

**Agenda Item No:** 10  
**Report To:** **AUDIT COMMITTEE**  
**Date:** **1<sup>st</sup> December 2015**  
**Report Title:** **REPORTING FOR ABC COMPANIES**  
**Report Author:** Lee Foreman - Accountant  
Sarah Hartles – Principal Solicitor for Property and Projects  
**Portfolio Holder** Cllr Shorter  
Portfolio holder for Finance, Budget & Resource Management



**Summary:**

This report sets out the governance arrangements that have been put in place for the council's companies, outlining the relationships and structures that have been put in place to manage the Council's interfaces with its companies.

The report discusses the appointment of external auditors for the companies and the mechanics of the loan agreement that has been established with the property company.

**Key Decision:** No

**Affected Wards:** None

**Recommendations:** **The Audit Committee be asked to:-**

- 1. Note the governance arrangements between the Council and the Council's wholly owned subsidiaries, A Better Choice for Building Consultancy Ltd and A Better Choice for Property Ltd.**

**Policy Overview:** The council is seeking to develop income streams through the use of companies trading services. The Council has established 2 companies a Building Consultancy Company and Property Company.

**Financial Implications:** None

**Background Papers** **Cabinet 6 December 2012** - Creating Local Authority Trading Companies – In principal report  
**Selection & Constitutional Review Committee 13<sup>th</sup> June 2013** - The Creation of a Trading and Enterprise Committee of the Cabinet  
**Cabinet 13 June 2013** - Trading Companies - Main Report

including business cases and business plans

**Overview & Scrutiny Committee 9<sup>th</sup> July 2013** – To consider the call-in of Cabinet Minute 33/06/13: Trading Companies

**Cabinet 11 July 2013** - Report of Overview & Scrutiny Committee – Call-in of Cabinet Minute 33/06/13: Trading Companies

**Cabinet 12<sup>th</sup> September 2013** - Trading Companies – Update following O&S Recommendations

**Cabinet 13 February 2014** - Property Company Progress Report

**Overview & Scrutiny Committee 27<sup>th</sup> January 2015** - Progress Report on the Council's Commercial Companies

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## **Report Title: REPORTING FOR ABC COMPANIES**

### **Purpose of the Report**

1. To provide members of the Audit Committee with assurance that the governance arrangements put in place between the Council and the Council's wholly owned companies are robust and provide effective assurance over the running of the companies.

### **Issue to be Decided**

2. To note that the current governance arrangements between the Council and the Companies are robust and provide appropriate assurance to the Council as shareholder.

### **Background**

3. In December 2012 the Council agreed the principle of creating two local authority companies to allow commercial trading activities to take place, with both companies being wholly owned subsidiaries of the Council.
4. Following extensive work, a report was presented to Cabinet in June 2013 where individual business cases were agreed, governance arrangements set, and appropriate delegations put in place. This Cabinet report was then called in by Overview and Scrutiny where seven further recommendations were made and subsequently approved by Cabinet. The seven recommendations, whilst not changing the substance or the purpose of the Cabinet's original recommendations, did satisfy a number of Members' concerns.
5. A Better Choice for Building Consultancy Limited ("ABC Building Consultancy Ltd") then commenced trading in January 2014. A further progress report was presented to Cabinet in relation to the property company on 13<sup>th</sup> February 2014, this additional report set out findings of an independent review of the business model (as had been recommended by Overview & Scrutiny Committee) and sought approval for the creation of the property company. A Better Choice for Property Limited ("ABC Property Ltd") then commenced trading in April 2014.
6. Both companies have a Shareholder's Agreement with the Council, which set out what each company can and can't do and when it needs consent from the Council, Cabinet or Trading & Enterprise Board for certain activities or actions.
7. A report was presented to the Overview and Scrutiny Committee in January 2015, which provided details of the progress of both companies.

## **REPORTING FOR ABC COMPANIES**

### **Structure and relationship between ABC and Companies**

8. A Better Choice for Building Consultancy Limited and A Better Choice for Property Limited are wholly owned subsidiaries of the Council, this means the Council is the only shareholder . This gives the Council complete control over both companies.

9. As shareholder, the Council has the ability to appoint and remove the Directors if it does not like the way in which the Directors are running the companies. This gives the Council ultimate control over how the companies are run on a day to day basis and the activities that they carry out.
10. The Council exercises this control through the monitoring and reporting regime that was put in place in the Shareholder's Agreement that both companies have entered into with the Council. The Shareholder's Agreement also sets out what each company can and can't do and when it needs consent from the Council, Cabinet or Trading & Enterprise Board.
11. The Trading & Enterprise Board ("TEB") is a sub-committee of Cabinet and as such consists of Cabinet members and one councillor who is not a member of the Cabinet, who acts as an observer. It is to the Trading & Enterprise Board that the companies report their performance to, and any changes to their business plans and any new business plans, must be approved by the Trading & Enterprise Board before they are put before Cabinet for approval. A Schedule of items that are required to be reported to the TEB has been attached at Appendix C.
12. The terms of reference of the TEB were approved by the Selection and Constitutional Review Committee, and subsequently by Council, in June 2013. They enable the TEB to determine how often and when it should meet and gives the TEB responsibility for overseeing any trading companies that the Council has an interest in.
13. At the meeting of the TEB on 9<sup>th</sup> November the original reporting requirements were amended slightly to those now shown in Appendix C. The amendments were requested as the original timescales have not proven to be practical in the first year of business. In some cases, there has been nothing or very little to report on the original reporting dates. The TEB supported these amendments and its recommendations will be put forward to the cabinet in December.
14. Another layer of control is that each company currently has one director who is also a member of the Council, but there is no limit on the number of directors who are also members.
15. Councillors are given a further opportunity to observe the work of the companies by attending their Annual General Meetings. The requirement to hold an Annual General Meeting is contained in the Articles of Association of both companies. This obligation is also included in the Shareholder's Agreement, where it also says that all Councillors shall be invited to attend and that the companies shall report to the AGM on those matters that the Trading and Enterprise Board require it to report on annually. The recent AGM's are discussed later in this report.

## **Funding for the Property Company**

16. In relation to ABC Property Ltd, the Council has entered into a loan agreement with it for £10million. This £10million is to be drawn down in tranches of £2million and each tranche needs the approval of full Council before it can be released to ABC Property Ltd.

17. All of the money that the company borrows is secured against the properties that it buys and the Council has a first legal charge on each property. The loan facility agreement contains provisions that state that the loan to value ratio must not be higher than 1 to 1, thus protecting the Council's investment.
18. In order to ensure that any loan the Council makes to ABC Property Ltd complies with European State Aid laws, the Council has to ensure that the interest rate that it is charging ABC Property Ltd is one that the company could reasonably expect to obtain in the commercial market, or one that a reasonable parent company would make available to a wholly owned subsidiary company. In order to do this, the Loan Facility Agreement states a number of reference points that the Council will use to determine the interest rate that will apply to that drawdown at the point that the company draws down the funds. This ensures that ABC Property Ltd is not getting preferential interest rates as a result of the Council being a public body. This also means that the Council can borrow at a lower rate than it is charging ABC Property Ltd and gets to keep the interest uplift, generating an income for the Council. These interest rates are determined using the reference points set out in the Loan Facility Agreement, by the Council's section 151 officer at the time the company requests a drawdown.
19. If something were to go wrong, or the Council decided to close the company, it would be able to use its powers as mortgagee to take possession of the properties and sell them to realise the capital value and repay the borrowings.
20. It should be noted that included in the loan agreement is an undertaking by the Council to refinance the loans when the loan facility expires. This assurance provides comfort to the company that its re-financing risk can be managed.

## **Appointment of External Auditors and Consolidation of Accounts**

21. As the companies are wholly owned subsidiaries of the Council they have to be audited by an Auditor approved by Public Sector Audit Appointments Ltd. (PSAA). Due to this requirement the auditors that can carry out the audit are restricted to only a handful of companies: Ernst & Young, BDO, Grant Thornton, KPMG, or Mazars. In light of this the companies have agreed independently at their respective AGM's to appoint Grant Thornton LLP (GT). The appointment of GT has a number of benefits including alignment with the Council's auditors, consistency in approach and interpretation of accounting standards, and underlying knowledge of the companies' activities.
22. ABC Building Consultancy Ltd has been audited, received a satisfactory audit report and accounts subsequently filed with Companies House. ABC Property Ltd will be audited later in the year with accounts due to be filed with Companies House by 31 December 2015.
23. In relation to the consolidation of the companies accounts with the Councils, the Council did not consolidate accounts in 2014/15 following consideration of CIPFA's publication, Accounting for Collaboration in Local Government. The primary factor for not consolidating accounts was the lack of material affect the consolidation would have on the Council's accounts. This will be re-assessed on an annual basis and judged accordingly. This decision has been reviewed by, and is supported by, Grant Thornton in their capacity as the

Council's Auditor. However given that the level of Materiality for the Council's accounts is circa £1m, and that the assets of the property company are exceeding that figure, it makes harder to argue that group accounts will not apply and therefore there is a strong probability that group accounts will apply next year.

## **Companies Statement of Accounts 2014/15**

24. The accounts for ABC Building Consultancy Ltd were agreed at its AGM on 17<sup>th</sup> June 2015 where Cllr Mrs Bell represented the Council as shareholder as substitute for Cllr Bell (who is the Council's appointed Shareholder Representative as Chair of the TEB). A copy of the Company's financial statements can be seen at appendix A.
25. The Accounts for ABC Property Ltd were agreed at its AGM on 29<sup>th</sup> June 2015 by the Shareholder's Representative, Cllr Bell. A summary of the draft financial statements can be found at appendix B.

## **Conclusion**

26. The Governance structures outlined in this report are significant and adequate and the Cabinet has delegated responsibility to the TEB for the ongoing monitoring of the companies.

## **Portfolio Holder's Views**

27.

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A Better Choice for Building Consultancy Ltd  
**Financial Statements**

**Statement of changes in equity for year ended 31 March 2015**

	Retained Earnings £	Total Equity £
<b>Balance at 1 April 2014</b>	<b>0</b>	<b>0</b>
<b>Changes in equity for 2014/15</b>		
Profit for the year	13,405	13,405
Total comprehensive income for the year	13,405	13,405
Dividends	<b>0</b>	<b>0</b>
<b>Balance as at 31 March 2015</b>	<b>13,405</b>	<b>13,405</b>

**Statement of cash flows for the year ended 31 March 2015**

	2014/15 £
<b>Cash flows from operating activities</b>	
Profit before taxation	16,756
Adjustments for non-cash income and expenses:	
Increase in trade and other receivables	(7,870)
Increase in trade payables	52,509
Income taxes paid	0
<i>Net cash from operating activities</i>	61,395
<i>Cash flows from investing activities</i>	0
<i>Cash flows from financing activities</i>	0
<b>Net increase in cash and cash equivalents</b>	<b>61,395</b>
<b>Cash and cash equivalents at beginning of year</b>	<b>0</b>
<b>Cash and cash equivalents at end of year</b>	<b>61,395</b>

A Better Choice for Building Consultancy Ltd  
**Financial Statements**

Appendix A

**Statement of comprehensive income for the year ended 31 March 2015**

	<b>2014/15</b>
<b>Continuing operations</b>	<b>£</b>
Revenue	77,552
Cost of sales	(57,856)
<b>Gross profit</b>	<b>19,696</b>
Administrative expenses	(2,941)
<b>Profit before tax</b>	<b>16,756</b>
Income tax expense	(3,351)
<b>Profit for the year</b>	<b>13,405</b>

**Statement of financial position at 31 March 2015**

	<b>2014/15</b>
	<b>£</b>
<b>ASSETS</b>	
<b>Current assets</b>	
Cash	61,395
Trade and other receivables	7,870
	<b>69,265</b>
<b>LIABILITIES</b>	
<b>Current liabilities</b>	
Trade payables	52,509
Current tax liability	3,351
	<b>55,860</b>
<b>Net Assets</b>	<b>13,405</b>
<b>Equity</b>	
Retained earnings	13,405
<b>Total equity</b>	<b>13,405</b>



A Better Choice for Property Ltd  
Financial Statements

<b><u>Comprehensive Income and Expenditure Statement</u></b> <b><u>(CIES) for Year Ending 31/03/2015</u></b>	
<b>Revenue</b>	<b>£</b>
Rent Received	<b>2,308</b>
Fees Reimbursed	<b>5,516</b>
<b>Total Revenue</b>	<b>7,824</b>
<b>Cost of Sales</b>	
Other Expenditure	<b>6,978</b>
<b>Total Cost of Sales</b>	<b>6,978</b>
<b>Profit / (Loss) from Operating Activities</b>	<b>846</b>
Finance Costs - Interest Charges	<b>5,612</b>
<b>Profit / (Loss) Before Tax</b>	<b>(4,766)</b>

<b><u>Statement of Financial Position as at 31/03/2015</u></b>	
<b>Assets</b>	<b>£</b>
<b>Non-Current Assets</b>	
Investment Properties	1,113,354
<b>Current Assets</b>	
Cash	26,236
Debtors	150,000
<b>Total Assets</b>	<b>1,289,590</b>
<b>Equity</b>	
Retained Earnings	145,234
<b>Non-current Liabilities</b>	
Long Term Borrowings	1,118,910
<b>Current Liabilities</b>	
Payables (Creditors)	25,446
<b>Total Equity and Liabilities</b>	<b>1,289,590</b>

## **Commercial Companies Reporting Requirements**

### **Routine Reporting**

#### Six monthly to the TEB

Within 15 working days after the end of each half of the financial year, a report showing progress against the Business Plan to the TEB.

No later than 20 working days after the end of each half of the financial year, a financial statement and unaudited management accounts to be provided to the TEB.

#### Annually

Accounts must be audited within 6 months of the end of the year and provided to the TEB.

An annual general meeting is to be held and all councillors invited to attend.

A report on the progress against the Business Plan to be provided to the TEB at least 90 days before the end of each Financial Year (30<sup>th</sup> December for a 31<sup>st</sup> March Financial Year end), and request any variations.

Appointment of the Auditors – approval of the TEB required.

#### New Business Plan

To the Board – at least 90 days before the end of the Business Plan Period (30<sup>th</sup> December for a 31<sup>st</sup> March end of plan) submit a new Business Plan to the TEB for approval.

To the TEB to approve the Business Plan submitted by the Board and to recommend it to Cabinet for approval.

### **Event driven actions**

If the company wishes to carry out an area of business not within the current Business Plan but within the core business of the Company with an annual value in excess of £25,000, then a specific Business Plan needs to be submitted to the TEB for that area of business.

Amendment of Financial Regulations – with approval of the TEB

Purchase or contract where the price is greater than £250,000 for ABC Building Consultancy Ltd, or £400,000 per unit for ABC Property Ltd – with approval of the TEB if it is contained in the Business Plan, otherwise with Cabinet and Council approval.

Entering into any borrowing arrangements or giving security – approval of the TEB

Entering into or applying for grant funding – approval of the TEB

Before lodging an appeal to a planning decision – approval of the TEB

Any restructuring matters (ie creating a subsidiary, entering into a Joint Venture) – approval of Council

Before anyone (director or employee) is paid by the Company and determining the level and terms of the remuneration – approval of Council

Any winding up action – approval of Council

Before changing the registered office or place of business – approval of Council

Issuing any shares in the Company – approval of Council