

North Yorkshire Council

Executive

7 May 2024

Creation of a new Audit, Counter Fraud and Related Governance Services Company

Report of the Corporate Director Resources

The Appendices to this report contain information of the type defined in:

-paragraph 3 of Part 1 of Schedule 12A Local Government Act 1972 (as amended) as it contains - information relating to the financial and business affairs of Veritau Limited;

-paragraph 5 of Part 1 of Schedule 12A Local Government Act 1972 (as amended) Information in respect of which a claim to legal professional privilege could be maintained in legal proceedings, and it is considered that the public interest in maintaining the exemption outweighs the public interest in disclosing the information.

1.0 PURPOSE OF REPORT

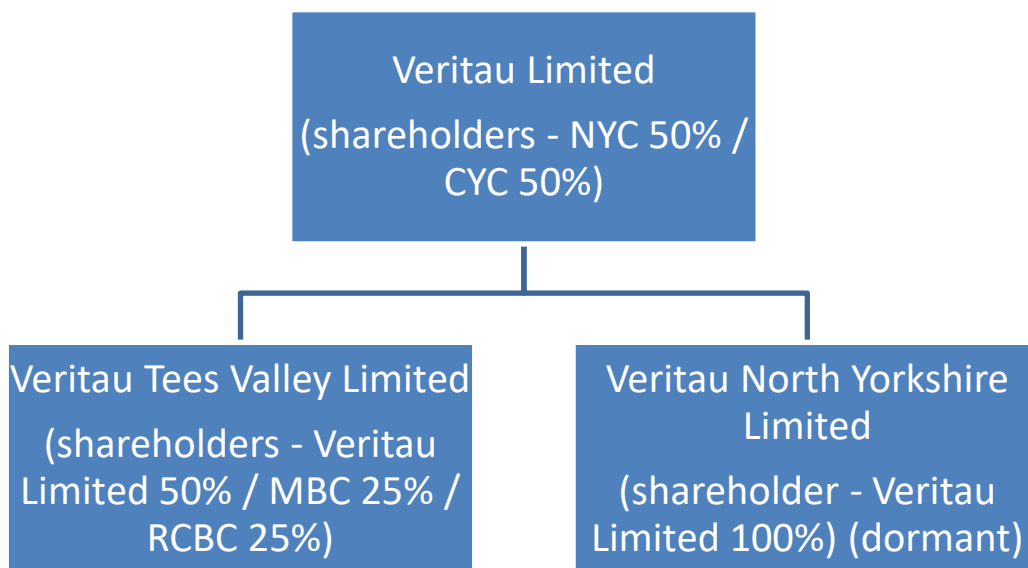
- 1.1 To provide Members with the Business Case for the establishment of a new company for the provision of audit, counter fraud and information governance services which would adhere to the Teckal exemption in the Public Contracts Regulations 2015.
- 1.2 To seek Member's approval to the establishment of the new company which will be jointly owned between the North Yorkshire Council and other authorities and limited by guarantee on the basis of the Business Case.
- 1.3 To seek Member's approval for Veritau Limited to operate on a commercial basis in the future without the benefit of the Teckal exemption.

2.0 BACKGROUND

- 2.1. Veritau Limited currently operates as a Teckal company (in accordance with the Public Contracts Regulations 2015) and is jointly owned by the Council and City of York Council (**CYC**). Veritau Tees Valley Limited is a subsidiary of Veritau Limited and is also a Teckal company part owned by Middlesbrough Borough Council (**MBC**) and Redcar and Cleveland Borough Council (**RCBC**). Collectively these companies are known as the "Veritau Group".
- 2.2. The range and scope of work undertaken by the Veritau Group is extensive, and touches on all Council service areas to varying degrees. As part of their scrutiny role, the Council's Audit Committee review the overall performance and activity of Veritau as a key part of the Council's overall framework of governance, control, and risk management.
- 2.3. Veritau Limited (**VL**) have provided a business case for a proposed restructure of the Veritau Group (**Appendix A**).
- 2.4. The proposal is to create a new Teckal compliant company, limited by guarantee (**Newco**). Newco will be jointly owned between the Council, CYC, MBC, RCBC and will enable the company to grow and invite more member authorities to join as owners of the company.

3.0 CURRENT GROUP STRUCTURE AND PROPOSAL FOR RESTRUCTURE

- 3.1. After the creation of VL in 2009, the shared service model proved to be successful, resulting in several other local authorities expressing an interest in joining.
- 3.2. A further joint venture company called Veritau North Yorkshire Limited (**VNY**) was established in February 2012, which was co-owned by VL and five of the North Yorkshire District / Borough Councils. Following local government reorganisation in 2023, VL purchased the shares in VNY previously held by the North Yorkshire District / Borough Councils. VNY is therefore now a wholly owned subsidiary of VL, and the company is currently dormant.
- 3.3. A second joint venture company called Veritau Tees Valley Limited ("**VTV**") was formed in December 2019.
- 3.4. Both VL and VTV were established as Teckal compliant companies. This enabled the local authority members of both companies to take advantage of the exemption contained in Regulation 12 of the Public Contracts Regulations 2015 to award contracts to the companies for the supply of services without the requirement to undertake a public procurement exercise, providing certain conditions were satisfied throughout the life of any long-term contracts they have with local authority members (set out in Section 8 below).
- 3.5. The current group structure is therefore:

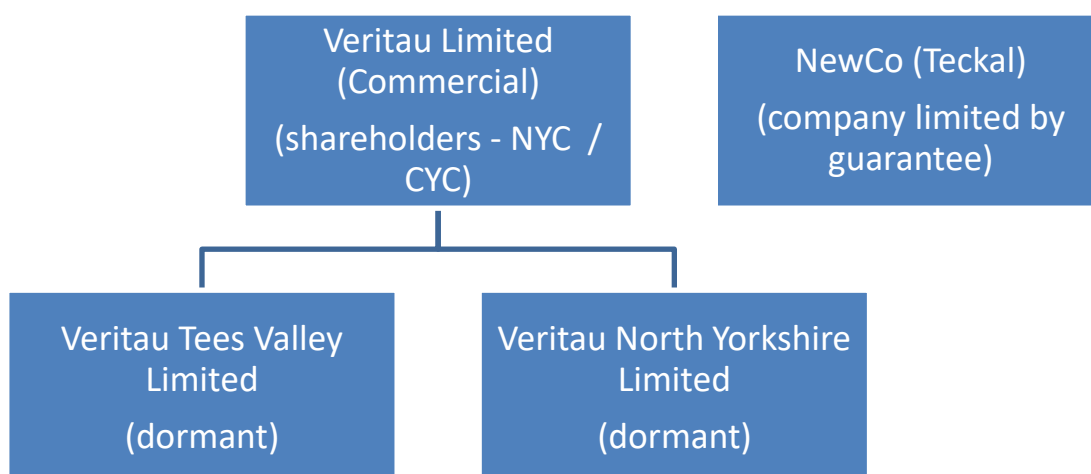


- 3.6. In addition to providing assurance services to its four local authority members, the Veritau Group now provides assurance services to over 700 other clients. To comply with the Teckal exemption this commercial work must amount to less than 20% of the overall work of the company, which restricts the growth opportunities of the Veritau Group.
- 3.7. The shared service model continues to attract interest from other councils. However, the existing corporate structure for both VL and VTV does not allow new local authority members to be easily admitted due to the need to issue additional shares, and the impact this has on existing shareholdings. Existing member councils also cannot easily leave.
- 3.8. The key drivers for a change to the Veritau group's current shared service model and corporate structure are:

- to maintain its *Teckal* status to allow Veritau to continue delivering audit and assurance services to its current local authority members;
- to allow for more local authorities to join to ensure its *Teckal* compliance and continue said expansion.
- to allow VL to continue to grow its commercial offering, for the benefit of its local authority shareholders and to allow Veritau to remain competitive in the market.

4.0 THE PROPOSAL – CREATION OF VERITAU ASSURANCE LIMITED

- 4.1. The proposal is to create a new Teckal compliant company, limited by guarantee.
- 4.2. The four existing member authorities (CYC, NYC, MBC and RCBC) would all become the initial members in the new company, (with potentially further members in time).
- 4.3. Each member authority of NewCo will be required to pay a one-off subscription fee to join to cover set-up costs, working capital and contingencies. VL would pay a dividend to NYC and CYC to fund each council's subscription.
- 4.4. The future liability of NYC and the other member authorities, otherwise known as the guarantee, would be capped at an agreed value of no more than £10. The guarantee is the maximum sum which would need to be paid by the member council to the company in the event of the company being wound up. If the Council or one of the other local authorities ceased to be a member of NewCo, the guarantee would continue to apply for one year after the date of exit.
- 4.5. All the existing commercial contracts would remain with VL and VL would become a non-Teckal company providing services to external clients. VL would continue to be a company limited by shares co-owned by CYC and NYC. The staff and any assets in VL will transfer to Newco, staff would transfer through a TUPE transfer.
- 4.6. In respect of staffing, NewCo would recharge the associated payroll and overhead costs to VL at a market rate, and, in respect of strategic leadership services, Newco would charge VL a management fee.
- 4.7. To the extent that Newco make a surplus in respect of any services it provides (whether to VL or to its member councils), this would either be reinvested in its business operations or returned to the member councils in the form of a rebate.
- 4.8. Both VNY and VTV would eventually be wound up.
- 4.9. The Veritau Group structure would be as follows:



This corporate structure would satisfy the *Teckal* exemption within the Public Contracts Regulations 2015. A company limited by guarantee would also facilitate the admission and exit of member authorities which permits growth of the company.

5.0 CONTRIBUTION TO COUNCIL PRIORITIES

- 5.1. The services provided by internal audit seek to give assurance to members that the Council's control framework is operating effectively and as such it underpins all of the Council's activities helping to ensure delivery of all of the Council's priorities.

6.0 ALTERNATIVE OPTIONS CONSIDERED

6.1. Alternative Option 1 - Do Nothing

- This option is not viable as it does not permit growth of the company for either local authority or commercial work.

6.2. Alternative Option 2 - Keep the existing business structure but take steps to ensure continued Teckal compliance

- This would require careful monitoring of external fee work, and if it was necessary to reduce the work could have a negative impact on the Veritau Group's financial viability due to any reduction in profitable commercial work.
- The corporate structure would still not allow for the easy admission of additional authorities.

6.3. Alternative Option 3 - Re-purpose VNY and novate all external commercial work to VNY

- This option would involve VL transferring its shares in the current dormant company, VNY, to NYC and CYC and converting the company into a standalone commercial business. The existing commercial contracts held by VL would then be novated to VNY.
- This would partially address any longer-term concerns about potential Teckal compliance but would still not allow for the easy admission of new authorities to assist with continued expansion of the external commercial work, due to VL's status as a company limited by shares.

- 6.4. As such, these alternative options are considered not to be viable and the proposed creation of the new company limited by guarantee remains the most appropriate solution to ensure continued Teckal compliance and growth.

7.0 FINANCIAL IMPLICATIONS

- 7.1 The financial implications of this report relate to the proposal to pay both NYC and CYC a dividend which is then subsequently used to pay a one-time subscription fee for the new company. This will allow the new company to operate with a minimum level of reserves, but without any additional financial risk to NYC.

- 7.2 The recommendations of this report will look to retain a cost-effective audit, risk and assurance service which supports NYC in providing assurances about the efficient and effective delivery of its services to the residents of North Yorkshire.

8.0 LEGAL IMPLICATIONS

- 8.1. The Council will rely on the general trading powers in conjunction with its powers to carry out the activity in question. Both general trading powers require the authority to trade through a company:
 - Section 95 of the Local Government Act 2003 enables relevant authorities “to do for a commercial purpose anything which they are authorised to do for the purpose of carrying on any of their ordinary functions” i.e. anything they are empowered to do in legislation. The section 95 power can be limited by order and authorities exercising it must have regard to guidance issued by the Secretary of State.
 - Section 4 of the Localism Act 2011 enables the local authority to do for a commercial purpose anything that it is empowered to do under section 1 (the general power of competence). The section 4 power is therefore wider than the section 95 power.
- 8.2. The section 95 and section 4 trading powers prescribe which company structures may be used, one of which is a company limited by guarantee.
- 8.3. The local authority must prepare a business case supporting the exercise of the section 95 power, which the authority must approve (Local Government (Best Value Authorities) (Power to Trade) (England) Order 2009). The business case attached at Appendix A fulfils this purpose.
- 8.4. It is proposed that Newco will comply with the Teckal exemption which has now been incorporated into the Public Contracts Regulations 2015. Regulation 12(1) enables a contracting authority to directly award contracts to a company it owns without undertaking a procurement exercise where the following criteria are satisfied:
 - the contracting authorities exercise the same amount of control over the company as it does over any of its internal departments. (This will be governed through reserved matters in the company’s Articles of Association, Members Agreement and corresponding Scheme of Delegation and the composition of the Board of Directors of the company which will contain a majority of member authority directors); and
 - more than 80% of the company’s turnover is derived through activities performed for the contracting authority; and
 - there is no direct private capital participation in the company.
- 8.5. It is proposed that Newco will be set up and operated in a way which will fulfil all three criteria.
- 8.6. It will be possible for Newco to admit new members to it provided that the vehicle continues to satisfy the control and activities tests under Teckal. This is possible due to the company being limited by guarantee.
- 8.7. The Procurement Act 2023 introduces slightly different tests for Teckal (under the Act referred to as “vertical arrangements”) but in practice the control test contained in Schedule 2 of the Act is not fundamentally different from that currently contained under Reg 12(1) of the Public Contracts Regulations 2015. There is a new component of the test under the Procurement Act 2023, requiring that any controlling or member entity fulfils the requirement of ‘parent undertaking’ as defined under section 1162, Companies Act 2006.
- 8.8. The Council may provide equity to the company. The powers contained in the Local Government Act 2000 extend to authorising the local authority to giving financial assistance to any “person” and entering into arrangements or agreements with any “person”. Any agreement must be for a commercial purpose and may provide for grants, loans or guarantees. The provision of equity to the company by the Council is compliant with the Subsidy Control Act 2022 as capital is being provided in circumstances that would be acceptable to a private investor operating under normal market economy conditions. This can be taken to apply where a new company is set up with the public authorities holding the entire

capital or a majority or minority interest, provided the authorities apply the same criteria as provider of capital under normal market economy conditions. The Council will be responsible for the debts and losses of the company to the extent of the nominal value of its guarantee (i.e. £10) and to the extent of any specific guarantee or contractual arrangement that it has entered into.

- 8.9. NewCo's activities will be bound by the Public Contracts Regulations 2015. The company will need its own Procurement and Contract Procedure Rules. It is proposed that where Newco requires use of office accommodation it will enter into appropriate commercial leasing or licencing agreements.
- 8.10. VL will become a commercial company which will not be subject to the Public Contracts Regulations 2015. In addition to providing audit and related assurance services to its Member Councils, Newco will also provide staff resources and strategic leadership services to VL on an ongoing basis. Any services provided by Newco to VL would be charged at market rates. Any services provided by Newco to VL would count towards the (less than) 20% total activity limit.
- 8.11. The proposal for VL to declare a dividend to its shareholders (CYC and NYC) is permitted with both shareholder's consent. Therefore approval of the dividend will be required by the Council.
- 8.12. The staff within VL will transfer to Newco under the Transfer of Undertakings (Protection of Employment) Regulations 2006 (TUPE). Legal advice will be provided to assist with the TUPE transfer.

9.0 EQUALITIES IMPLICATIONS

- 9.1. There are no equalities implications as a result of this report.

10.0 CLIMATE CHANGE IMPLICATIONS

- 10.1. There are no climate change implications as a result of this report.

11.0 RISK MANAGEMENT IMPLICATIONS

- 11.1. Internal Audit provides assurance across all of the council's activities, helping to identify control weaknesses and mitigation actions. The proposal will also reduce the risk of potential future non-compliance with the Public Contracts Regulations 2015.

12.0 REASONS FOR RECOMMENDATIONS

- 12.1. To ensure that the Veritau Group can continue to deliver audit and assurance services to the Council and the other member authorities (both present and future) in compliance with the Public Contracts Regulations 2015.
- 12.2. To allow greater flexibility than the current shared service model, by allowing new member authorities to be more easily admitted and exiting members to leave more easily.
- 12.3. To remove or reduce duplication of costs/operating inefficiencies within the current shared service model.
- 12.4. To allow VL to continue to grow its commercial offering for the benefit of its current shareholders, CYC and the Council.

13.0 RECOMMENDATIONS

Members are requested to

- i) approve the Business Case at Appendix A

- ii) approve the implementation of a new jointly owned company, in accordance with the details set out in the Business Case at Appendix A;
- iii) approve the setting up of a company limited by guarantee;
- iv) delegate to the Chief Executive (as Shareholder Representative) the approval of any dividend payment by Veritau Limited and authorise the Chief Executive (as Shareholder Representative) to sign any relevant shareholder resolutions in relation to a dividend;
- v) approve the investment of a “subscription fee” in NewCo;
- vi) delegate the approval of the articles, the company name, the members agreement and any other governance documents associated with new company to Assistant Chief Executive – Legal and Democratic Services;
- vii) delegate the Council entering into all other agreements and documents necessary for the establishment of the new company to the Assistant Chief Executive – Legal and Democratic Services;
- viii) delegate to the Assistant Chief Executive Legal and Democratic Services to progress and conclude the working arrangements of NewCo including the method of the provision of support services, staffing and secondment arrangements between NewCo and Veritau Limited;
- ix) delegate all other necessary steps to secure the implementation of the proposed Option to the Assistant Chief Executive – Legal and Democratic Services;
- x) delegate to the Chief Executive (as Shareholder Representative) the appointment of the directors of NewCo on behalf of the Council; and
- xi) agree that the appointed officers to the board of directors of the company on behalf of the Council will be entitled to indemnity in accordance with the Council’s Indemnity Policy for Members and Employees.

APPENDICES:

Appendix A – Business Case (Confidential)

BACKGROUND DOCUMENTS: None

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7 May 2024

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Note: Members are invited to contact the author in advance of the meeting with any detailed queries or questions.