

## VERITAU LIMITED - Business Case for expansion

### DETAILED PROPOSALS

#### Summary

- 1 It is proposed that the services currently provided by NYAP to the 5 district councils are transferred to Veritau on 1 April 2012. Staff currently employed in providing those services would then transfer to Veritau in accordance with the Transfer of Undertakings (Protection of Employment) Regulations (TUPE).
- 2 Veritau will form a subsidiary company called Veritau – North Yorkshire Limited (VNY) to deliver the transferring services. The subsidiary company will be limited by shares with Veritau holding 50% of the share capital and each district council holding 10%. The subsidiary company will have a board of directors comprising an officer from each district council and two directors appointed by Veritau.
- 3 The creation and future operating arrangements of the subsidiary company will be governed by a formal Shareholders Agreement. The Agreement will set out the rights and obligations of the shareholders and the ongoing relationship between each district council and Veritau as participants in the venture. The services to be provided to each district council will be specified in separate Service Agreements, identical or similar to the existing Service Agreements which Veritau currently has with the council and NYCC. The length of the new Service Agreements would be coterminous with Veritau's existing Service Agreements.
- 4 Each district council will nominate a client officer to oversee the delivery of services under its Service Agreement with VNY. The annual fee for the core service will be calculated on the basis of an agreed daily fee rate, multiplied by the agreed level of service i.e. the number of days required by each district council. The daily fee rate will be same for each district council and the rate charged by Veritau to the council and NYCC. Each district council will however be able to request additional work under its Service Agreement. The fee for such additional work will be calculated on the basis of rates for additional work for the appropriate grade of staff which will be specified in the relevant Service Agreement.

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- 5 Each district council will provide serviced office accommodation on similar terms to the existing arrangements Veritau has with the council and NYCC.
- 6 Veritau will seek to ensure that the transferring staff are included in the Local Government Pension Scheme. Staff will also be given the option of transferring from their existing terms and conditions to those of VNY (which will be identical to those offered by Veritau).

### Legal Implications

- 7 The new arrangement must comply with the EU public procurement regime and the Public Contract Regulations 2006. Specific case law (including Teckal) has established that if a local authority wishes to award a contract to supply services, to a company set up by that local authority, then the authority does not need to carry out a competitive tender exercise before awarding such a contract provided that the following principles apply:
  - the authority must exercise a similar degree of control over the company to that which it exercises over its own departments;
  - the exercise must be 'a power of decisive influence over both the strategic objects and significant decisions of the company';
  - the essential part of the company's activities must be carried out on behalf of the controlling authority. Any activities undertaken for bodies other than the controlling authority can be of no more than marginal significance.
  - The exemption also applies to companies controlled by more than one authority, providing the principles set out above are complied with.
- 8 Section 95 of the Local Government Act 2003 provides a general power to local authorities to trade in function related activities. Section 95 also defines the type of company that an authority can use for trading activities. The Section states that the company must be a company regulated by Part V of the Local Government and Housing Act 1989, which limits the proposed structure to:
  - companies limited by share;
  - companies limited by guarantee with or without share capital;

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- unlimited companies;
  - societies registered under the Industrial and Provident Societies Act.
- 9 As with Veritau, the new company would be funded from the public sector so its own procurement activities would be bound by the Public Contract Regulations.
- 10 The new company's primary objective will be to provide high quality internal audit and counter fraud services to the five North Yorkshire district councils. The company will also seek to provide services to other local authorities and public sector bodies in the region where it is possible to generate an appropriate level of profit and there is no potential conflict of interest. However, to demonstrate compliance with the Teckal principles, it is proposed that the provision of services to external customers will be limited to no more than 10% of the subsidiary company's total activities. An external customer is defined as anyone who is not a shareholder of the company. As the council and NYCC will not be direct shareholders in VNY then any work undertaken for either council would count against this limit. Any fees to external customers will be calculated so as to recover the full economic cost of providing the service plus an element of profit. Charges to the five 'member' councils would be at a lower rate (see paragraph 30 below). Work would not be undertaken where there was considered to be an unacceptable level of risk to either the company or the services provided to the five district councils. Where services are provided to third parties then these would be undertaken on a contractual basis.
- 11 The proposed transfer of staff from Ryedale District Council to VNY will be regulated by the Transfer of Undertakings (Protection of Employment) Regulations 2006 which guarantee that there will be equivalence of terms and conditions of employment. In addition, because this is a public sector TUPE transfer there would also be equality of pensions involving a "buy in" to the North Yorkshire Pension Fund (NYPF).
- 12 A formal Shareholders Agreement will be required to govern the rights and obligations of the shareholders of VNY and the ongoing relationships between the five district councils and Veritau Limited as participants in the venture. The main issues which the Shareholders Agreement will deal with are the:

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- shareholders' voting rights;
  - arrangements for allowing any future changes in the company's membership (including the possible admission of the remaining two North Yorkshire district councils);
  - arrangement for appointing and removing directors;
  - arrangements for board meetings, including their frequency and quorum;
  - appointment of the company secretary;
  - future profit sharing arrangements;
  - arrangements for resolving disputes;
  - exit arrangements for one or more shareholders;
  - information which the company will be required to supply to each shareholder.
- 13 It is proposed that the new company will continue to use the existing office accommodation provided by each district council on a 'like for like' basis and that the cost of such accommodation will not be passed on to VNY but will continue to be met by each council (as a client responsibility). To facilitate this arrangement, VNY will enter into premises licences with each council for fully serviced accommodation.

Company Formation

- 14 It is proposed that the new company will be limited by shares, with a nominal share capital of 1,000 £1 shares. 500 shares will be issued in total with each district council holding 50 shares and Veritau Limited holding 250. The company will have share capital of £20,000. Each district council will therefore be required to provide capital of £2,000. Veritau will invest £10,000. The company will be formed and the shares issued prior to the planned transfer date of 1 April 2012.
- 15 The future liability of each shareholder will be limited to the value of the issued share capital. Future profits will be distributed to each shareholder in proportion to the issued share capital (assuming that the company decides to pay a dividend). In the event that the company is wound up then the residual value of any assets will also be distributed in proportion to the issued share capital.

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- 16 The company's Articles of Association will be prepared in accordance with the Companies Act 2006, and follow a standard format for this type of private company.
- 17 VNY will be a regulated company under the terms of the Local Authorities (Companies) Order 1995. Regulated companies are those classed as either being 'controlled' or 'public sector influenced' by a local authority. The subsidiary company falls within the definition of a 'public sector influenced' company and must therefore comply with a number of specific governance and accountability rules, including;
- identifying the relevant local authorities on business documents;
  - limiting directors' remuneration;
  - removing directors who are disqualified as councillors;
  - prohibiting party political publicity;
  - requiring the provision of certain information to the local authority's Members, officers and auditors.
- 18 It is proposed that VNY will have a board of directors consisting of:
- the Director of Finance (or equivalent) from each of the district councils;
  - two directors appointed by Veritau.
- The VNY board of directors will be responsible for the strategic management and direction of the company. The directors of VNY will waive their right to any remuneration but will be entitled to claim mileage and subsistence expenses in line with the rates payable to the staff of VNY.
- 19 Since April 2008, private limited companies have no longer been required to have a company secretary. However, as a 'public sector influenced' company it is felt appropriate that VNY should have a company secretary to act as a formal point of communication between the board of directors and the company's shareholders, and be responsible for:
- organising and preparing the agendas for meetings of the board and the annual general meeting (AGM);

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- maintaining the company's statutory books, including the registers of members, directors and secretaries;
- ensuring that statutory returns are submitted to Companies House and other regulatory bodies;
- contributing to meeting discussions;
- liaising with the external auditors, and other regulators and advisers, if required.

It is proposed to appoint an employee of Veritau to act as the company secretary of VNY. Training will be provided to the appointee and further support will also be available from Veritau's existing company secretary.

- 20 As the company is likely to be classed as a 'small company' it would only need to prepare abbreviated annual accounts for submission to Companies House. Similarly, the company would be exempt from audit as its turnover, balance sheet value and number of employees are likely to remain below the current thresholds. However, it is recognised that the company's shareholders would probably wish to elect for an audit to be undertaken. It is therefore proposed that Veritau's existing external auditors (Barron & Barron) should be appointed to provide audit services to VNY. An indicative quotation will be obtained for this additional work.
- 21 It is proposed to use Veritau's existing registered office at Douris House, Roecliffe Business Park as the registered office for VNY.
- 22 The new company would be a separate legal entity but, as far as possible, the Veritau 'group' would operate as a single entity with common systems, working practices and one overall management structure. Specific governance rules will also be established to ensure that the two companies in the Veritau 'group' operate and take decisions in the context of a common understanding and shared vision. To ensure effective communication between the two boards of directors, copies of agendas and minutes of meetings will be circulated between each. In addition, at least one of the directors appointed to the board of VNY will also be a director of Veritau Limited (see paragraph 18 above).

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- 23 The Veritau management team will be responsible for all aspects of VNY's operational management. The specific responsibilities of the board of directors and the management team will be set out in a scheme of delegation (similar to the one adopted for Veritau). Transfer pricing arrangements will need to be established between the two companies to reduce the risk of challenge by HMRC but these will be kept simple to avoid any unnecessary additional administrative burden.

Service Provision

- 24 It is proposed that each district council will enter into separate Service Agreements with VNY. The Agreements will be for the same duration and, as far as possible, contain standard terms and conditions. It is also proposed that the Service Agreements will be identical or similar to those which Veritau currently has with the council and NYCC.
- 25 The length of the new Service Agreements will be coterminous with Veritau's existing Service Agreements (ie they will run for 7 years from 1 April 2012). There will also be an option for each district council to extend their Agreement for a further period of 5 years. Each Service Agreement will also include an option for the relevant council to terminate the arrangement, subject to providing written notice. The notice period will be a minimum of 12 months.
- 26 As well as providing the core internal audit and counter fraud service, VNY will provide other audit and governance related services (including risk management and benefit fraud investigation) on request. Whilst any contract would be with VNY, the actual services may be delivered by staff employed by Veritau Limited. Any additional work will be charged at the standard daily rate for additional work specified in the relevant Service Agreement.
- 27 The district councils will be required to grant VNY an exclusive right to supply internal audit and counter fraud services, except in specified circumstances (for example, for specialist assignments where the company does not have the necessary technical skills, where the company has insufficient capacity to undertake the work in the required timescales, and/or where there is a potential conflict of interest).

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### Financial Implications

- 28 As noted in paragraph 14 above, Veritau will invest £10,000 in VNY. The funding for this will be taken from the company's reserves.
- 29 A draft budget has been prepared for the Veritau 'group'. The budget reflects the economies of scale which will be possible by operating an expanded business and cost savings which will accrue from the decision not to replace the existing NYAP Head of Internal Audit when he retires. For 2012/13, VNY is expected to achieve a profit of approximately £25k based on a turnover of approximately £400k.
- 30 For 2012/13, proposed daily fee rate for internal audit and counter fraud services to the district councils will be £225. The fee represents a reduction of 4.3% on the existing fee rate chargeable by NYAP. It is also proposed that the daily fee rate charged by Veritau to the council and NYCC will be reduced to £225 in line with this revised rate. This will represent a saving to the council of approximately £13k pa (2.0%) on existing fees.
- 31 Veritau has a contract with PricewaterhouseCoopers (PWC) for the provision of specialist computer audit services. These services will be made available to the district councils on request but would be recharged at cost.
- 32 Set-up costs will be incurred as a result of the creation of VNY and the transfer of services from NYAP. These costs will include the provision of legal advice, additional licences for IT applications and support to staff through the change process. It is estimated that these costs will be approximately £16k. It is proposed that the actual set-up costs will be shared 50/50 between Veritau and NYAP. Veritau's share of the set-up costs together with the initial capital contribution of £10k (see paragraph 14 above) will be met from the company's reserves. It is also recognised that NYAP will incur some expenditure in winding up the partnership. These costs will be met from the partnership's reserves.



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- 33 Veritau will not be taking on any liabilities from the existing NYAP business. All current debts will be retained and settled by NYAP as part of the winding up process for the partnership. The existing pension deficit (for past service) is being retained by Ryedale District Council although this liability is likely to be shared with the other district councils. VNY will only be responsible for paying for pension service post transfer. The intention is for NYAP to complete all 2011/12 work before 31 March 2012 thereby minimising the value of work in progress. Veritau will also be seeking an indemnity from Ryedale District council to cover any potential employee related liabilities relating to service before the date of transfer.
- 34 It is expected that VNY will be profitable however Veritau will be able to take advantage of consortium relief for any future tax losses made by VNY in the future (to the extent that the losses cannot be offset against VNY's own profits).
- 35 The existing support service arrangements (legal, IT, finance, HR and payroll) which are currently provided to Veritau by the council and NYCC will be extended to include VNY.

### Project Management

- 36 A detailed action plan has been prepared to complete the implementation process. Subject to approval, a project board comprising officers from Veritau and NYAP will oversee the set up of VNY and complete the transfer of services and employees to the new company.

### **BENEFITS**

- 37 The key benefits of the proposal to the council and NYCC as shareholders in Veritau are that it will:
- help achieve greater critical mass and hence provide scope to further improve the resilience and capacity of the existing services provided by Veritau;
  - deliver cost savings to the council and NYCC. These cost savings will be achieved by sharing overheads, reducing unproductive time and greater economies of scale;
  - allow access to a new market to sell audit related services;

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- further enhance the focus on service delivery, professionalism and quality;
  - further increase the opportunity for staff to specialise as well as enhancing career opportunities, resulting in greater staff satisfaction and retention;
  - further reduce reliance on key members of staff for service continuity;
  - enable the council and NYCC to retain full control of Veritau (whilst offering the district councils influence over VNY);
  - avoid the need for the council and NYCC to value their existing shareholding in Veritau and for the district councils to purchase a proportion of the shares;
  - avoid any risk to the council's investment in Veritau should VNY encounter future financial or operational difficulties. Veritau could continue trading even if the wider 'partnership' failed;
  - offer greater transparency since the different parts of the business will be trading as separate entities;
- 38 The proposed structure of the expanded business is considered less likely to be subject to challenge under EU public procurement legislation (Teckal) compared to granting the district councils a minority shareholding in Veritau itself. The approach also offers a model for any further expansion of the company, for example to accommodate other future public sector 'partner' organisations.