

By: Budget Informal Member Group
Lynda McMullan, Director of Finance

To: Governance and Audit Committee – 30 June 2008

Subject: **REVIEW OF TRADING ACTIVITY WITHIN COMMERCIAL SERVICES**

Contributions From: Peter Mulholland, Andrew Larnar,
Kevin Harlock, Les Coulson, Nick Vickers

BACKGROUND AND SUMMARY

At the last meeting of the Governance and Audit Committee, a report on the trading activities of Commercial Services was requested. This was to ensure that the appropriate controls were in place, in order that Members could be satisfied that such activity did not breach any legislative or best practice.

To facilitate the required report, the Budget Informal Member Group (Budget IMG) agreed a “menu” of issues to be covered (see Appendix E). The Group then met on 10th April and 7th May to discuss a draft version of the report and suggest improvements.

Officers with corporate expertise in areas of legal, procurement and finance were on hand to answer questions, as was the Director of Commercial Services. Each section of this final report contains a summary of what the Group felt to be the main points Members of the Governance and Audit Committee should be aware of.

After discussion, Members agreed that the following recommendations should be made to the Governance and Audit Committee:

1. The positive direction of travel for Commercial Services is formally welcomed and that the Director of Commercial Services, Kevin Harlock, be congratulated for the achievements of his service.
 2. The Governance and Audit Committee should consider setting up a Sub Group to oversee the governance of all the Council’s trading activities, involving Members of all political groups.
 3. Commercial Services should be encouraged to post accounts for medium sized companies as a gesture for greater openness about the Council’s trading activities.
 4. The Council’s ability to support private companies (for example by offering its own preferential procurement arrangements to suppliers) within Kent should be promoted.
 5. New business cases should be considered by the sub group of Governance and Audit Committee prior to being submitted to the relevant Cabinet Member for approval.
-

1. INTRODUCTION

- 1.1 Since Compulsory Competitive Tendering (CCT) legislation (Local Government Acts of 1988 and 1992) was abolished there has been no obligation on Local Authorities to put specified activities out to competition. There does however remain an obligation, under the 1985 Transport Act, to put subsidised local bus services beyond a quarter of Kent County Council (KCC) spend out to open tender,
- 1.2 However, the 1999 Local Government Bill introduced the requirement to deliver “Best Value” in services. This change recognised a fairly widespread belief (including within the business community) that the competition rules concentrated more on cost than quality. It applies to all services not just those specific services covered by CCT.
- 1.3 KCC has taken a “neutral” approach to service delivery. The “Towards 2010” commitment is to “ensure that KCC uses its significant purchasing power to allow fair and open competition”. While the Council is clear that it is the commissioner of services, there is no preconception about who should provide these services – whether the public, private or other sector.
- 1.4 KCC procures some £860M of goods and services every year. Of the £860M, Commercial Services provides about £28M worth - just over 3 %. Excluding arrangements whereby Commercial Services simply purchase goods on behalf of the rest of the Council (for example energy supplies) the figure is probably closer to 1%.
- 1.5 For example:
 - 85% of adult care provision is provided by the private and 3rd sectors
 - 100% of highways work is provided by the private sector
 - 94% of transport services are provided by the private sector
 - Almost 100% of property services are provided by the private sector
- 1.6 In line with Best Value Accounting requirements all trading activity must be fully accounted for. There is a requirement under the “Best Value Accounting Code of Practice” for trading accounts to be kept in accordance with proper accounting practices including the requirement to reflect total cost. Total cost includes a fair apportionment of overheads, capital charges etc. but does exclude “Corporate and Democratic Costs” and “Non Distributed Costs”. The external auditor reviews this every year.
- 1.7 Commercial Services is wholly non-budget funded and there is no known financial subsidisation from wider KCC or internally between activities. The independent External Auditor is obliged to review the allocation of overheads to trading activity as part of the annual Final Accounts audit. In addition, this has been subject to “special attention” by external auditors as requested by the private sector (most recently with respect to transport and agency staffing) with no evidence found to suggest the accounts have been misrepresented.
- 1.8 It has been claimed by some that cross-subsidisation of a non-financial kind occurs, for example when meetings are held in corporate meeting rooms. There is a charging policy for council meeting rooms, so this is certainly not the case in this particular instance. There have been no other specific claims that KCC is aware of and any such claims would be referred to the External Auditor should there be any doubt.

1.9 Traditionally Commercial Services have three main roles:

- To produce a net trading surplus to KCC primarily from non-KCC business.
- To act as a market regulator to minimise net cost to KCC
- To provide a range of goods and services to KCC which have already been subject to any procurement rules and which provide best value. This function includes negotiating corporate and national framework contracts to minimize net costs to KCC whilst maximizing profits derived from others.

	Internal	External	Total
	£000s	£000s	£000s
Internal KCC	28,500		28,500
Schools	14,500	59,000	73,500
Other Kent Business	29,000		29,000
Non Kent Business		149,000	149,000
TOTALS	72,000	208,000	280,000

1.10 The contribution Commercial Services makes to the KCC taxpayer in 2008-09 is forecast to be £6M plus further market moderation and savings. We estimate this benefit to be worth over 1.5% off the council tax every year or about £15 for the average Band D council tax payer in Kent.

2. OPERATING WITHIN THE LEGAL CONTEXT

2.1 The following section sets out the relevant legislation and accompanying Government guidance. The Budget IMG felt it was important that Members were clear that this section simply reflects the legal framework within which KCC operates.

Compulsory Competitive Tendering – A Reminder

2.2 The CCT legal framework was set out in the Local Government Act 1988 and the Local Government Planning and Land Act 1980. The stated idea was to “secure that local and other public authorities undertake certain activities only if they can do so competitively”. The specified activities were originally manual and building work but by the end of the regime included legal, finance, vehicle maintenance, IT, personnel, etc.

2.3 Where it was wished to keep work in-house there had to be a tender process with detailed rules (this was under English law). The local authority had to divide its staff into “client side” (to manage the tender process and act as client to the selected provider) and “contractor side” (to prepare and submit a bid and to carry out the work in accordance with the specification if selected). The process did not apply if it was intended to put the work out to the private sector.

2.4 A key criticism was that the regime in practice focused attention on following the rules and avoiding legal challenge, rather than on improving overall quality of service provision. CCT was repealed by the Local Government Act 1999, with effect from 2nd January 2000.

2.5 There does however remain an obligation, under the 1985 Transport Act, to put subsidised local bus services beyond a quarter of KCC spend out to open tender.

EU Procurement

- 2.6 Meanwhile, the EU procurement regime was coming into force. There were EC Council directives which in turn were passed into English law by Regulations in 1991 to 1993.
- 2.7 These directives were consolidated 2004 (with some changes) and this is now all in the Public Contracts Regulations 2006.
- 2.8 The current value thresholds are £139,893 for supplies and services, and £3,497,313 for works contracts.
- 2.9 On the face of it, the full procurement regime only applies to contracts for goods/services/works over the relevant specified threshold value. In addition, the Services regulations apply the regime only to certain (“Part A”) services, and in respect of residual services (“Part B”) only limited parts of the regulations apply. So for many years it was thought that the EU Procurement regime really had no application to contracts for Part B services or contracts under the relevant value threshold.
- 2.10 The European courts, however, have decided that the EU treaties impose a general obligation of equal treatment of all EU nationals, and in contract terms this means that ALL contracts must be awarded via a process that is fair and transparent, and that contracts must be advertised appropriately.
- 2.11 EU Regulations have three main principles:
- Advertising of contracts throughout the European Union (EU) so that all firms in the member states have an opportunity to submit tenders;
 - The equal treatment of all enquiries so as not to eliminate on the basis of the nationality of the supplier or the origin of the goods or services. This includes the banning of national technical specifications liable to discriminate against foreign tenderers;
 - Application of objective criteria in the tendering and award procedures so as to achieve a high degree of transparency.

Power to Trade

- 2.12 There have always been powers under specific statutes to provide services and charge for them. An example is the Local Authorities (Goods and Services) Act 1970 which allows local authorities to supply certain services to other public bodies.
- 2.13 These specific powers continue, but there is a new power in the Local Government Act 2003 (‘the Act’) and the “Local Government (Best Value Authorities) (Power to Trade) (England) Order 2004 (S.I. 2004/1705), (‘the Trading Order’ to trade generally in any of the Council’s ordinary functions. The relevant rules are:
- The Trading Order applies only to best value authorities which are local authorities within the meaning of section 1(2) of the Local Government Act 1999 and which are CPA rated as ‘excellent’, ‘good’ or ‘fair’.
 - The powers under the Act enable local authorities to trade with private bodies and persons for profit (i.e. charges fixed at more than cost recovery).

- The power to trade is only exercisable through a company. This is intended to help to ensure a level playing field with the private sector.
- A best value authority is authorised to do for a commercial purpose, anything which it is authorised to do for the purpose of carrying on any of its ordinary functions.
- Before exercising the power, a best value authority is required to prepare a business case in support of the proposed exercise of the power which must be approved by the authority.
- A best value authority shall recover the costs of any accommodation, goods, services, staff or any other thing it supplies to a company in pursuance of any agreement or arrangement to facilitate the exercise of the power.
- Where a best value authority ceases to be “excellent”, ‘good’ or ‘fair’ there are transitional provisions for trading to cease.
- Trading activity needs to contribute towards Best Value in the related function. Local authorities can only set up trading arms in function-related activities. Authorities need to be clear that they have the power to engage in an activity before they trade in it.
- Trading should be conducted on a fully transparent basis and authorities should not distort markets through the provision of inappropriate subsidies to trading companies.

Relationship of trading companies and the Council

- 2.14 The situation is quite different from that under CCT. There is no restriction at all under English law or EU law on any part of KCC providing goods or services to another part of KCC without a tender process, with or without a transfer of funds between the two.
- 2.15 The complication comes in deciding whether for EU procurement purposes a trading company run by KCC should be considered to be a part of KCC (so that the procurement rules do not apply between the two) or whether it is to be considered a separate entity.
- 2.16 The European court has decided that for the company to be considered to be just another part of KCC’s own structure (i.e. no need to go through a procurement process) the following conditions must be complied with:
- (a) The authority exercises over the company a control which is similar to that which it exercises over its own departments
 - (b) The company carries out the essential part of its activities with the controlling authority i.e. the company’s activities are devoted principally to KCC and any other activities are only of marginal significance. The activities are those activities which the company carries out as part of a contract awarded by KCC regardless of who the beneficiary is: KCC itself or the user of the services. It is also irrelevant who pays the company, whether it be KCC or third-party users of the services provided by the company
 - (c) There must be NO private capital in the company, not even as a minority shareholder.

2.17 These conditions are interpreted strictly by the courts.

So:

- i. If KCC client department wants to procure goods/services from KCS (or another KCC department) direct – no tender process needed
- ii. If KCC client department wants to procure goods/services from a KCC company that complies with the conditions set out in (a) (b) and (c) above – no tender process needed
- iii. If KCC client department wants to procure goods/services from a KCC company that trades with the outside world (or that otherwise does not comply with the conditions set out in (a) (b) and (c) above) – a proper procurement in accordance with Spending The Council's Money is needed, which might be an EU tender process.

2.18 If there are efficiencies in KCC providing goods/services through a company then it might be that there are two separate KCC companies needed for each area of business - one to supply KCC and one to trade with the outside world.

2.19 Whether the EU procurement rules will apply to other procurements by the company will depend on the circumstances of that particular company.

2.20 Appendix A sets out the guidance issued by the Director of Law and Governance last December. Please note that these figures were updated in January 2008 in line with the above.

Summary

Apart from transport KCC is not legally obliged to put out any services.

Up to 25% of subsidised local bus services could be provided by KCC without any competition (currently 6% is provided after competition).

This includes work delivered by a KCC company where KCC exercises control, most of the activity of the company is with KCC and there is no private capital.

Where work is tendered this must comply with EU rules to the appropriate extent.

3. THE NATIONAL AND REGIONAL CONTEXT

Emerging government policy

3.1 There is an increased emphasis in government on better procurement and on increasing the capacity for strategic commissioning to reshape the markets relevant to local government.

- 3.2 On the national scene centres of Excellence were set up in 2004 and KCC was awarded the South East Region. Current realignment of the Centres with the Regional Efficiency and Improvement Partnerships (REIP) has just been completed in order to set one coherent framework for collaboration and improvement of activity across local government. Efficiency gains up to the end of 2007-08 were set at £3bn for local government but this is currently standing at £4.2bn. The REIPs have been charged with producing 3% efficiency gains for the three years ending 2010/11 which for the SECE region equates to £691M.
- 3.3 The Budget confirmed that local authorities will be expected to contribute around £4.9bn to the efficiency target for the whole public sector of £30bn by 2011. Of this some £2.8bn or almost 60% is assumed to come from improved procurement. This underlines the belief that public sector is spending more than it should on purchasing goods and supplies.
- 3.4 The Audit Commission's Report "Healthy Competition" again confirms the £4.9b of efficiencies and goes on to suggest that the majority of this can be met through enhanced competition and smarter procurement. It suggests that the individual procurement strategy for each area of procurement spend needs to be considered and set down, so that efficiencies can be captured.

Existing best practice

- 3.5 KCC has developed its understanding of its external spend and used this to inform its corporate procurement strategy. The approach of aggregating spends and channelling them to get the best deals possible is entirely in line with best practice.
- 3.6 KCS is the larger of the 2 South East centres of procurement expertise and has skills in a number of the key commodity markets that are better than any in the public sector. The work that KCS has done on bus operations and temporary staff has led the way in reshaping those markets for Kent and has acted as an exemplar for others in the region. Other work, for example energy and vehicle procurement, has been a service that compares well with the best available to any part of the public sector and supports better procurement in many authorities.
- 3.7 Over the last 3 years the South East Centre of Excellence (SECE) has encouraged collaboration on commodity procurement. As a part of this it has and continues to compare the deals available through all the major providers to local government. KCS has compared very favourably in these exercises and as a result SECE has supported authorities elsewhere in the region accessing arrangements available through KCS.
- 3.8 It is also worth noting that since the introduction of the CPA regime procurement has become recognised as an area which has a large impact on local government. In recent CPA Guidance for example there has been a move to highlight more stringent requirements to actually identify and respond to procurement to ensure that efficiencies are made and value for money is maximised.
- 3.9 Appendix B sets out what some other councils are doing.

Summary

Government has set challenging efficiency savings both nationally and for Local government since CSR04.

Efficiency savings targets contained in CSR07 equate to some £4.9bn nationally or about £691M for the South East over the 3 year period.

Government sees better procurement of goods and services delivering approximately 60% of these targeted savings.

SECE consider work KCC to be doing as “best practice”.

4. KCC POLICY

- 4.1 Procurement is defined as all purchases or grants made by or on behalf of KCC. Governance arrangements exist to control this external expenditure i.e. where money actually leaves the council. When compiling these figures KCC also includes any expenditure incurred with its Commercial Services.
- 4.2 Fundamentally KCC uses its procurement to deliver its objectives. Importantly it is worth noting that these objectives can be achieved not only by what is bought but by where and how the money is spent.
- 4.3 KCC spends £862M annually (see table below) on procurement (see definition above). From this the annual spend which is carried out through Commercial Services (approx £28M) could be deducted but for the purposes of this report have been included. Within this £28M are supplies, such as energy procured for the rest of KCC. The other 97% is sourced predominantly from the private sector.

	£M
Social Care	363
Buildings	169
Roads and Regeneration	122
Other	62
Buses and Taxi's	34
Equipment and Supplies	28
Waste Disposal	50
IT	24
Special Education	10
Total	862

- 4.4 In 2005 the County Council agreed the first Corporate Procurement Strategy which sets out our high level approach. This document will be reviewed and updated in 2008 (attached as appendix C).
- 4.5 Within Towards 2010 there is a procurement related objective which states it will “ensure that KCC uses its significant purchasing power to allow fair and open competition”.

- 4.6 KCC procurement policy is “pure” to the extent that the best overall price for the council tax payer is key. Nevertheless, the procurement strategy sets out the key policy areas that the successful tender must cover – such as equality and diversity. All compliant bids are therefore compared having met the Council’s stated requirements on an equal playing field.
- 4.7 The essence of commercial trading is taking risk, by investing time and money to generate returns on investment. The then ODPM trading guidance in relation to the Trading Order under section 95 of the Local Government Act 2003 states: 'Local authorities will need to be prudent, in particular about putting council tax payers' money at risk'. For this reason the Order requires that KCC produces a comprehensive business case for each trading activity which must be approved by the Council prior to commencement of trading. This is a Cabinet member decision.

Summary

KCC’s overall policy is reflected in Towards 2010 which states it will “ensure that KCC uses its significant purchasing power to allow fair and open competition”.

Of the £862M KCC annually procures, £28M or 3% is procured through Commercial Services. Less when supplies, such as energy, are excluded.

Procurements reflect KCC’s required policies and all compliant bids are compared on this basis.

Each trading activity must prepare a business case before trading, which is agreed by the Cabinet Member.

5. CLARIFICATION OF KCC CORPORATE STRUCTURES / RESPONSIBILITIES

- 5.1 The KCC approach to procurement is based on:
- 5.2 **KCC Directorates** - ownership of the main spend categories eg social care, highways, buildings. A senior manager is nominated as the responsible officer for each spend category.
- 5.3 **Commercial Services** - for procurement of commodity type goods and services eg vehicles, stationery, office equipment. This is reinforced by a Spend Mandate to make sure budget managers use these county wide contracts.
- 5.4 **Strategic Procurement Unit** - based within Corporate Finance in CED the unit’s role is:
- Ownership of the high level Corporate Procurement Strategy.
 - Development and monitoring of the “rules and regulations” on procurement. These were launched as “Spending the Council’s Money” in late 2007.
 - Advice to KCC managers on procurement where there are not procurement specialists within the operational area.
 - Ensure that cross-cutting issues such as equalities and diversity, sustainability and eProcurement are addressed.

- 5.5 This structure means that procurement decisions are taken within the business by the people who know that business best. The approach of using Commercial Services for the commodity type spend means that we should be able to maximize our purchasing power - the effectiveness of this has been independently reviewed by PWC.
- 5.6 KCC also participates in the Central Buying Consortium which is a grouping of Local authorities in the South East / Midlands to promote collaborative procurement. The KCC Commercial Services Director represents CBC on Pro 5 which is a group of the 5 main local authority regional procurement groups.
- 5.7 This approach is overseen by the Procurement Board chaired by the Chief Executive. The Head of Financial Services chairs the Procurement Forum which consists of senior procurement practitioners drawn from across the Council.

Summary

There is now a clear governance framework around procurement roles and responsibilities.

“Spending the Council’s Money” sets out the operational governance arrangements for procurement across the Council.

6. WHAT DOES COMMERCIAL SERVICES DO AND ITS FINANCES

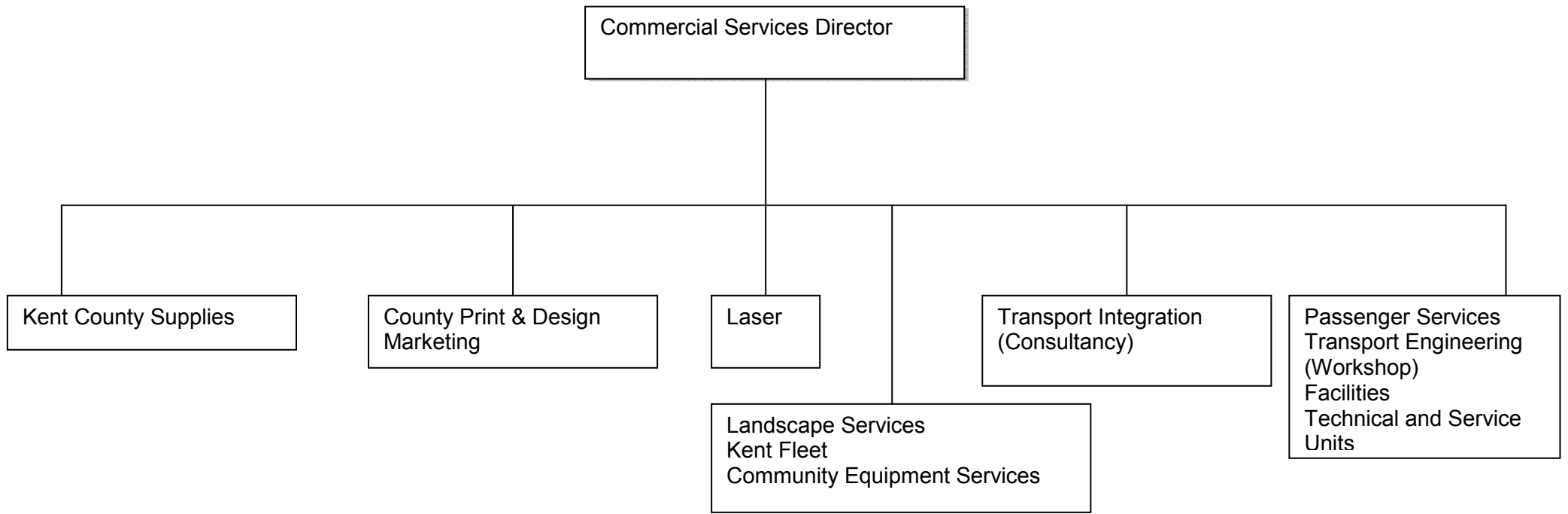
- 6.1 Commercial Services is wholly non-budget funded and there is no known cross-subsidisation from wider KCC or internally. Traditionally it has three main roles:
- To produce a net trading surplus to KCC primarily from non-KCC business.
 - To act as a market regulator to minimize net cost to KCC.
 - To provide a range of goods and services to KCC which have already been subject to any procurement rules and which provide best value. This function includes negotiating corporate and national framework contracts to minimize net costs to KCC whilst maximizing profits derived from others.
- 6.2 Commercial Services either purchases direct from vendors and delivers directly to its customers, or acts as broker and receives a percentage referral fee from vendors. All of the businesses are charged with making a net return to KCC although their contribution varies. Where this is insignificant it is where their market regulation effect or other added value is dominant. For example, the Passenger Services unit has depressed the costs of home to school transport to Education by an estimated £1m per annum over the last three years, KASS reported a saving of £600k on temporary care staff when Kent Top Temps entered the market.
- 6.3 More recently Commercial Services has been:
- Incorporating units where there is a sound business case for so doing. KCC is enabled, as a local authority, only to supply goods and services to other public bodies. Trading as a limited company allows utilization of assets to be maximized by filling spare capacity with business for the private sector, bringing

competition on a level playing field basis where competition is scarce, or filling a gap in the market where there is limited provision.

- Working closely with Finance to identify opportunities for shared service delivery, particularly with Districts.
- Acting as a regional procurement and supply hub across the southeast under a Memorandum of Understanding with the South East Efficiency Improvement Partnership (SECE).
- Providing KCC brand exposure and market presence particularly through operation of its commercial bus fleet.
- Investing in modern technology, for example a web catalogue, electronic ordering and invoicing capability to assist partners in back office cost reduction.
- Increasing its impact on carbon reduction through introducing an own brand range and leading for KCC on energy management for buildings and transport.

6.4 Commercial Services currently:

- Consists of 14 internal business units, based at West Malling and Aylesford. (2 of its businesses have been incorporated and are separate trading companies – and a further 2 incorporated companies are dormant - see attached structure chart).
- Employs approx 800 staff, flexing seasonally up to approx 900 staff.
- Turns over £280m and brokers a further £350m.
- Plans to return £5.7m as a 'dividend' for 2008/09.



6.5 The following table sets out which each activity covers:

Kent County Supplies - is the largest single local authority educational, office equipment/IT and furniture supplier, providing a 'One Stop Shop' across the South East, parts of the West, London Boroughs and Essex. It has a central warehouse stocking 9000 items complemented by 7000 directly delivered lines.

County Print and Design – is the largest local authority sheet-fed printer in England, providing a complete design and commercial printing service plus bulk copying and mailing services. It undertakes all the printing for Kent and Surrey Police.

Transport Integration - professional passenger transport procurement. Integrates requirements on behalf of CFE, KASS, E and R and other public bodies.

Transport Engineering - provides fleet vehicle maintenance and repair services to KCC, Kent Fire and Rescue and other public bodies in accordance with 'Department for Transport' and 'Health & Safety' legislation. It has full workshop facilities for servicing, maintenance and accident repairs from a lawnmower to a gritter lorry.

Passenger Services - provides in-house passenger transport to schools and care establishments. A wide range of vehicles is provided from cars through to mini buses and coaches (with driver).

Kent Fleet - supplies lease cars, commercial vehicles and minibuses (without driver) to public bodies and charitable organisations throughout the southeast, east and south west including many London Boroughs.

LASER – the largest local authority energy purchasing organisation in UK, aggregating volume and providing best value for some 80 local authorities including 24 London Boroughs, TFL and thousands of schools. Laser also provides energy contract management services to KCC and other public partners.

Landscape Services - provides complete grounds maintenance, landscape/playground/sportsfield design and construction plus street cleaning and cemetery maintenance. Its customers include most Kent schools and many District councils. It also provides services to all East Sussex schools and most of W Sussex schools. Ancillary services include testing of all electrical appliances, plus maintenance of fire extinguishers and the provision of fire safety training.

Technical Services - maintains and repairs audiovisual and computer hardware equipment.

Community Equipment Service - provides support to independent living in the Community

Service units - From 2008/09, two service units, Facilities Management and Staff Care Services have transferred into CS. The intention is to consolidate these and market them to other organisations thus generating additional income streams.

***Kent Top Temps Limited.** This unit commenced trading on 4 April 2005 under its private company status. Whilst Kent Top Temps had been in existence for approx. two years, this private company wholly owned by KCC was created in response to the 'Freedom to Trade' power effective from July 2004.

***Kent Top Travel** is a trading division within Kent Top Temps Ltd. It tenders for home to school transport, local bus services and private hire.

***Kent Facilities Management Ltd** has only one trading division, InsideOut which provides small building works to a range of primarily, but not exclusively, public sector customers. It has not yet completed a full year's trading.

***Kent County Supplies Ltd and Invicta Services Ltd** have been incorporated but are both dormant.

** Company structure*

- 6.6 Commercial Services is the largest contributor to the 17 member Central Buying Consortium comprising primarily shire authorities, which turns over £750m, where it leads on over 60% of the procurement activity.
- 6.7 As well as the annual Final Accounts requirement, most of the units have been the subject of a number of external and internal reviews over the past few years, (1992 PWC, 1995 KPMG, 1997 Chief Officer, 1999 Best Practice Review, 2003 Best Value Review) with more recently various audits of individual businesses. Each review considered the need for and value of CS; all overwhelmingly recognised its contribution and supported its retention.
- 6.8 In response to the concerns expressed by the transport sector about possible cross-subsidisation PWC were asked to review both relevant tenders and accounts. In October 2007 our new external auditors the Audit Commission was asked to review the potential for cross subsidisation with Top Temps. Findings for both are contained as Appendix D.
- 6.9 We are approaching year end and the Audit Commission will be reviewing this yet again as part of the annual closing of the accounts programme.
- 6.10 The, as yet, unaudited, accounts for 2007/08 show a return to KCC in excess of £4.5m. In addition, market moderation delivers savings to KCC of some £2m per annum. Before Passenger Services entered the market cost increases in contracts of some 25-30% were common. The last round of tenders for one quarter of the subsidised local bus services resulted in a virtual standstill. KASS say the temps supplied by the private agencies are now costing some £400k per annum less than before KTT moderated the market. Supply teachers are approximately £20 per day less to many schools. The cost benefit in prices for provision of stationery, grounds maintenance, and vehicle maintenance cannot be calculated but is significant.

6.11 The total annual value to KCC, when other benefits to the authority (such as rental stream on KCC freehold site, contribution to the pension back funding and market regulator effect are taken into account), has been estimated by Corporate Finance as follows:

Annual Benefit to KCC	£000s	of total
Rent to Property	520	7%
Savings - competitive pricing	1,500	19%
Market regulator effect	1,000	13%
Annual trading surplus	4,500	57%
Contribution to pension backlog	400	5%
Total	7,920	100%

6.12 Finally it should be noted that Commercial Services provides goods and services across the country. Broadly, the area relates to a line roughly from Devon and Jersey to Norfolk in the East, with some supply into most of the London Boroughs. All of that non-Kent activity generates business for Kent suppliers who supply Commercial Services.

Summary

Commercial Services has three main roles:

- To produce a net trading surplus to KCC primarily from non-KCC business.
- To act as a market regulator to minimise net cost to KCC.
- To provide a range of goods and services to KCC which have already been subject to any procurement rules and which provide best value.

Of the 14 business units, 2 are now incorporated as trading companies.

Commercial Services turns over £280m and brokers a further £350m, but clearly not only through KCC.

The total annual value to KCC of Commercial Services in 2007-08 was approximately £8M or about 1.5% on Council Tax.

7. REPORTING

7.1 All companies must prepare full accounts for its shareholders but small and medium-sized firms can send abbreviated accounts to the Registrar of Companies.

Small companies must deliver to the registrar:

- An abbreviated balance sheet containing the main headings of assets and liabilities.

- Selected notes to the accounts explaining accounting policy, share capital, particulars of creditors payable in more than five years and the basis of any foreign currency transactions.
- A special auditor's report, unless exempt.

For medium-sized companies, the accounts must contain:

- A full balance-sheet that lists, by account category, all the assets and liabilities of the company.
- An abbreviated profit-and-loss account containing only the main headings of income and expenditure, but providing no detail.
- Notes to the accounts explaining accounting policy, share capital, particulars of creditors payable in more than five years and the basis of any foreign currency transactions.
- A director's report summarising the company's position.
- A special auditor's report confirming that the accounts are a "true and fair" representation of the company's financial state on that date.

7.2 In the UK, to qualify as a small company you must satisfy two of the following three tests: annual turnover of less than £2.8 million, assets of less than £1.4 million and fewer than 50 employees. As well as being allowed to file abridged accounts, small companies are exempt from having an audit. Medium-sized companies must satisfy two of the following three tests: annual turnover below £11.2 million, assets less than £5.6 million and employ fewer than 250 people.

7.3 While the companies operated by KCC are classified as "small", there is no external barrier to filing more detail, assuming that they give at least the minimum amount of information required by the relevant legislation. However, there is obviously a cost attached to this.

7.4 In terms of internal reporting, the financial data is based on monthly reporting against the approved phased budget, and re-forecast of the annual out-turn. The process starts with individual business management review of the results and forecast. This is followed by a finance review by Commercial Service's Head of Finance, prior to the monthly review by the SMT, which includes a review of the annual forecast and any major issues affecting the businesses. The financial reports are then forwarded to the CEO of KCC, the lead member for finance Mike Snelling, and to KCC Corporate Finance. In addition, the CS head of finance holds a monthly meeting, with KCC Finance Director.

Summary

The KCC companies currently are classified as "small" and report accordingly to the Registrar of Companies

Internally, financial reports are compiled monthly and feed into the corporate process.

8. GOVERNANCE / ROLE OF DIRECTORS

- 8.1 The underlying principles of good governance for local authorities are set out in the guidance provided by CIPFA and SOLACE. Currently most of Commercial Service's activities are governed in much the same way as other KCC business. The Director of Commercial Services reports to KCC's Chief Executive and to the Lead Member on a regular basis. Financial information is reported to the Director of Finance and through the Council's normal monitoring process.
- 8.2 For the trading companies there is additional guidance contained within the '*The General Power for Local Authorities to Trade in Function Related Activities through a Company*'. This stipulates the following:
- The board of directors will run a trading company, answerable to the membership in accordance with the articles of association.
 - A board of 3- 8 people is recommended with representation from KCC.
 - The members or officers appointed directors will participate directly in the company activities however other local authorities' members may be involved if given the right to attend board meetings as observers, however they cannot participate in decision-making.
- 8.3 The Company Directors for the companies are currently: Kevin Harlock, Lynda McMullan, Lawrence Faulkner and Mike Snelling. These positions attract no additional remuneration and reflect core responsibilities. Following his successful appointment as Head of Finance for Commercial Services, Les Coulson will be replacing Lynda McMullan as Company Director in due course.
- 8.4 It is the view of the Director of Law and Governance that the companies within Commercial Services follow the relevant guidance.

Summary

Specific guidance covering the governance of local authority companies is mainly covered in "*The General Power for Local Authorities to Trade in Function Related Activities through a Company*".

It is the view of the Director of Law and Governance that the companies within Commercial Services follow the relevant guidance.

9. WORKING ALONGSIDE THE PRIVATE AND OTHER SECTORS

- 9.1 Notwithstanding the work carried out by KCC's Environment and Regeneration Directorate, there is additional synergy to be gained through closer working partnerships between KCC and other sectors.
- 9.2 While it would be difficult for KCC to offer goods and services at its own preferential rates for all business, clearly there is a strong case for doing so for its suppliers. For example, bus companies bidding for work would be able to access and assume the same deals for vehicles or fuel, as if they were part of KCC. While this idea has been mooted to business previously, it would appear that this message has not been received.
- 9.3 Furthermore, KCC is reviewing whether it would be able to provide support services (notably payroll and administration) to all Kent businesses through a trading company. This would be at no profit, with the objective of helping local business thrive. This idea has been discussed with local business, to see if this idea would be welcomed.

Summary

There is more work to be done by KCC to communicate what goods and services could be accessed through its preferential procurement rates by potential suppliers for a win/win result

There is some potential for KCC to work with the private and other sectors to provide support services, at no profit

CONTRACTING WITH A KCC COMPANY Headline Guide for Managers

It is possible to contract with a KCC Company as the Council and the Company are two separate legal entities.

Can work be put out direct to the company or do the EU Procurement rules apply?

Work can be put out direct, provided:

1. KCC exercises control over the company similar to that exercised over its own departments AND
2. The company carries out most of its activities with KCC AND
3. The company has no private capital invested in it

(If KCC and another public authority exercise control over the company (one party having at least 20% of the shares) similar to that exercised over their own departments then work can still be put out direct as long as points 2 and 3 above also apply)

EU Procurement rules must be followed, if:

1. KCC does not exercise control over the company OR
2. The company does not carry out most of its activities with KCC OR
3. The company has any private capital

This guide is in relation to contracts over the EU Procurement Thresholds (currently £144,371 for Services and Supplies contracts and £3,611,319 for Works contracts)

Contracts for a lesser value are still governed by "Spending the Council's Money":
<http://knet2/policies-and-procedures/finance-and-procurement/procurement/spending-the-councils-money/?searchterm=spending%20the%20council's%20money>.

Managers are reminded that transparency and fairness are still the guiding principles when contracting and that seeking advice from Legal Services early in the procurement process should save both time and the risk of challenge.

Geoff Wild
Director of Law & Governance
December 2007

Trading and Charging Operations in other County Councils

Norfolk County Services Ltd:

The company was set up in the 1980's in response to blue collar CCT and converted to a wholly owned limited company to enable it to trade more widely. It was formed to carry out direct labour activities for the Council and joint venture subsidiary companies have been formed with two district councils. It currently has a turnover of £70m.

NPS Property Consultants Ltd (Norfolk County Council):

Similarly to Norfolk County Services Ltd, the company was set up in 1992 in response to white collar CCT. It has a turnover of £30m with activities including architectural services, building surveying, estate management and project management. Subsidiaries have been established to provide services for Wigan and Wakefield councils.

BANES (Bath and North East Somerset County Council):

The Council is in the process of setting up a building and engineering company to provide services to third parties, (work for the council will be provided in-house). No staff are transferring to the company through this process (simplifying the legal arrangements).

In addition to these example of trading companies, a larger number of councils actively 'charge' through operations similar to KCC's Commercial Services.

Cornwall County Council (CCC)

CCC has a contracting arm set up to compete with the private sector for cleaning, grounds and catering services. It employs a highly trained, well motivated, and experienced local workforce of over 1,500 people and has an annual turnover of £10 million.

All work undertaken is subject to competition, and is delivered under Competitive Tender, Best Value contracts, service level agreements and individual purchase orders.

Leicester County Council

Leicestershire Highways is the trading arm of the Highways, Transportation and Waste Management Department of Leicestershire County Council. The primary business is the efficient and effective delivery of best value highways services to our clients.

It directly employs over 200 trained operatives, backed up by a professionally and technically qualified management structure.

Its policy of continuous improvement means that Leicestershire Highways invests in the on-going training of its employees and is proactively involved in the development of new and innovative techniques and processes. Leicestershire Highways also utilises environmentally friendly practices in its pursuit of improving service delivery.

Lancashire Country Council (LCC)

LCC's Commercial Services Direct Services Organisation prepares school dinners and is the primary provider of building, cleaning and catering services to schools and other council establishments. It also provides the staff for the County Mess and Civic Catering service and the School Crossing Patrol service. It employs over 3,500 staff, serving 50,000 meals a day and cleaning 400 buildings.

From: McMullan, Lynda - CED FIN

Sent: 14 March 2008 15:21

To: Dean, Trudy - MEM; Chard, Nick - MEM; Smyth, Derek - Labour; Law, John - Member

Cc: Ballard, Stuart - CED L&DS; Harlock, Kevin - CED CS; Wood, Andy - CED ; Wild, Geoff - CED L&DS; Vickers, Nick - CED FIN; Snelling, Michael - MEM

Subject: Budget IMG - April

I have discussed a proposed "agenda" with Kevin, regarding the discussion we intend to have around the Commercial Services activities at our next meeting. My intention is to work with others to supply papers in advance that cover the following :

1. **The legal context** (an outline of the relevant EU and national legislation covering both our powers to trade and also how we procure. In particular we will cover the issue around KCC companies ie what route we need to take when purchasing from them. I will ask Geoff if it is possible to have a "witness" from legal to answer any questions)

2. **The national and regional context** (a view of the national savings built into CSR07 from procurement and how councils are having to be a lot "smarter" in responding to this agenda. Hopefully gain perspective from regional centre and how they are promoting CS as best practice ie we are being seen as leaders in this area plus how industry is responding in other areas eg is this a kent issue or a national one. I will ask Andrew Lerner if we can have a "witness" to answer any questions)

3. **KCC Policy** (what is KCC procurement policy and how does this sit with regeneration, green or other policies. I suggest Nick or one of the strategic procurement team be available to take questions)

4. **Clarification of KCC corporate structures / responsibilities** (who does what, separation of duties etc)

5. **What does CS do** (outline of CS activities - both those within KCC and those within KCC companies. What are the main objectives ie setting out mkt moderation role etc as well as the immediate financial imperatives)

6. **Financial Review** (review the financials of each trading activity at high level - whether mainstream KCC or KCC company. Robustness of figures ie is there any cross subsidisation)

7. **Reporting** (outline requirement for reporting financial data and discuss issues around commercial confidentiality / FOI requests)

8. **Governance / Role of Directors** (discuss)

This is our "starter for 10" and happy to take any suggestions. I suggest on day we go through each issue but focus our time on areas where we feel we need to understand more or feel improvement could be made. This will help inform what we take to G&A cttee in June.

I have copied Mr Snelling as lead member and suggest he is invited to attend should he wish. He is a member of G&A cttee in any case.

Thanks - Lynda