

Bath & North East Somerset Council

Corporate Structure Review

Final Report

31st August 2017

Contents

1. Background, scope and review conclusions.....	1
2. Review of BaNES proposed group structure.....	3
3. Review of existing governance arrangements	7
4. Accounting implications for proposed group structure	12
5. Appendices	14

1. Background, scope and review conclusions

1.1 Background

Austerity measures have driven local government to focus on income generation through identifying and generating additional revenue streams. In recent years, there has been a growing focus on commercialising services through trading or pooling resources with other local authorities jointly to provide services.

Bath and North East Somerset Council (“BaNES” or “the Council”) have explored alternative approaches to providing certain services and looked to identify revenue generating opportunities. In doing this the Council has established a number of Local Authority Trading Companies (“LATCos”).

Prior to 2017, the Council wholly owned two LATCos, Aequus Developments Limited and Bath Tourism Plus Limited. These commercial companies provide additional housing to the local market and generate new local tourism business opportunities. We understand that the Council is looking to include further LATCos into its existing group structure, including the proposed establishment of Audit West Limited. Sections 2 and 3 of this report provides further detail on the corporate governance structure of these companies.

1.2 Scope

As per the agreed scope with the Council, we have performed a review of the corporate structures of BaNES’ subsidiary companies, including:

1. Review and assessment of the proposed group structure for the Council and it’s trading companies from the outset;
2. Reviewing corporate governance arrangements for the proposed new structure, capturing existing arrangements and identifying potential areas of conflict; and
3. Assessing accounting implications for structure changes and proposed companies, including consideration of consolidation, group accounting and impact on single entity accounts.

1.3 Review Conclusions

1.3.1 Proposed corporate governance arrangements

BaNES Council Officers have proposed a corporate governance arrangement, which includes a holding company sitting between the Council and its LATCos, to enable effective streamlining of decision making processes and clear delegation of roles and responsibilities to avoid conflicts of interests from arising. A Shareholder Group, consisting of Council Members, will sit within the Council. There will also be a holding company, consisting of Council Officers, who will provide governance and operational support to the LATCos. Through a shareholder agreement between the Shareholder Group and the holding company, the holding company will represent the Council and act as shareholder with certain matters (including strategic and high risk decisions) to be escalated to the Shareholder Group for consideration.

This proposed structure will enable the Council to implement a clear approach to governance across its LATCo group, with there being a single point of access to the Council and broader

representations of board members. The structure will also enable the governance approach to be consistent if the Council decides to grow its group structure and establish further LATCos.

1.3.2 Existing corporate governance arrangements of the Council's LATCos

From our review of the existing corporate governance arrangements of the Council's LATCos, we have identified some existing areas where potential conflicts of interests may arise. We have identified instances where Council Members are acting as both company directors and shareholders. We have also identified examples where Council Officers have a company director role which may conflict with their Council role. Further details of these conflicts are set out in Section 3 of this report.

CIPFA guidance on good governance recommends that duality of roles, such as those identified in Section 3 of this report, should be avoided in order to create a robust governance structure, which ensures transparent and unbiased decision making.

1.4 Recommendations

As noted above, the detailed findings across each of the scope areas are set out in Sections 2, 3 and 4 of this report. From the work we have performed we have identified the following recommendations for the Council:

- a. The Council should ensure that the Terms of Reference of the proposed Shareholder Group clearly define the roles and responsibilities of Council Members in acting as shareholder representatives.
- b. Clear Terms of Reference should be developed for the holding company, including the shareholder and governance activities it will conduct on behalf of the Council and definition of the matters which need to be escalated to Shareholder Group.
- c. The Council should ensure that the board of the holding company has appropriate competencies, experience and skills mix to provide effective governance to all group entities.
- d. Duality of roles between shareholder representative and company director should be avoided to ensure an effective and robust corporate governance structure.
- e. We also recommend that the Council reviews the composition of the holding company and individual trading company boards to ensure that there is sufficient independence and representation in decision-making and avoidance of over-reliance on particular directors.
- f. We recommend the Council adhere to the latest available CIPFA guidance for best practice on structured corporate governance. The guidance will steer the Council's strategic governance arrangements to ensure consistency and accountability is incorporated.

2. Review of BaNES proposed group structure

2.1 Summary

This section of the report reviews the Council Officers' proposed group and corporate governance structure. We have reviewed the Council's documentation on *Governance of interests in Local Authority Companies* (see Appendix 5.1) to assess whether the proposed arrangements are effective in building a robust corporate governance structure.

While there are clear benefits in councils operating commercial trading companies, the corporate governance structure can present challenges, particularly in the overall decision-making processes and board composition. The governance of an entity established under Companies Act legislation is markedly different from that of local government bodies. Despite being owned outright, or in majority, by local government bodies (the Shareholders) a LATCo established under the Companies Act must adhere principally to that legislation ahead of local authority rules and codes of conduct.

There needs to be careful consideration given to the corporate governance structure to avoid conflict of interests and ensure there is transparency and accountability between the Council as a shareholder and its companies.

The Companies Act 2006 codifies the general duties of Directors which specifically provides guidance on managing conflicts of interest (s171 – 176, specifically s175).

2.2 Proposed group structure

The proposed group structure, developed by Council Officers, reflects existing decision-making processes and governance arrangements. We understand that this proposal includes the formation of a Shareholder Group structure within the Council and a holding company, consisting of Council Officers, which sits above the individual LATCos. The Shareholder Group would be comprised of Council Members to provide strategic oversight and direction to the holding company who will oversee the operational aspects of the subsidiary companies.

2.3 Governance challenges

The Council's role within its commercial companies can impact on the operations of their business. While having wholly-owned companies, such as Aequus Development Limited, can be advantageous in terms of enabling greater control over the strategic direction of the business, this approach can also raise potential governance challenges:

- Ø **Effective decision-making / conflicts of interest:** where individuals have taken on the dual role of Company director and Shareholder representative, this can impact on decision-making as conflicts of interests may arise, which prevent them from fulfilling their obligations appropriately to both the company and the Council as shareholder.
- Ø **Agility:** whole-ownership of LATCos, whilst enabling local authority control, may restrict the ability of a company to act commercially within its competitive market. A successful LATCo will need to be agile in responding to changing market conditions and will need to make decisions based on commerciality and return.

- Ø **Accountability:** unlike their private sector competition, a LATCo may be required to demonstrate additional accountability to their local authority shareholder over the use of public funds. However, this would need to be appropriately balanced alongside the commercially sensitive nature of any information being shared, which could potentially place a LATCo at a competitive disadvantage.

2.4 Formation of the Holding Company

In its proposed group structure the Council is looking to establish a holding company. This is intended to provide a streamlined and consistent approach to governance whereby the holding company will represent the Council as shareholder in each of the LATCos. It is intended that Council Officers sitting on the holding company board will act as the shareholder on behalf of the Council, addressing day-to-day responsibilities through agreed shareholder agreements and escalating strategic decisions up to Council Members who will represent the Council through a Shareholder Group.

It is expected that this proposed structure will enable the Council to fulfil its shareholder responsibilities whilst minimising any potential conflicts of interest, which may arise. A group structure with a holding company will also enable the Council to apply an approach to governance across of all its subsidiaries, which can remain consistent if the Council decides to establish further LATCos.

The successful execution of this proposed group structure and governance approach is dependent on the following three factors:

1. Ability to apply this structure across all subsidiaries, including those where the Council is not the sole shareholder (e.g. Brunel Pension Partnership and Adoption West);
2. Ensuring the holding company board of directors has the appropriate skills and experience to discharge its responsibilities through the proposed shareholder agreements; and
3. Clarification of the role of elected Council Members in the shareholder role.

In relation to the role of Council Members as shareholder representatives, we understand that the Council has considered different approaches. These include a unified board approach, where the Board of the commercial entities includes elected members (as well as officers and potential unconnected non-executives), and an approach where there are no elected members on the board but Members sit on a Shareholder Group, which exercises the Council's rights as shareholder in each of the commercial entities. Having reviewed the advantages and disadvantages of each, the formation of a Shareholder Group within the Council can provide an effective means of governance, as it will avoid conflicts of interest arising whilst enabling:

- Ø **Proper strategic oversight:** there will be a single point of access to the Council, which ensures that elected members are able to make clear strategic decisions in line with the Council's business objectives;
- Ø **Retain control:** the Council (being sole shareholder) can have ultimate control over the business without hindering the operational management of the subsidiary companies;

- Ø **Broader political representations:** as the Council recognises the Shareholder Group will allow for broader political representations than can be housed on a board of directors; and
- Ø **Broader representations:** as the Shareholder group can be comprised of a greater number of representatives, this allows for diversity that can provide greater efficiencies in decision-making processes and avert potential conflict from arising between members on the boards and members exercising the shareholder.

The proposed Shareholder Group will enable the Council to maintain influence over the strategic direction of their commercial entities and provide them with a greater degree of flexibility in relation to the role of elected members within the Holding Company arrangement.

The Council should ensure that all necessary steps are taken to avoid any conflicts of interest arising from any proposed Shareholder Group.

2.5 Conclusion

Council Officers have considered a number of options in regards to the corporate governance arrangements of the Council's commercial entities, with the key priority to retain control and ensure that the companies can be used as *'tools to increase income for the Council'*.

The proposed corporate governance structure developed by Council Officers will enable effective streamlining of decision making processes and delegation of roles and responsibilities to avoid conflicts of interests from arising. The proposed formation of a Shareholder Group within the Council consisting of Council Members, and a holding company consisting of Council Officers, will provide a governance approach, which is consistent across all companies, particularly in matters of strategic oversight, provide a single point of access to the Council and enable the Council to further expand the LATCo group without changing the governance structure.

We consider the proposed group structure to be an effective form of corporate governance, as it will provide a consistent platform across the group to achieving robust internal control, identify clear segregation of roles and responsibilities and enable implementation of good practice in transparency of decision-making between the different entities.

2.6 Recommendations

From our work, we have identified the following recommendations:

- a. The Council should ensure that the Terms of Reference of the proposed Shareholder Group clearly define the roles and responsibilities of Council Members in acting as shareholder representatives.
- b. Clear Terms of Reference should be developed for the holding company, including the shareholder and governance activities it will conduct on behalf of the Council and definition of the matters which need to be escalated to Shareholder Group.
- c. The Council should ensure board of holding company has appropriate competencies, experience and skills mix to provide effective governance of all group entities.

The Council should refer to the CIPFA guidance on delivering a good governance framework¹. This framework sets out how local authorities can form appropriate governance structures, giving consideration to the legislative and constitutional arrangements. Below are seven principles of governance that support local authorities in achieving their outcomes:

- i. Behaving with integrity, demonstrating strong commitment to ethical values, and respecting the rule of law;
- ii. Ensuring openness and comprehensive stakeholder engagement;
- iii. Defining outcomes in sustainable economic, social and environmental benefits;
- iv. Determining the interventions to optimise the achievement of the intended outcomes;
- v. Developing the entity's capacity, including the capability of its leadership and the individuals within it;
- vi. Managing risks and performance through robust internal control and strong public financial management; and
- vii. Delivering effective accountability through transparency in reporting.

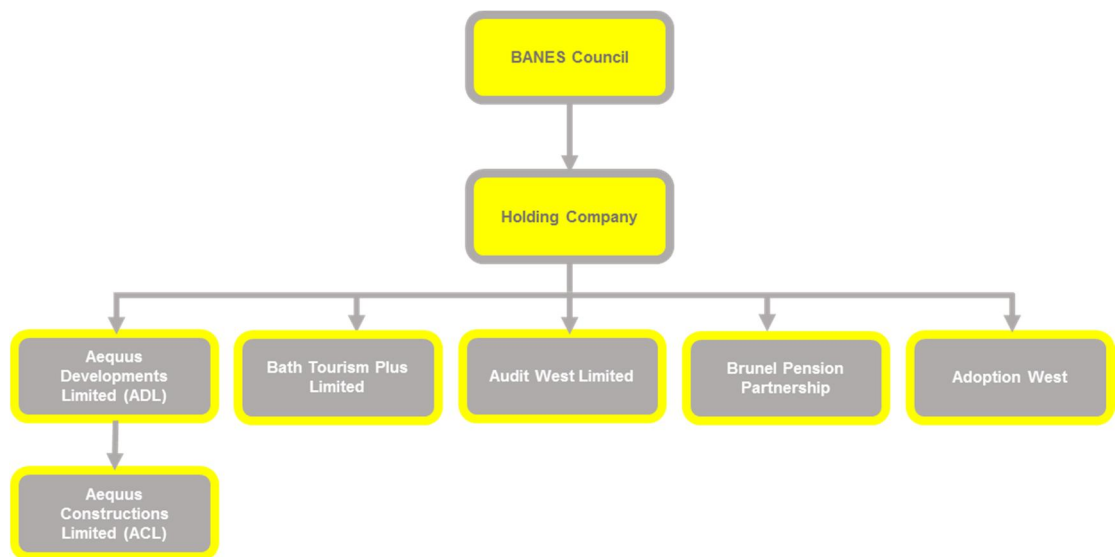
¹ CIPFA: Delivering good governance in Local Government Framework (2016)

3. Review of existing governance arrangements

3.1 Summary

In this section, we have reviewed the existing arrangements of the Council's LATCos to identify any existing areas of conflict. From review of the documents received, as detailed in Appendix 5.1, we have provided below a summary of each commercial entity and the potential conflicts of interest identified.

3.2 BaNES Proposed Group Structure



As per the diagram above, from our discussions we have summarised the Council's existing and proposed subsidiary companies:

- Ø Aequus Developments Limited and Aequus Constructions Limited (*subsidiary of ADL*)
- Ø Bath Tourism Plus Limited
- Ø Audit West Limited (*proposed*)
- Ø Brunel Pension Partnership (*not yet established*)
- Ø Adoption West (*in discussion*)

3.2.1 Aequus Developments Limited and Aequus Construction Limited

In March 2016, the Council set up Aequus Developments Limited (“ADL”) to develop, deliver, own and manage the Council’s private residential property assets. The Council wholly owns ADL (100%). It was established as part of the Council’s strategic review of its financial process, having observed similar housing and development companies being established in other councils.

The overall mission of the ADL is to generate revenue income and maximise revenues for the Council, to acquire and sell private market property, and to hold, manage and operate high quality private lettings. Another objective of ADL is to be fully policy compliant on affordable housing.

As per the ADL’s business plan 2016/17-20/21, the objectives of ADL are:

- Ø To generate income and deliver a financial return to the Council;
- Ø Managing private residential property assets and delivering new housing for both private ownership and the private rented sector;
- Ø Maximise the value with commercial return, whilst providing affordable homes for example young professionals;
- Ø Acting as a responsible landlord;
- Ø Delivering new housing developments within BaNES area for local residents;
- Ø To provide sustainability and healthy living; and
- Ø Work with the Council seeking vacant sites and brown field sites for housing development.

The membership of the ADL board is outlined below as per Appendix 5.3:

- Chairman : Cllr X
- Managing Director : Tim Richens
- Operations Director : Derek Quilter
- Executive Director : Martin Shields
- Non-Executive Director : Cllr Y
- Independent Non-Executive : Paul Robathan
- Independent Non-Executive : Bob Marshall

We have identified that the board composition of ADL includes two councillors, Cllr X (Chairman of the Board) and Cllr Y, a non-executive director. Their role within the board presents a conflict of interest, as they are operating dual roles as both shareholder representatives and company directors. With duality of roles there is a risk that individuals are not able to discharge their responsibilities of both roles appropriately and we have seen with other LATCOs where such duality has resulted in decision making which has a Council bias rather than the required commercial focus.

We understand that the Council is in the process of reviewing the above roles, and board composition of ADL.

The Council has established an additional company, Aequus Construction Limited (“ACL”), to carry out the construction projects for ADL housing projects. ACL will be a 100% wholly owned subsidiary of ADL and will be a company limited by shares, registered at Companies House. In the proposed structure, any developments sites that are held in the Council, are to be transferred for construction to ACL. Once they have been completed, ACL will dispose of the units, transferring to ADL for letting. ACL assets will be held under a 50-year lease, when the lease expires all the assets related to the company will be transferred to the Council.

The directors for both of the Companies are responsible for the day-to-day management of the company’s operations. However, the shareholders may direct the directors to take, or refrain from taking, specified action due to the Shareholders’ reserve power. The directors who sit at the Shareholder group, must take decisions collectively. From May 2016, three directors is the minimum number to hold a directors’ meetings.

Currently it is proposed that the ACL board will share three directors (as per Appendix 5.3, Tim Richens, Derek Quilter, and Martin Shields) with the ADL board. Whilst this will ensure a smooth transition of operations between ADL and ACL this may present a potential conflict of interest for those directors as they are acting in a decision-making capacity for both entities. In addition to this, two of the directors are also Council

Officers (Derek Quilter and Martin Shields), which presents a conflict of interest given the services these companies will provide to the Council.

It should be considered whether additional and independent representation is required on the ACL board.

3.2.2 Bath Tourism Plus Limited

Bath Tourism Limited was originally established in July 2003 as a spin-out of the Council's tourism activities. Bath Tourism Plus Limited is currently a company limited by guarantee. The Council recently re-acquired ownership of the company in April 2017 renaming it to Bath Tourism Plus Limited ("BTP"). As part of the change of ownership, interim arrangements have been agreed between the Council and the original BTP board for a 12-month period during which BTP could sit outside of the proposed governance arrangements. This short-term arrangement will enable the Council to appoint two new board directors and shareholders approval on revised business plans.

BTP generates new local tourism business opportunities, working with other official partners within the district, offering membership scheme to local businesses for marketing promotion. From doing this, they have been able to attract more than 500 local tourism businesses. Since 2005, BTP has been responsible for the management and operation of the Bath Christmas Market. Given to its growing popularity, BTP is putting in place plans to reach a wider international platform.

The objective of BTP are as follows:

- Ø Support the economy of BaNES by marketing and promoting the Bath area, in particular leisure, conference, business and educational visitor destination and supporting members to deliver tourism and conferencing services;
- Ø Providing information to visitors and local residents about the area;
- Ø Securing a more equitable distribution of the benefits of tourism to the residents of the Bath area;
- Ø Support businesses involved in the tourism sector; and
- Ø Promoting the heritage, cultural and knowledge of BaNES.

The following membership of BTP Board is outlined below, as per Appendix 5.4:

- Ian Bell (Chairman)
- Cllr Z
- Frank Collins
- Franco de la Croix-Vaubois
- Victor Da Cunha
- Douglas J Douglas
- Roger Jones (newly appointed)
- Craig Jenkins (newly appointed)

The board composition of BTP as detailed above consists of a chairman and seven non-executive directors. There is a Senior Management Team (SMT), where they manage day-to-day operations:

- . CEO : David James
- . Head of Events : Vicky Bunt
- . Head of Business Development and Partnerships : Leslie Redwood
- . Visitor Services Operation Manager : Jane Warren
- . Head of Marketing and PR : Caroline Hook
- . Head of Membership and Business Relations : Jim Oribine
- . Head of Finance : Andy Mullett

As per the SMT BTP Interim Governance paper, we understand that there was one Councillor (Cllr Z) sitting on the BTP Board. His dual role as shareholder representative and company director would have presented a potential conflict of interest. However, based on discussions, we understand that Cllr Z will stand down from the BTP Board. Roger Jones and Craig Jenkins have been newly appointed as non-executive directors, which will be announced at the September 2017 meeting

We have also identified a cross board conflict of interest, where Cllr X who sits on the Shareholder Group for BTP, also sits on the ADL board of directors. This presents a conflict of interest in potential over-representation of Council Members in the operational management of the companies and the challenges this may present in fulfilling the shareholder representative role effectively.

3.2.3 Audit West Limited (proposed)

Audit West Limited is proposed to be established as an independent partnership between BaNES and North Somerset Council ("NSC") to deliver a shared internal audit service, which could be offered to other local authorities.

We understand that the Council is looking into possible options for the ownership arrangements of Audit West. Combined ownership of Audit West with NSC will provide financial savings and, more importantly, ensure that the outsourcing of services remain within the Council's remit. However, the Council will need to consider any proposed revenue growth of Audit West and any implication that may have on maintaining Teckal compliance, especially if external revenue is expected to exceed 20%.

It is proposed that Audit West will have two appointed officers who will sit on the board as company directors. Tim Richens will represent BaNES and Malcolm Coe will represent North Somerset Council.

Potential conflict of interests may arise for example, if the internal audit services from Audit West are been offered to ADL or ACL, given Tim Richens' position in both companies. This may impact the independence of any services provided.

3.2.4 Brunel Pension Partnership

We understand for Brunel Pension Partnership, BaNES has an equal shareholding with 10 other local authority fund members, therefore BaNES will not be able to influence or change the governance structure in that company. As discussions on the establishment of this company are still ongoing we have not performed any additional work on this entity.

3.2.5 Adoption West

We understand the Council will also have a 17% interest within another company, Adoption West. As discussions on the establishment of this company are still ongoing we have not performed any additional work on this entity.

3.2.6 Conclusion

From our review of the existing arrangements of the Council's LATCos we have identified potential conflicts of interest including:

- a. Duality of Council Members as shareholder representatives and company directors. On the ADL board there are two councillors, one who is a chairman and another is a non-executive director. Duality of roles creates a potential conflict of interest as it presents a challenge to discharging the responsibilities of each role fully. We have identified a similar conflict in the BTP board however we understand that the Council has taken steps to mitigate the associated risks as it is expected that the councillor on this board along will step down after the appointment of two new directors.
- b. Over-representation of directors across company boards: there are plans to incorporate three directors from the ADL board onto the ACL board. We have also identified that the Adoption West and ADL/ACL boards will share a common director. These instances may create a potential conflict of interest whereby for those directors as they are acting in a decision-making capacity for both entities.

3.2.7 Recommendation

- a. For BaNES to avoid conflicts of interests from arising, careful consideration should be given to the company board compositions. We recommend that duality of roles between shareholder representative and company director should be avoided to ensure an effective and robust corporate governance structure.
- b. We also recommend that the Council reviews the composition of the holding company and individual trading company boards to ensure that there is sufficient independence and representation in decision-making and avoidance of over-reliance on particular directors.
- c. ***There is no easy solution to these perceived and actual conflicts of interests within the LATCo environment.*** We understand that the Chartered Institute of Public Finance and Accountancy (CIPFA) are soon to issue a paper highlighting lessons learned from the establishment and operation of LATCos to date and suggested mitigations moving forward.

4. Accounting implications for proposed group structure

4.1 Summary

In this section, we have considered the accounting implications for the proposed group structure, including consideration of consolidation, group accounting and impact on single entity accounts.

4.2 Recognition

For those companies where the Council will be the sole and/or significant equity shareholder then consideration will need to be made for consolidation of those companies as subsidiaries. *Paragraph 9.1.2.26 of the Local Authority Code of Practice* ("the Code") sets out the considerations in determining whether an entity meets the definition of a subsidiary. As per the Code, the following conditions must be present:

- a. **Control** – Entities that the authority controls if and only if it has all three of the following:
 - i. power over the entity;
 - ii. exposure, or rights, to variable returns from its involvement with entity;
 - and
 - iii. the ability to use its power over the entity to affect the amount of the authority's returns.
- b. **Nature of Council involvement** – The nature of the involvement and the returns is not restricted in the Code.

4.3 Accounting treatment

As per paragraph 9.1.26 of the Code, where it is deemed that an entity is a subsidiary the following accounting treatment should be applied:

- Ø A subsidiary is consolidated by adding like items of assets, liabilities, reserves, income and expenses together line by line to those of other group members in the financial statements.
- Ø Intragroup balances and transactions are eliminated in full.
- Ø 100% of all other balances and transactions are consolidated, even if the authority's controlling interest is less than 100% – minority interests are recognised as an unusable reserve in the Group Balance Sheet.

4.4 Single entity accounts

Within the Council's single-entity accounts, the investment in each of the LATCOs will need to be reflected in the Statement of Financial Position.

4.5 Materiality

We are aware of other local authorities whereby, although the conditions outlined above have been satisfied for the recognition and consolidation of a subsidiary entity, they have chosen not to consolidate on the grounds of materiality. In such cases local authorities have successfully argued that the entity in question is not materially significant to the group.

However, this assessment would need to be made on a company by company basis and will need to take into account the projected funding, revenue and capital streams for each of the companies. We would expect ADL and ACL to be material for consolidation purposes. The Council should seek further advice from its external auditors.

5. Appendices

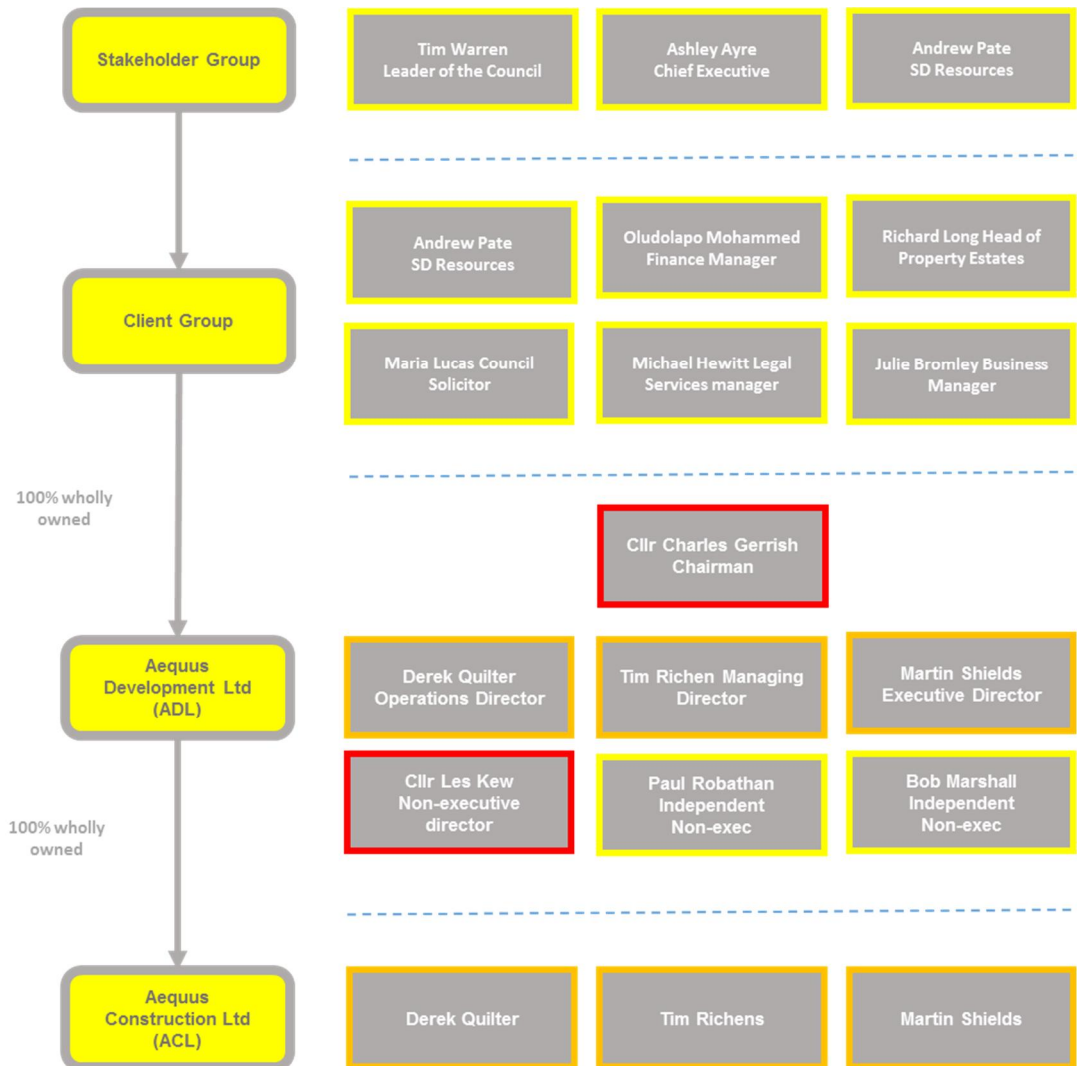
5.1 Key documentation provided by the Council:

No.	Title of the document	Author
1	Governance of Interests in Local Authority Companies	BANES
2	Aequus Developments Limited – Articles of association	Trowers & Hamlins
3	Aequus Developments Ltd Business Plan 2016/17 – 20/21	BANES
4	Aequus Developments Ltd – Property Development – Structure Proposal	Monahans
5	Aequus Construction Limited – Articles of association	Trowers & Hamlins
6	Report on the establishment of Aequus Construction Limited	Trowers & Hamlins
7	ACL and ADL – Establishment of a Local Property and Development Company	Cabinet
8	BANES and ACL and ADL – Umbrella Development Agreement	Trowers & Hamlins
9	Member's Agreement in respect of Bath Tourism Plus Limited	Trowers & Hamlins
10	BTP Articles of Association – Company Limited by Guarantee	Trowers & Hamlins
11	BTP company governance arrangements	BANES
12	BTP Cabinet & Portfolios - 24.07.17	BANES
13	BTP SMT Interim Governance	BANES
14	One West Company Structure Chart	BANES

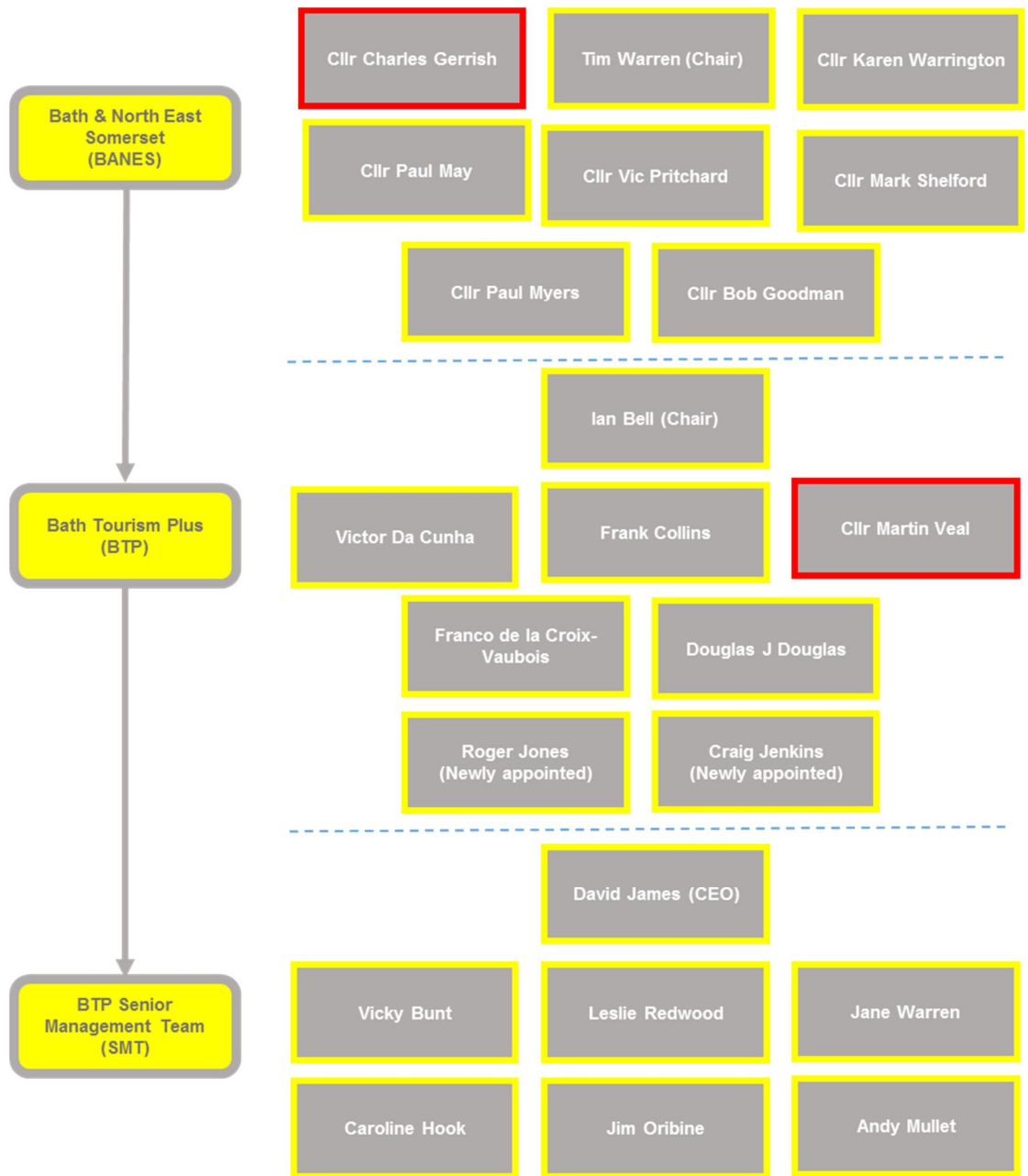
5.2 Interviews with key personnel:

No.	Key personnel	Date
1	Managing Director (ADL/ACL)	21 st June 2017
2	Head of Finance	22 nd June 2017
3	Update call with Head of Legal and Legal Services Manager	8 th August 2017

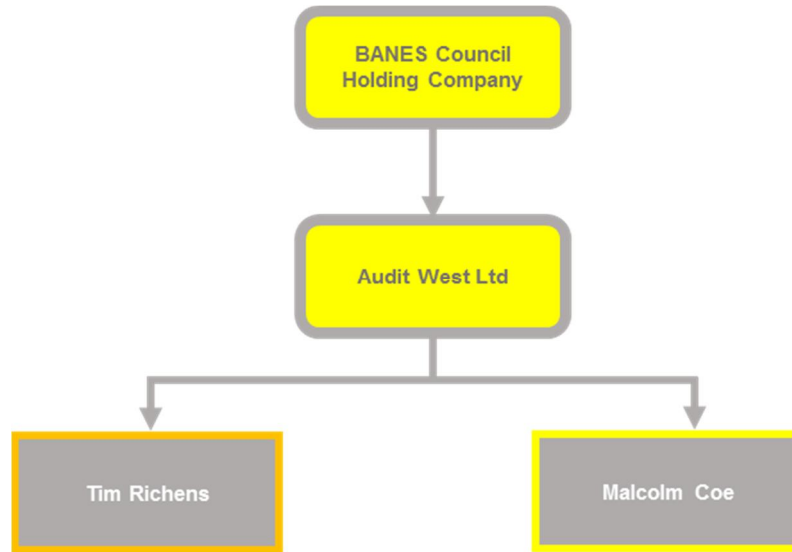
5.3 ADL and ACL Board Structure:



5.4 BTP Board Structure:



5.5 Audit West Ltd Board Structure:



5.6 Further reading:

No.	Title of the document	Author
1	International Framework: Good Governance in the Public Sector	CIPFA & IFAC
2	Delivering good governance in Local Government Framework 2016 Edition (Agenda Item 7 Appendix A)	CIPFA
3	Alternative service delivery models transforming organisations in local government	CIPFA

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