a root and branch review of the commercial arms that make up Kent Commercial Services.

Conclusion

A quick look under the bonnet has shed some light onto parts of the engine which require deeper scrutiny and rework. An inventory of improvements has been recommended to better manage the operation and ensure that Commercial Services is a viable and sustainable business in the future. However, Commercial Services is a complex vehicle and the next step should be to give each of these identified areas a thorough examination in order to reshape and retune the vehicle to best suit the new environment, renewed focus of the Council and wider public sector context.

The potential for Commercial Services as a business is enormous. Implementing the recommendations holistically will ensure that the organisation is best positioned to limit its risk exposure and maximise on market opportunities. With a rationalised organisation, properly resourced Executive and good governance in place the likelihood of protecting and indeed, increasing its margin is high. It will also ensure that it is able to better consider the appropriateness of acting in a market moderating role.

SECTION 2: DETAILED RECOMMENDATIONS

No	Situation	Target	Recommendations	Timeline	Approx. Cost
1	**STRUCTURE:** The structure of Kent Commercial Services is unnecessarily complex and not fit for purpose, it lacks the appropriate direction and has become un-tethered from the Council.	Form a single governing unit with responsibility for the effective, profitable and sustainable existence of Commercial Services.	**Formally constitute a stand alone business as an Arms Length Organisation,** controlled, but uninhibited by the Council to enable it to be fit for purpose and deliver sustainable business outcomes and income for its parent. This single entity must be able to act in isolation and be divorced from the Council. (Further detail is given in Section 5). **Under the parent body form two discrete business units one Teckal compliant the other in open competition**, under which the current 25 business units are distributed accordingly. This recommendation should be implemented within 3 months of the formation of the Executive [recommendation 7 The long term future of the discrete business units is the subject of a separate recommendation [recommendation 12]	By June 2012	Cost is staff time as defined in the new Exec structure.
2	**REPORTING LINES:** Currently CS reports to the Corporate Director of Environment and Enterprise, whose department is itself a major client of CS. This could lead to a conflict of interest,	Have reporting lines that keeps CS appropriately tethered to and aligned with the One Council plan whilst leaving it free to operate as a viable commercial concern**.**	**CS should be realigned to report to the Deputy Managing Director** to whom it should be responsible for meeting KCC targets. The Deputy Managing Director of the Authority should sit as the Chair of the Executive on the Governing Board and as a member of the Advisory Board. **IMPORTANT:** Given the fact that Commercial services has changed operational reporting lines 3 times in 2 years it is recommended that the move to the Deputy Managing Director should be delayed pending the outcome of the detailed strategic review of CS	**By Apr 2012**	**Cost neutral** **£0**

No	Situation	Target	Recommendations	Timeline	Approx. Cost
3	**GOVERNANCE:** There is an absence of strategic guidance from within the Council. There is also a lack of independent challenge from outside the Council. CS's current Governance arrangements are part of the overall Governance arrangements of Kent County Council. However, accountability back to the Council is weak and reporting in some areas non-existent It would not be unreasonable to expect a division of this size to have a clearly separate and distinguishable Governance arrangement that mirrors good practice guidance in a commercial environment.	To give Kent Commercial Services strategic guidance and the appropriate level of external consistent challenge and guidance. Ensure accountability is strong with appropriate and regular reporting.	**Create an appropriate Governing Board chaired by the Deputy Managing Director constituted with responsibility to the Cabinet & Scrutiny for:** • set the strategic direction and decide the role of CS • governing the organization by establishing broad policies and objectives • selecting, appointing, supporting and reviewing the performance of the Managing Director of CS • ensuring the availability of adequate financial resources • approving annual budgets • accounting to the Cabinet for the organization's performance. The final construct of the boards will be determined by the root and branch review as described in recommendation 14. **Create an advisory Board with external advice in the guise of non-Exec Directors, drawn from relevant sections of the market that match those delivered by CS.** The role of the advisory board will be to advise the two operating companies on how to deliver the business model and in addition advise the Governing Board.	To be in place by 1 Apr 2012	An annual cost of £18,000. (Based on 3 roles)

No	Situation	Target	Recommendations	Timeline	Approx. Cost
4	**THE EXECUTIVE:** The Executive is inappropriately structured to enable it to drive the organisation forward and react to the direction of an established governance board	An appropriately structured Executive Management Team should be established to enable the effective outcome of a full Commercial Services review and to implement the recommendations of that review.	Notwithstanding the outcomes of the detailed Commercial Services review the Executive should be established, in the short term composed of the following: • Director of CS • Head of Finance • Head of Commercial • Head of Operations • Head of Personnel • Head of Teckal company • Head of Market company This Executive should be formed and in place by no later than April 2012. At an estimated additional cost of£300k to cover the period of transition. The final organisational structure, to sustain the organisation, should form part of the independent review of the trading arm, informed by the size and construct of the final organisation following the transition. This Executive should manage the transformation from CS's current position to the new organisational structure.	In place by Apr 2012	c. £300k (for period from Apr 2012 to Sep 2012)
5	**RELATIONSHIP WITH OTHER PUBLIC SECTOR BODIES**: The relationship with CBC, Pro 5 and other public sector trading bodies & commercial operations should be aligned to ensure that the roles of KCC and CS are separated. (One is decider the other is provider)	To separate out the decider / provider role and to differentiate relationships between KCC and CS with other public sector bodies. CS cannot represent KCC.	Appoint the new Head of Procurement to manage the relationship with CBC, Pro5 etc on behalf of KCC. This must be discrete from the affiliation with CS (as provider).	Oct – Dec 2011	Cost Neutral £0

No	Situation	Target	Recommendations	Timeline	Approx. Cost
6	**EU AND REGULATORY COMPLIANCE:** CS must be compliant with regulations both internal and external (EC and as defined in English law)	The appropriate governance, from a regulatory footing, must be put in place.	The current arrangement is that the Head of Procurement Services Group (PSG) is responsible to the Head of Procurement (HOP) within KCC for adherence with EC and internal regulations. It is recommended that this relationship is hardened and that it should be between the MD of CS and the HOP and that this ensures all CS commercial operations are carried out in accordance with relevant regulations.	Oct – Dec 2011	Cost Neutral £0
7	**SERVICE LEVEL AGREEMENTS** The current SLAs need to be fit for purpose and properly describe the relationships between Directorates and CS.	To describe and apply appropriate relationships between KCC and CS.	That the Council fully adopts the role of Intelligent Customer and appropriate, balanced and agreed SLAs are drafted, agreed and implemented. A Programme of regular review (annual) is established under the auspices of KCC Head of Procurement.	In place by Jun 2012	£50k (soft charge)
8	**BUSINESS RELATIONSHIPS** Currently all sales to KCC are subject to a collective profitability rebate to the Council. This situation leads to suspicion and, in some cases, open hostility towards CS.	To enable CS to have an effective and viable long term relationship with KCC staff at all levels.	Rebates to Directorates are applied based upon sales. Overall rebates to the Authority are adjusted accordingly and Directorate budgets aligned. We are unable to determine the method for addressing this issue as there are a number of options all of which have ramifications. This should be a follow on piece of work for CS to undertake and agree with the Head of Finance within KCC.	In place by Apr 2012	c£50k (combination of soft charge and IS fees) depending on method decision

No	Situation	Target	Recommendations	Timeline	Approx. Cost
9	**FINANCIAL RELATIONSHIP BETWEEN CS AND KCC:** Different accounting systems clearly separate the finances of CS and KCC, however greater clarity is needed in some areas.	To achieve a clear, fully transparent and legally compliant financial relationship between CS and KCC	Focus effort on clarifying the fuzzy lines between Kent CC and CS such as clarifying the status of; the pensions liabilities, deconstructing the annual recharges and understanding the implications of the premises arrangements.	By 31 Dec 2012	
10	**RISK:** In benchmarking CS against good practice there is no stand alone risk policy which is relevant and applicable to a commercial arm.	CS must adopt a fit for purpose Risk Policy.	CS to draft an appropriate risk policy which should be communicated to all staff in line.	By Apr 2012	Costs covered by the new Audit Staff
11	**AUDIT:** The Audit process is disjointed and takes no account of the commercial activity undertaken by CS.	CS must adopt a fit for purpose Audit function following the industry (Turnbull) best practice.	CS is in the process of recruiting an appropriately qualified audit team of 2 to be responsible for the ongoing audit function. This action is wholeheartedly endorsed. The auditors, once in post, must be responsible for the audit and risk functions described later in the detail of this report and they should be accountable from a technical compliance perspective to the Head of Audit and Risk of KCC.	By Apr 2012	Costs covered under the recruitment of the new CS audit team [£130k]

No	Situation	Target	Recommendations	Timeline	Approx. Cost
12	**LEGAL:** The convoluted and shifting structure of CS, combined with unclear messaging as to its role and function, engenders a lack of transparency and understanding.	To achieve clear understanding from the Council and customers.	Simplify the organisational structure and put in place a clear vision mission and objectives for the corporate entity and individual business units. Clarify who does what for whom through which company or unit, the role and function of each business unit and whether it should be in the 'public' or private side of the organisation moving forwards.	By Apr 2012	
13	**LEGAL** At present the arrangements are not sufficiently transparent to demonstrate the commerciality of the arrangements between the Council and the corporate trading entities.	To ensure the required transparency and demonstrate compliance with EU competition and state aid law.	Any financial arrangements should be properly documented at the earliest opportunity and commercialised.	By 31 Dec 2011	

No	Situation	Target	Recommendations	Timeline	Approx. Cost
14	**DETAILED REVIEW OF COMMERCIAL SERVICES** and its operating arms is required to move the business forward and give it a sustainable future, this should be part of a fundamental change programme. The current 26 business units are not properly aligned. Some are not fit for purpose and some run in conflict from the requirements of the parent organization (KCC) (for example the fractured relationship between EduKent and the Education facing IS structures within CS – and the role of the PSG etc).	To describe a fit for purpose set of operating arms organized under a teckal and a non-teckal compliant body, as part of a fundamental change programme.	Carry out a root and branch review using the ROAD© process and report back by no later than Dec 2011 with a detailed report which will inform the future structure to be implemented by the revised Management Executive by no later than Apr 2013. This report should include a detailed recommendation on the future role of market moderation currently undertaken and the role of PSG. Savings will be achieved through greater efficiency and focused application of staff and resources which will offset some of the investment required. This investment will enable the realization of the true potential of the business and give greater confidence to CS meeting future targets. This must be part of a co-ordinated and properly controlled change programme which should be delivered at pace and completed by no later than Apr 2013.	By 31 Dec 2011	£108k

SECTION 3 : STRATEGIC OVERVIEW

The Commercial Landscape

Kent Commercial Services (CS) does not follow a common model for Local Government Purchasing Consortia. Most consortia are multi-based, and are governed and funded by management committees representing more than one Local Authority. The exceptions to this are few and are much more limited in their scope of services. CS however, is wholly owned by Kent County Council (KCC) and has a thorough mix of service provision and a turnover of over £400m pa.

Background

CS has grown organically without any strategic link between itself and Kent County Council (KCC). This growth has been driven by the budgetary strain on KCC resulting in a year on year target to increase the returns to the Council. This has in some ways been counter productive because whilst it has driven CS to be focused on creating and retaining revenue streams it also encourages a culture to concentrate on profitability in isolation. There are examples of where CS goals have been diametrically opposed and conflicted with the success of the goals, ambitions and strategic plans of the Council for the delivery of front line services.

The drive to contribute a profit margin, at all costs, has meant an incredible growth pattern for such an operation into a diverse area of commercial delivery not normally seen nor aligned with one another. It could be argued that the raison d'être for its formation has been lost in the fog of war and the reason for its formation and growth have been forgotten.

This is not to say that CS is not a viable operation. The overall profitability of CS is in line with private sector values and margins.

Crucial to the viability of CS is that it is appropriately aligned, to the overall goals of KCC, and is effectively governed to meet these goals. Its current structure does not provide for either of these missions to be achieved. Indeed the relationship with the County Council is at best fractured, and at worst counter productive to the single mission of the Council. The lack of clear governance and resulting lack of transparency inhibits the organisation.

Commerciality

It is imperative that if Kent Commercial Services is to survive as a viable entity which supports the County Council then it must decide which business units:

a) have a real future and are aligned with the overarching mission of KCC
b) which should be realigned to the Council strategic direction
c) those that will either add no value, are a reputational risk without adding value and/or are a distraction or deflection from the corporate aims of the council.

Given the brief to keep our work at a strategic level we have noted where further work will be required to determine the business units future. A more detailed study is required and is subject to recommendation 12.

It is worthy of note that LASER equates to 62% of the overall turnover of CS; with CS, Kent Top Temps and Kent fleet making up a further 26% of turnover. These 4 business units attract 88% of the overall turnover of the commercial operation. The revenue distribution by Company / BU is highlighted in Chart 1.

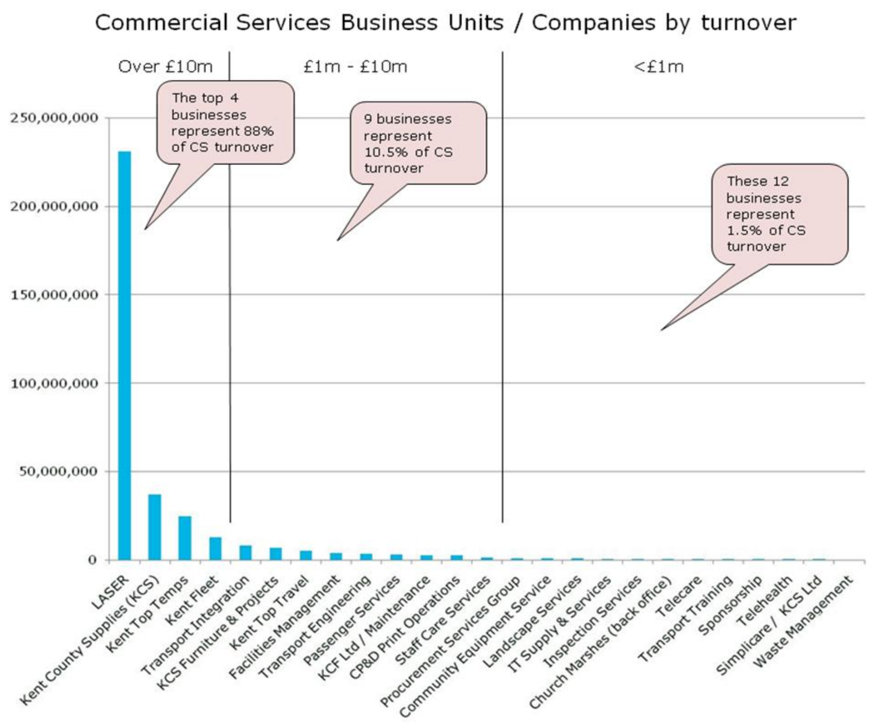


Chart 1

We have refrained from detailed comment on specific business units in this report in accordance with the specific guidance given to us under the auspices of this commission. We can determine that the organic and untethered growth of the organisation without adequate investment in an effective Executive puts the business at an indeterminate level of risk.

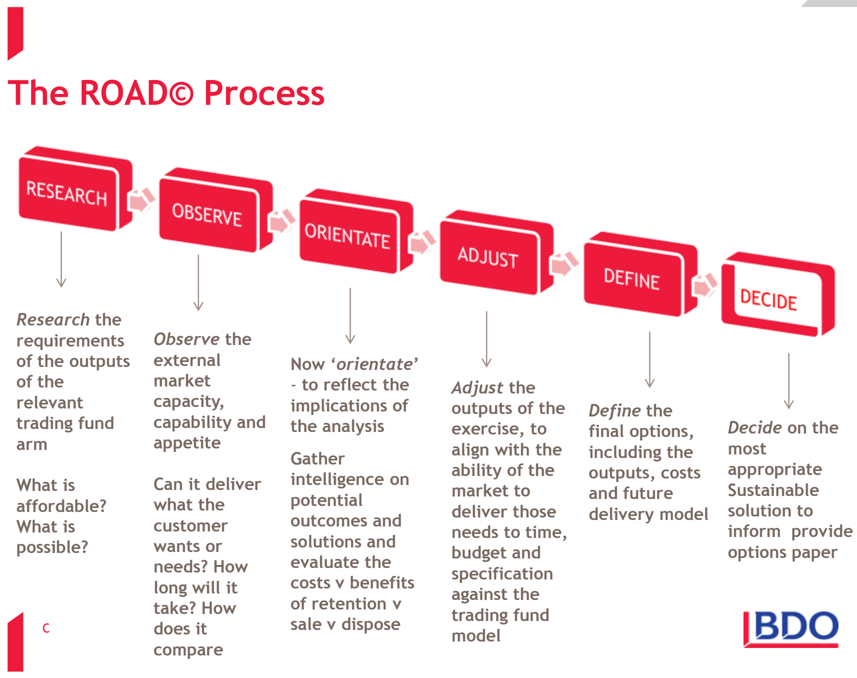
The vast majority of financial risk to Kent County Council is associated with one business, LASER. Conversely, the reputational risk of the 'tail' of the profile of 24 Business Units is disproportionate to the financial return. This can only be established by a thorough review of these units.

Market Moderation

Market moderation is a three stage process which should be achieved by entering, moderating and withdrawal. The organisation should now be planning the withdrawal process from certain markets.

SECTION 4 NEXT STEPS

We propose that a root and branch review of the commercial arms that make up Kent Commercial Services is an appropriate next step to ensure that the future operating model is appropriate, fit for purpose, legally sound and sustainable in the long term. We recommend that each arm of County Supplies is reviewed using the ROAD©[i] process. This procedure has been developed to simplify and add value to the planning and preparation stages of any supply chain model. At the core of the methodology is that nothing about the supply chain is assumed or 'given' from the outset. Application of the process can result in surprising, but legally compliant and effective supply chain solutions.



[1] ROAD was designed by Ian McPherson of BDO and Dr David Moore at Cranfield University

The output of a ROAD Review is some crucial intelligence upon which to base the strategic supply chain options, as follows:

- Affordability
- Ability of the Market to Deliver
- Timescale
- Cost
- Capability
- Configuration control
- Continued life support
- Confidence

Which will inform a set of costed options defining retention, sale or disposal recommendations, as appropriate for each arm culminating in an overall profitable and sustainable commercial body.

To enable this the focus should be on the orientate phase of ROAD which will enable the Governing Board to make informed decisions based upon evidence based analysis.

The Gantt chart on the next page shows a timeline incorporating all the recommendations in Section 2, including ROAD review (Rec. 14 'Detailed review of CS').

Rec.	Workstream	Task	Who	2011 Oct	2011 Nov	2011 Dec	2012 Jan	2012 Feb	2012 Mar	2012 Apr	2012 May	2012 Jun
5	**Relationship with other public sector bodies**	Appoint Head of Procurement as Relationship manager for PS Bodies e.g. CBC, Pro5	KCC									
6	**EU & Regulatory Compliance**	Harden relationship from MD CS to Head of Procurement	KCC & CS									
9 & 13	**Financial Relationship between CS and KCC:**	Clarify areas of financial ambiguity and document and commercialise all arrangements.	KCC & CS									
14	**Detailed review of CS**	Root and branch review of all CS BUs / Ltd Companies	External									
3	**Governance**	Create Governing Board	KCC & CS									
		Create Advisory Board	KCC & CS									
7	**Service Level Agreements**	Review, amend and, where necessary, create SLAs between CS and KCC	KCC									
8	**Business Relationships**	Apply rebates to Directorates based upon sales	KCC & CS									
10	**Risk**	Draft, agree and roll out New Risk Policy	KCC & CS									
11	**Audit**	Recruit and embed 2 new CS auditors and develop robust programme of Audit	KCC & CS									
12	**Legal**	Vision, Mission, Objectives for CS entity as a whole and its constituent parts	KCC									
4	**Executive**	Recruit Executive Team	CS									
2	**Reporting Lines**	Realign CS to report to the Deputy Managing Director	KCC									
1	**Structure**	Formally constitute a stand alone business (ALO)	KCC & CS									
		Form two discrete business units one Teckal, one not	KCC & CS									
0	**Programme Management**	Develop detailed transformation plan. Drive, coordinate, monitor and report on progress of plan. Ensure delivery to timescales & cost.	External									

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SECTION 5: GOVERNANCE AND ASSURANCE

Strategic Aim

The main finding in the area of governance was the absence of any strategic aim and role for CS. The only target, for which the organisation was being held to account, was a financial one.

There is a need to go back to first principles in line with the County Council plan and vision of the Leader, Group MD and Members to establish what is required from CS, how can it best be delivered and most importantly to what aim. This will chart the strategic course and direction of the organisation, against which coordinates the Executive can drive the vehicle.

The Board

The next page shows a proposed new Governance Structure with three lines (and only three lines) of accountability back to Kent County Council. This structure combined with a more robust internal audit programme and adequate resources will ensure direction, control and monitoring of the organisation whilst at the same time leaving it free of the constraints to pursue and maximise relevant business opportunities.

The new structure should be designed over the period October 2011 and April 2012 during which time it will make the required margins (discuss).

The focus and role of the Board and the Executive over the period Oct 2011 to 2012 is to realign the business to ensure that it is fit for purpose and acts with due probity to:

- Deliver sustainable services to support the operational directorates of KCC
- Realign those services.

Internal Audit

As identified in previous external reviews, CS needs a more robust internal audit service. The audit must be undertaken by staff with the right-set of commercial competencies. (NB. The recruitment of these resources has already been agreed and the wheels are in motion to address this).

CS should also develop its own risk based strategic (3-5 years) internal audit programme out of which will come the development of an annual internal audit plan. Advice should be sought from CS Internal Audit function, on how this will work.

The CS Audit team should report regularly into the main audit committee at Kent County Council and have a direct professional line to the Head of Audit.

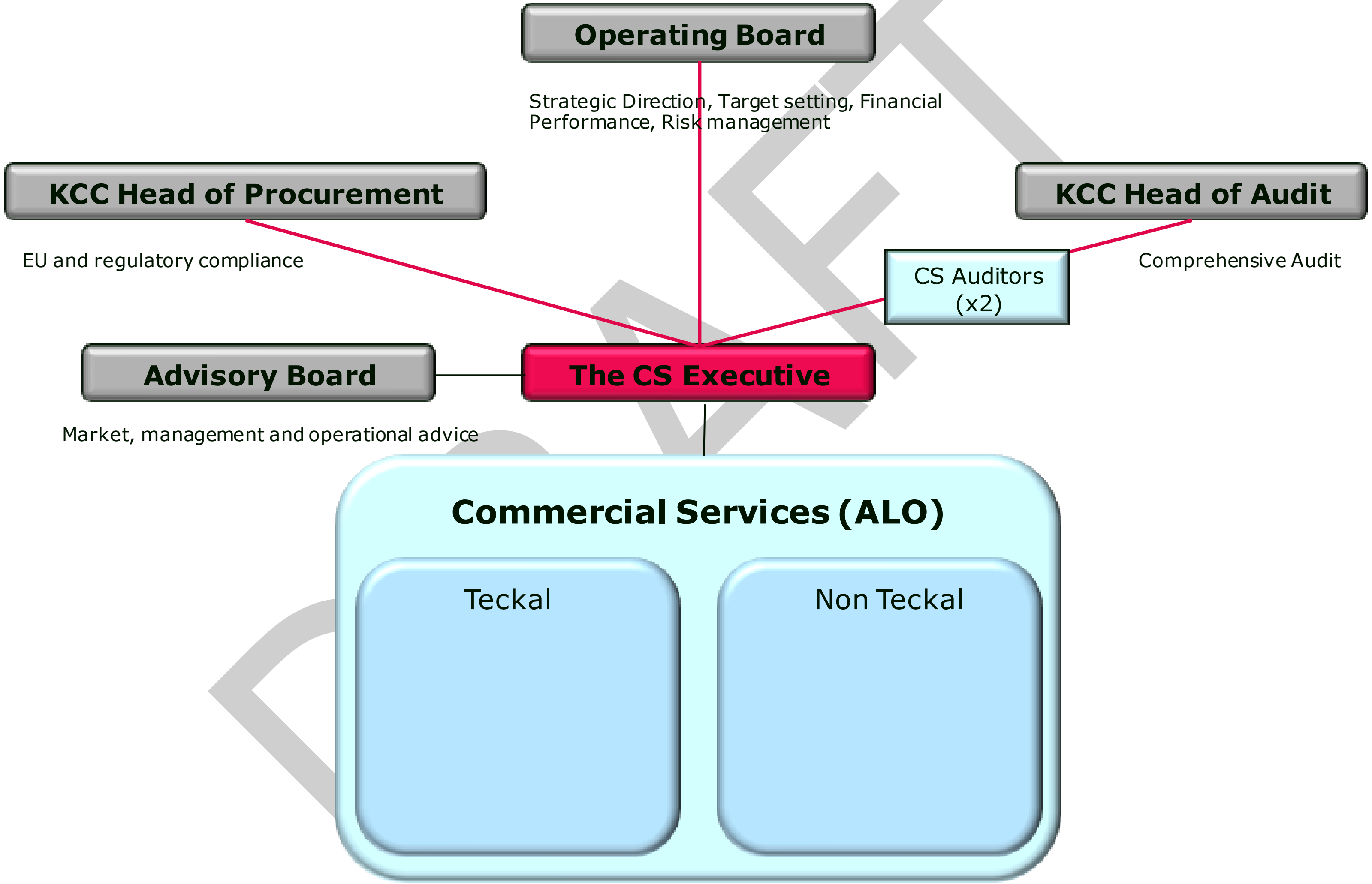
Risk Management

There does not appear to be a Risk Management Policy in place specifically for CS. However, in the Internal Audit Annual report it states that an external review by Deloitte on Risk Management within the Council provided 'substantial' assurance that the controls around risk management processes were effective.

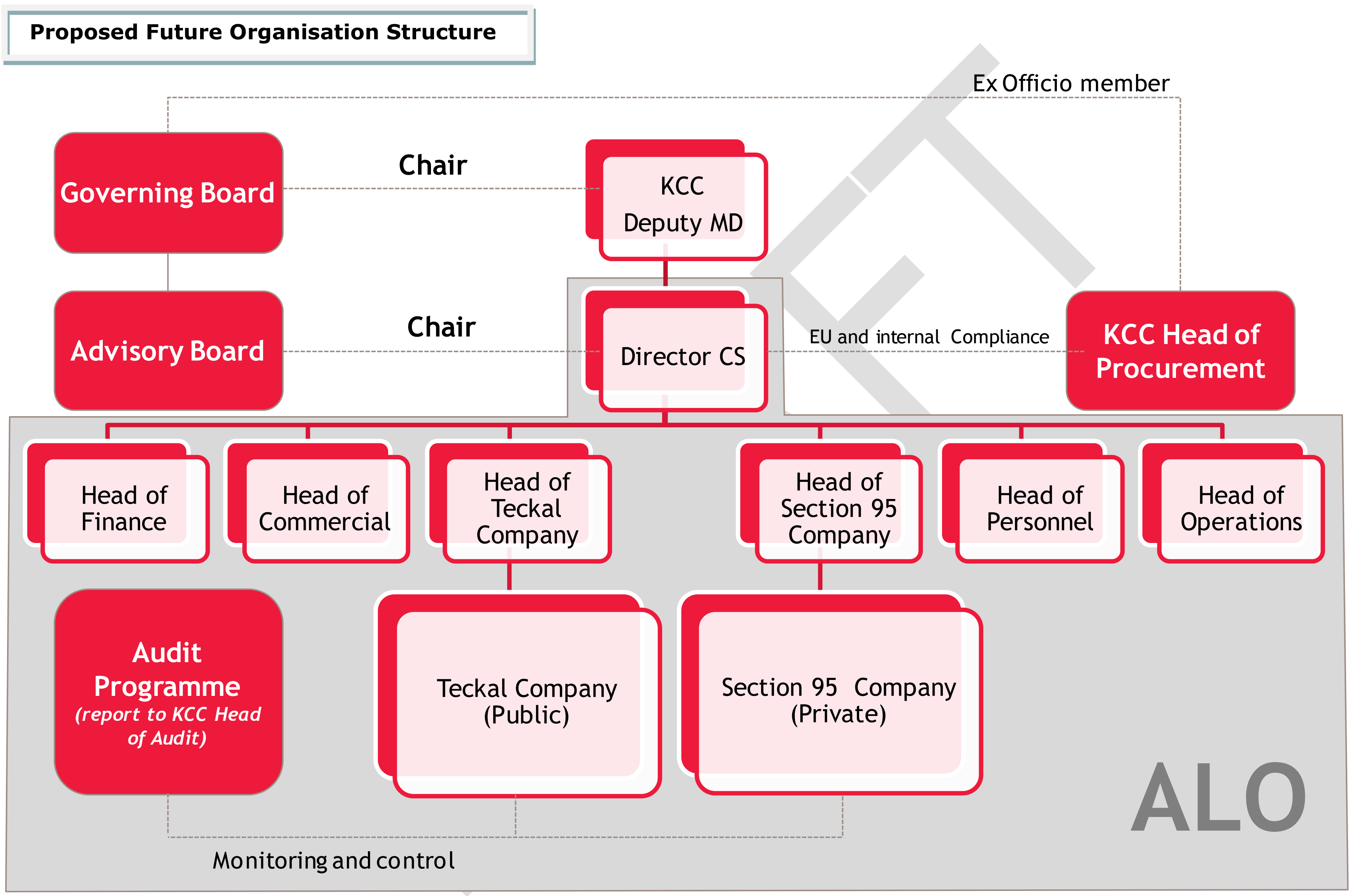
CS does have a risk register covering the whole of its operations however, the risks are too generic and numerous to be purely strategic and are not specific or focussed enough to cover the diverse range of markets and businesses through which CS operates.

A proper programme of reporting of the above elements must be established to give the ability for any member of the council to question the activity of CS either directly or through scrutiny.

'TO BE' Governance Structure



GOVERNANCE BODY	ROLE	MEMBERSHIP
CMT & CABINET	To ensure the Governing Board and Advisory Board are properly established and these bodies provide adequate control and assurance. To question the activity of CS either directly or through scrutiny at any time.	
GOVERNING BOARD	i. Set the strategic direction and decide the role of CS ii. Govern the organization by establishing broad policies and objectives iii. Select, appointing, supporting and reviewing the performance of the Managing Director of CS iv. Ensure the availability of adequate financial resources v. Approve annual budgets vi. Account to the Cabinet for the organization's performance vii. Target setting.	**Chair:** Deputy Managing Director • Permanent Members: Cabinet Members • Financial Director KCC • Non exec from Advisory Board (x1) • Head of Procurement (ex officio) • Corporate Director for Environment and Enterprise (Interim) • Director of CS (permanent invitee).
CS EXECUTIVE	To carry out the operational delivery of the Business Plan.	• Director of CS • Head of Finance • Head of Commercial • Head of Operations • Head of Personnel • Head of Teckal company • Head of Market company.
ADVISORY BOARD	Advise the Management Executive of CS how to meet targets from a market focused perspective and give advice on the appropriateness of business plans and forward growth to meet those plans.	**Chair:** Director of CS Non-Executive Directors (x3) Client representative (external to KCC) The Executive (permanent attendees).
KCC HEAD OF PROCUREMENT	To ensure CS compliance with EU procurement law and regulations.	
KCC HEAD OF AUDIT	To ensure a that a comprehensive and appropriate audit programme is developed and implemented for CS and appropriate measures are taken to address any areas of concern. Power to hire and fire CS auditors.	


Proposed Future Organisation Structure
Ex Officio member
Governing Board
Chair
KCC Deputy MD
Advisory Board
Chair
Director CS
EU and internal Compliance
KCC Head of Procurement
Head of Finance
Head of Commercial
Head of Teckal Company
Head of Section 95 Company
Head of Personnel
Head of Operations
Audit Programme
(report to KCC Head of Audit)
Teckal Company (Public)
Section 95 Company (Private)
ALO
Monitoring and control

ALO Key Characteristics

The structure of the Arm's Length Organisation (ALO) that we are proposing is shown in the diagram on the previous page. Consisting of an Executive at the very top and two distinct companies, one teckal (providing services to the public sector) and one s95 company (Ltd Company) which could trade with the private sector. Whilst the ALO is not a legal entity in itself it has the following characteristics:

- Fully self financing
- Separate governance structure (tethering it to Council)
- Greater management independence (stronger executive)
- Independent challenge (paid non executive directors on the Advisory Board)
- Monitoring and control by separate and comprehensive audit programme
- Separate set of accounts for the whole (including the Executive)
- Fully transparent pension schemes contributions and recharges
- Director of CS accountable to the Governing Board
- Director of CS has a professional Reporting line to Deputy MD of KCC
- The Executive would be employed by KCC
- The remaining staff would be employed by the two companies and would TUPE over their existing T&Cs.

SECTION 7: LEGAL ASSESSMENT OF CURRENT OPERATIONS

Ability to Act

As 'creatures of statute' local authorities need to act within the scope of local government legislation and are also bound by EU Directives that have direct effect on the state, including procurement and competition rules. Procurement rules have been implemented in the UK through the Public Services Contracts Regulations 2006 along with amendment regulations in 2009 to implement the Remedies Directive. Consortia, and in this case CS, must apply the procurement rules on behalf of their customers.

There are many misconceptions about municipal trading, there being a wealth of powers under which local authorities can charge for services and trade and make a profit, for example the Local Authorities (Goods and Services) Act 1970 with thousands of other public bodies as listed. Most of the charging and trading powers can be exercised by the Council itself without establishing separate legal entities. However a corporate vehicle will be required where the primary motive is commercial trading for profit with the private sector. Further information on powers and procurement is set out in the Annex.

There are two types of corporate structures: those that are formed but still owned and controlled by the local authority and delivering services directly to it which could potentially fall within the Teckal exemption from procurement (not a third party trading vehicle); and secondly a market facing trading vehicle often formed under s95, which cannot be given major contracts with the authority as of right and must not be subsidised by the authority, whether financially (i.e. loans/equity should be at market rates for the type of organisation) or in contracting for services or any other kind of support e.g. employees.

At present the arrangements are not sufficiently transparent to demonstrate the commerciality of the arrangements between the Council and the corporate trading entities.

Recommendation: Any financial arrangements should be properly documented at the earliest opportunity and commercialised.

Corporate Governance

Directors of companies are required to act in the best interests of the company, however, board meetings are held infrequently, member involvement is minimal and there appears to be a single chain of command within CS, notwithstanding that there are separate limited Companies, operating in different markets.

Accountability back to the Council is weak and reporting in some areas non existent – as a result there needs to be a review of who is appointed as member representatives and Directors on each of the companies (once reorganised) to strengthen the strategic direction of each of the companies – appointing non-executive directors to give independent challenge coupled with more regular reporting of performance with checks and balances through Cabinet, Audit & Governance and Scrutiny as mentioned above.

Recommendation: The lack of transparency over who does what for whom through which company or unit requires more clarity over role and function of each business unit and whether it should be in the 'public' or private side of the organisation moving forwards.

ANNEX 1 - INTERVIEW LIST

Name	Role	Interviewed
Mike Austerberry	Corporate Director Environment and Enterprise	Y
David Cockburn	Deputy Managing Director and Corporate Director of Business Strategy and Support	Y
Debbie Haigh	Director of Commercial Services (Interim)	Y
Bryan Sweetland	Cabinet Member	Y
Roger Gough	Cabinet Member	Y
Kathryn Kerswell	Group Managing Director	Y
John Simmonds	Cabinet Member for Finance and Business Support	Y
Les Coulson	Head of Strategic Finance	Y
Steven Munday	Retail (Kent County Supplies)	Y
Peter Bole	Head of ICT	Y
David Taylor	LASER	Y
Gary Cooke	Member (Director on Boards of Private Companies)	Y
Laurence Faulkener	Director on the Ltd Companies	Y
Cath Head	Finance Team KCC	Y
Chris Luke	Head of Procurement KCC	Y
Andy Wood	Director of Finance	Y
Geoff Wild	Head of Law and Governance	Y (telecon)
Nigel Brown	KCC Property Services	Y

ANNEX 2 – LIST OF DOCUMENTS REVIEWED

	List of Documents reviewed
1	Latest up to date Organisation Charts for KCC & KCS Group
2	Internal Audit Report 2010/11
3	SLAs between KCS and KCC
4	KCC Code of Conduct Blue Book
5	KPMG Draft Review of LASER
6	Medium Term financial Plan
7	Grant Thornton Report 2006
8	Barnes Roffe Report 2006
9	Audit Commission Report 2009
10	Risk Registers for the Businesses in KCS
11	Full List of Key Stakeholders for the project
12	KCC Information Governance Policy
13	PWC Terms of Reference for Education Models Review
14	Details of KCS property/occupation arrangements including Liberty Partnership
15	Companies House Company Searches
16	Details of services mandated to use KCS
17	'The Enabling Layer' paper
18	Proposal for Governance of Commercial Services; 'Trading Board' Paper
19	Change to Keep Succeeding Paper
20	Organisation Chart for DIVMT
21	Corporate Risk Register / Strategic Threats Register
22	Management responses to KPMG Report
23	Broad details of customer groupings
24	Electronic version of the corporate structure (companies and BUs)
25	3 Year Plan for Kent County Supplies

ANNEX 3 – DESCRIPTION OF THE COMMERCIAL PUBLIC SECTOR LANDSCAPE

A number of local authorities who had stores or commercial activities have moved, or are considering, moving away from this model:

- Northamptonshire County Council sold their Supplies Division to ESPO in 2006;
- Wiltshire County Council was subject to a management buy out in 1999 and now successfully operates as a private sector provider of the same services to the public sector under the name of the Consortium;
- Devon County Council closed is Supplies commercial arm in April this year, closure is blamed upon a changing private sector market who have reduced margins and are able to offer a zero stock turn service provision;
- West Mercia County Supplies is jointly owned by Worcestershire County Council, Herefordshire Council, Shropshire Council and Telford and Wrekin Council have decided that they need to give priority to investing in their core activities and believe it is right to sell the business whilst it is still very profitable. West Mercia Supplies currently employs 100 people and has a turnover of £50 million a year.

Those that remain work on different models, either because they are jointly owned or because they restrict themselves to operating on a more localised basis leveraging their purchasing power through membership of larger purchasing groups (for example CPC). A resume of the remainder of the market:

- **ESPO** (Eastern Shires Purchasing Organisation) is a local authority purchasing and distribution consortium, formed in early 1981 and is now run by committee by 7 Authorities. They offer broadly similar services to CS with a £400m turnover, but a large amount of staff time and turnover is dedicated to carrying out a strategic procurement function for member authorities.
- **YPO** is based in West Yorkshire it is co-owned by a management committee of elected representatives from 13 constituent authorities as a joint committee. YPO provides similar services to CS, employs 400 staff with a £400m pa turnover. Free of subsidy from any member authority, YPO is self-supporting and budgets each year to make a small surplus which is used for business development and expansion. In 2010, YPO launched its new profit share Loyalty Dividend Scheme, providing customers with further savings through a percentage of the organisation's profits based on their spend throughout the year.
- **NEPO** - The North East Procurement Organisation was established in 1976 is governed by a Joint Committee comprising members from the 12 North East Local Authorities. NEPO has recently received a renewed and enhanced mission agreed by the authorities in 2010 to deliver collaborative procurement in all major areas of external expenditure through leading edge category management processes to achieve significant savings.

The three stand alone models in the Local Government arena are:

Hampshire County Supplies is a business unit of Hampshire County Council (wholly within the Culture, Communities and Business Services Department (CCBS)) and a member of the Central Buying Consortium. As a member of CBC, they are also part of Pro5 procurement. Turnover is c£100 million pa, it services schools, colleges, Adult Services homes, libraries, police and fire stations in Hampshire, Portsmouth and Southampton, district councils, independent schools and many non-profit making community groups and voluntary organisations.

Nottinghamshire County Supplies is a part of Nottinghamshire County Council and serve customers in local government, the public and voluntary sectors in the Nottinghamshire area. It has a turnover of <£40m pa.

Hertfordshire County Supplies is the third standalone body with a turnover of c. £17m pa There is an intent for Hertfordshire to form an alliance with Kent which should be applauded.