



Internal Audit Report 2016/17

Company Governance Aylesbury Vale Broadband

MARCH 2017



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Distribution List

For action	Andrew Small – Director, Section 151 Officer
	Cllr Neil Blake – Leader, AVB Shareholder Representative
For information	Andrew Grant – Chief Executive
	Andy Barton – Assistant Director, Strategy & Digital
	Audit Committee

This report has been prepared only for Aylesbury Vale District Council (the Council) in accordance with the agreed terms of reference. The findings should not be relied upon by any other organisation.

1. Executive summary

Background and summary of findings

Background

Guidance on the principles to be applied in the governance arrangements of the Council's owned (part or whole) companies is set out in the document "Guidance to creation and working with companies in which AVDC has a financial interest". This "Guide" was approved by Council in March 2016. Good corporate governance is aimed at ensuring continuing maintenance of the reputation of both the company and AVDC, and overall to ensure that the company delivers against its objectives and its business plan.

This review focusses on the Council's governance arrangements relating to Aylesbury Vale Broadband Ltd (AVB). AVDC has a 95% shareholding in AVB; a company set up to deliver super-fast broadband to rural areas of Aylesbury Vale.

Using the "Guide to creation and working with companies" as a reference, the review evaluates the adequacy and effectiveness of key governance arrangements, including:

- Start up
- Roles of members and staff
- Role of Scrutiny Committee
- Appointment of directors
- Adequacy and effectiveness of reporting and performance monitoring, including:
 - Quarterly financials and performance compared to business plan
 - Annual report and business plan
- Loans

The scope of work and approach is set out in Appendix 1.

Members have a role to play in terms of oversight of the Council's investment in companies and their performance against the agreed business plan. But, in order to maintain the boundaries between the Council (as shareholder) and the Company, this role does not include involvement in day-to-day operational issues, this is the business of the Company and reserved for the Directors in accordance with the Company's articles of association.

Accordingly, this review focuses on AVDC's governance arrangements over the investment in AVB. The scope does not include review of AVB's internal processes, controls and governance arrangements.

Summary of findings

The Company has been set up in accordance with the principles of the “Guide”. However, this review highlights a number of areas where governance arrangements should be improved:

- To date, there has been a lack of information shared with the AVDC Shareholder Representative on progress against agreed targets and financial performance compared to forecast. This impedes the Council’s ability to perform its own assessment of risk of the investment and provide transparent reporting to Members. The Shareholder Representative and AVB Directors should agree the specific AVDC quarterly reporting requirements and format as a priority.
- AVB intends to prepare a revised Business Plan for subsequent approval by Cabinet. This should reflect actual results to 31 March 2017, detailed forecast for the year to 31 March 2018 and projections for at least two further years. Thereafter, the targets set out in this Business Plan should form the basis of quarterly reporting to AVDC.
- The roles of the Scrutiny committees with respect to ongoing monitoring of AVB performance should be reconsidered and the Terms of Reference be revised to reflect the role of Scrutiny with respect to the Council’s whole or partly owned companies.
- AVB’s concern around the treatment of confidential information has contributed to the lack of quality performance information that has been with shared AVDC and Members to date. In order for the spirit of transparency between AVDC and its companies to be maintained, there must be absolute confidence that information marked confidential will remain so.
- A review should be undertaken to identify any AVDC staff currently working on behalf of AVB and arrangements be formalised with appropriate recharging of costs.
- Further consideration should be given as to whether there is any potential for conflict of interest for the Councillor Directors.
- AVDC should formalise its arrangements for approval of the drawdown of funds against the loan facility.

Good practice noted

In a number of areas considered there was evidence that good governance procedures have been undertaken and in accordance with the “Guide”:

- The original business case and establishment of AVB Ltd was approved by Full Council resolution in April 2015, following Cabinet recommendation. The business case included clear objectives, funding requirements and a high level 3 year financial model.

- In accordance with the “Guide”, a second Business Plan was agreed by Cabinet in September 2016, with appropriate review by Scrutiny.
- The Articles of Association and Memorandum of Association have been appropriately drawn up and lodged with Companies House. Aylesbury Vale Broadband Limited was incorporated on 29 June 2015.
- Director appointments on start up were done in accordance with the provisions set out in the Articles of Association; Three Directors from AVDC being at least one "Councillor Director" and one “Officer Director” and; Andrew Mills of Ironic Thought.
- All changes to directors have been appropriately approved, documented and filed.
- Following the Council approval of the “Guide to creation and working with Companies in which AVDC has a financial interest”, further changes were made to the Company structure to ensure AVB was compliant with the “Guide”. To avoid potential conflicts of interest, the Leader of the Council resigned as Director and an alternate Councillor was appointed.
- The Leader now fulfils the role of Shareholder Representative.

The findings outlined in this report require urgent attention to strengthen the governance arrangements over the Council’s investment in AVB. A further review will be performed in six months time to assess the implementation of recommendations.

Management comments

The findings are received and accepted. As a first endeavour in this field the Council is still learning and understanding it’s role and relationship with its commercial entities and what legal mechanisms it has to influence their activities. Whilst some aspects are working well within the Council’s agreed control framework, other aspects need further work to strengthen their effectiveness. Considerable additional effort is already being invested in this area to address the points identified in the shortest possible time.

2. Detailed findings

1 Performance monitoring and reporting

AVDC's governance arrangements for companies in which it holds shares should include regular performance monitoring. This is to ensure that the investments made in the company are being well managed, are delivering on performance objectives and financial targets according to the business plan, and to ensure transparency to members and the electorate.

Quarterly reporting

As a shareholder, AVDC is not entitled to detailed information on the day to day specifics of the Company's plans, this is reserved for the Company and its Directors, but the information shared with AVDC must be sufficient to enable regular review of the performance compared to the approved business plan and to support robust consideration of any opportunities or risks, including financial and reputational.

AVDC's primary opportunity to determine the direction of AVB's performance is through the scrutiny and approval of the annual Business Plan and members should robustly use this opportunity to full effect. The Shareholder Representative is an important conduit between AVDC and AVB, and should serve as the channel for information to enable effective monitoring and reporting by AVDC.

To understand the level of performance information available (and with the Board's permission), the minutes of AVB Board Meetings were reviewed for the period June 16 to February 17. "Management Report and Accounts" is a standing agenda item but there has been a lack of management financial reporting presented to the Board. Information on progress has generally been shared via verbal update only but there is evidence of robust discussion and challenge around performance by the Board members.

It is not the purpose of this review to report on details of actual performance, but it is necessary to highlight the lack of information that has been shared with the AVDC Shareholder Representative (via the Board meeting) on progress against agreed targets and financial performance compared to budget. This impedes the Council's ability to perform its own assessment of risk of the investment and provide transparent reporting to Members.

The "Guide" sets out an expectation that AVDC will receive quarterly reports from the companies in which it has financial interest. As a matter of priority, the Shareholder

Representative and AVB Directors should agree the reporting requirements and format which should include at least:

- Current income and expenditure compared to budget
- Forecast income and expenditure (rolling 4 quarters)
- Current loan balance
- Capital asset value
- For selected key performance indicators, current position compared to business plan, with explanation for any significant variances
- Statement providing a narrative update on the business performance from the Board

The Council will include appropriate information in the Quarterly Digest to share with Members.

Annual reporting and business plans

The most recent Business Plan (prepared August 2016) was approved by Cabinet in September 2016. It is understood that AVB intends to revise its Business Plan to reflect changes in the delivery model brought about by enhancements in technology. The revised Business Plan should include actual results to 31 March 2017, detailed forecast for the year to 31 March 2018 and projections for at least two further years. Thereafter, the targets set out in this Business Plan should form the basis of quarterly reporting to AVDC.

It is recognised that during the pilot stages of a business there is likely to be uncertainty about future plans, and that these may change as the business idea evolves (particularly in the technology sector where the pace of change is often faster). Now that AVB is more established, it is not expected that the targets set out in the Business Plan should be changed before the next annual review, to allow for some consistency in the review and reporting of progress.

Annual financial report

The AVB annual accounts have been prepared by AVB for the year ended 30 June 2016. The audit is nearing completion and it is anticipated that the annual report will be filed by the deadline at the end of March 2017. To facilitate financial review and consolidation of AVB results by the Council, it is recommended that AVB is requested to change its year end to 31 March.

Recommendations

- 1.1 The Shareholder Representative and AVB Directors should agree the specific AVDC quarterly reporting requirements and format (such as those outlined above). This information should be provided for the year to 31 March 2017, and quarterly thereafter.
 - 1.2 A revised Business Plan be prepared by AVB and approved by Cabinet, reflecting actual results to 31 March 2017, detailed forecast for the year to 31 March 2018 and projections for at least two further years. Thereafter, the targets set out in this Business Plan should form the basis of quarterly reporting to AVDC.
 - 1.3 AVB be requested to change its accounting year end to 31 March to align with AVDC.
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2 Role of Scrutiny Committees

Reports covering AVB have been presented to the Council's Scrutiny Committees as follows:

Economy and Business Development

- September 2015 – AVB Business Plan and update
- March 2016 – AVB progress update and information on the latest position regarding the rollout of broadband in the district through the Connected Counties programme
- September 2016 – AVB Revised Business Plan (Aug 16)

Finance and Services

- July 2016 – Appointment of and remuneration terms for AVB Managing Director

The objective of the Economy and Business Development Scrutiny Committee is to; “attract new businesses to the Vale, improve our infrastructure, deliver town centre projects, improve our communications and interaction with our customers”.

Now that AVB and its business aims have been established, focus is on financial performance and the security of AVDC's investment. It should be considered whether the Finance and Services Scrutiny Committee should play a greater role in the ongoing scrutiny and oversight arrangements.

Neither of the scrutiny committee terms of reference specifically covers review of performance of the Council's commercial interests. In due course, the Terms of Reference should be reviewed and updated to reflect the role of Scrutiny in the oversight of the Council's whole or partly owned companies.

Frequency of review

The “Guide” sets out the expectation for formal annual reporting of companies via Scrutiny and Cabinet. There are currently no reports concerning AVB identified in the forward plans for Scrutiny Committee.

The content and frequency of review of the performance of the Council's investment in AVB by Scrutiny, for example Annual Report with half year progress update, should be considered and recorded in the appropriate committee forward plan.

Confidential and commercially sensitive information

The “Guide” states that, where possible, all reporting provided by the company should be able to be made public. As a minimum all reporting should have a summary commentary of progress and summary financial position able to be made public. Where performance and financial information is considered to be commercially sensitive (as defined in Paragraph 3 of Part 1 of Schedule 12A of the Local Government Act, 1972), the confidential elements

should be clearly marked in accordance with AVDC's information security policy.

As a new start-up company, operating in fast moving highly competitive technology space, there is a significant amount of nervousness on behalf of the AVB Directors about sharing information that might be used to disadvantage the Company. This is compounded by the belief that information previously presented in "yellow papers" has been shared with competitors.

Concern around the treatment of confidential information has contributed to the lack of quality performance information that has been with shared AVDC and Members to date. For the spirit of transparency and cooperation between AVDC and its companies to be maintained, there must be absolute confidence that information marked confidential will remain so. AVB's concerns relating to sharing information need to be balanced with the Council's requirement for sufficient information to allow oversight, enable assessment of risk and inform decision making.

AVDC and AVB should come to a decision regarding what level of confidentiality should be applied.

Recommendations

- 2.1 The roles of the Scrutiny committees with respect to ongoing monitoring of AVB performance should be considered and the Terms of Reference be revised to reflect the role of Scrutiny with respect to the Council's whole or partly owned companies.
 - 2.2 The content and frequency of review of the performance of the Council's investment in AVB by Scrutiny should be considered and recorded in the appropriate committee forward plan.
 - 2.3 Commercially sensitive information, appropriately marked as such, must remain confidential.
 - 2.4 In addressing the recommendations in finding 1, AVDC, the Shareholder Representative and AVB Directors should clearly identify which information is commercially sensitive, and which is suitable for presentation in documents which are able to be made available to the public.
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3 Role of members and staff

Recharging AVDC staff

The “Guide” outlines the requirement for AVDC and the Company to be aware of who staff/Members are working for and what their role is for the company and/or AVDC. This is particularly important when they are working for both AVDC and the company. Once the company has moved past the inception stage, a formal agreement must be in place for any AVDC staff working for the company and their costs charged out to the company at a full cost recovery rate.

Currently some aspects of AVB’s payment process are administered by an AVDC officer. The AVDC officer has access to AVB’s bank account and processes the payment transactions. This equates to an average of around 1 hour per week. Recognising that AVB is a small company with few staff members, this provides some element of segregation of duties between raising the payment request and processing the payment. The arrangement should be formalised and appropriately charged out to AVB.

Potential conflicts of interest

Staff /Members should be selected to avoid potential conflicts of interest if they remain in roles with AVDC. The “Guide” states that, “typically the section 151 officer, the Monitoring Officer and the Leader should not be directors of external companies, so that AVDC is still able to hold the company to account”.

Consideration should be given as to whether there is any potential for conflict of interest caused by the Cabinet Member for Finance, Resources and Compliance being a Director of AVB.

Recommendations

- 3.1 A review be undertaken to identify any AVDC staff currently working on behalf of AVB and arrangements be formalised with appropriate recharging of costs.
 - 3.2 Consideration is given as to whether there is any potential for conflict of interest for the Councillor Directors. The outcome should be documented.
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4 Loans and drawdown arrangements

In December 2014 the Council committed £1.536m of New Homes Bonus funding to support the rollout of superfast broadband across the district. From this funding, the loan facilities to AVB have been approved as follows:

£200k – Initial loan approved by Council in April 2015

£500k – Approved by Council April 2016

£550k – Approved by Council October 2015

Loan agreements are in place for each of the approved loan facilities. Loan terms, including interest rates and payback period, reflect appropriate consideration of risk and are on commercial terms. The loans are secured on the assets of AVB.

The Council's financial exposure is limited to the amount drawdown on the loan facility. In March 2017, the balance on the loan account is £985k.

AVB's process for approval of funding drawdown against the loan facility has been documented and is due to be ratified by AVB Board at their March 2017 meeting.

Whilst the overall loan facility with AVB has been approved by Council, in order to mitigate risk of financial exposure, AVDC should formalise its procedures for the approval of the release of funds by the Director with Section 151 Officer responsibility, or nominated deputy.

State Aid

State aid is characterised as all of the following: the provision of state resources to an economic undertaking; that confers an advantage on the undertaking that the undertaking would not have obtained in normal market conditions; that is selective in nature; and must be capable of distorting competition and affecting trade between Member States.

In setting up AVB, consideration was given to the risk of potential state aid but as AVB was set up prior to the "Guide", the suggested format to record these considerations was not used.

AVDC has made loans to AVB on commercial terms. In September 2016, an EU complaint was received. The complaint, in summary, is that the Council in lending money to Aylesbury Vale Broadband Limited has breached Article 107 of the Treaty for the Functioning of the European Union, in that the loan it has provided to the Company constitutes unlawful State aid.

The Council's position is that the provision of a loan does not constitute state aid because the Council, in providing the loan, is acting in the same way that a Market Economy Operator would. The EU has not yet reached a conclusion as to whether they are to

investigate or not and in February 2017 requested more clarification of the Council's position based on further comments made by the complainants. This clarification has been given.

Recommendations

- 4.1 AVDC formalise its arrangements for approval of the drawdown of funds against the loan facility.
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Appendix 1. Terms of Reference

Company Governance

This review is being undertaken in addition to the 2016/2017 internal audit plan approved by the Audit Committee. The Directors and Members recognise the importance of effective governance arrangements over the Council's whole or partly owned Companies and this review will provide insight to current status and inform further areas of focus.

Background and audit objectives

The governance of any company owned or invested in by AVDC is important as there is a need to:

- Ensure that it is clear for staff, public, members and the company staff who is responsible for what, when and why?
- Ensure that AVDC and the company is clear on its roles and responsibilities
- Ensure that nothing is developed that conflicts with AVDC, or places AVDC in an unlawful position
- Ensure that any and all legal or contractual issues are complied with
- Ensure that the company is operating ethically and transparency is in line with the council's legal responsibilities.

Good corporate governance is aimed at ensuring that the above are adhered to, to maintain the reputation of both the company and AVDC, and overall ensure that the company delivers against the reasons it was created and to its business plan.

Guidance on the principles to be applied in the governance arrangements of the Council's owned (part or whole) companies is set out in the document "Guidance to creation and working with companies in which AVDC has a financial interest". This guide was approved by Cabinet in March 2016.

Audit scope and approach

AVDC owns in part or whole four companies:

- Aylesbury Vale Estates (AVE)
- Aylesbury Vale Broadband (AVB)
- Vale Commerce (Under the brands Limecart and Incgen)
- Buckinghamshire Advantage

Using the "Guide to creation and working with companies" as a reference, this review will evaluate the effectiveness of key governance arrangements, as set out below, for each of the companies.

- Start up
- Roles of members and staff
- Role of Scrutiny Committees
- Appointment of directors

- Adequacy and effectiveness of reporting and performance monitoring, including:
 - Quarterly financials and performance compared to business plan
 - Annual report & business plan
- Loans and dividends
- Use of Council assets (IT, Property, Staff) and charges
- Data handling and protection
- State Aid

It is recognised that each company is different and at differing stages of establishment, but the principles set out in the Guide should still apply.

The findings and report will be shared with Management and Audit Committee.

Kate Mulhearn
Corporate Governance Manager
February 2017