

Portfolio Holder Decision

Date of Meeting: 21 November 2019

Report Title: Group of Companies' Trading Reserve

Portfolio Holder: Cllr Craig Browne, Deputy Leader

Senior Officer: **Jane Burns, Executive Director of Corporate Services**

1. Report Summary

- 1.1. The purpose of this report is to enable the Shareholder Committee to consider the Group of Companies' Trading Reserve and make recommendations to the Deputy Leader.

2. Recommendation/s

The Portfolio Holder agrees that:

- 2.1. To facilitate closure of the Trading Reserve the contractual agreements between the Council and each of its wholly owned Companies be amended, as described in the report; and by consultation and agreement with the Companies as required by the Variation Procedure
- 2.2. The Trading Reserve be closed and the monies transferred to the Council's General Fund Balance
- 2.3. Companies are encouraged to utilise their own retained reserves in respect of funding initiatives that are aimed at developing their business
- 2.4. In the event that development finance is required from the Council, companies may make a bid, via the Shareholder Committee, for support on an "invest to save" basis, for inclusion in the Medium Term Financial Strategy, as part of the Council's business planning and in-year review processes
- 2.5. The existing approach to year-end profit/ loss sharing also be considered as part of the ASDV Review and a further report be prepared in the event that any changes are proposed

3. Reasons for Recommendation/s

- 3.1. Proposals for use of the Trading Reserve have previously been considered and approved by Cheshire East Residents First Ltd (CERF). Following several years of trading by the companies – and the creation of the Shareholder Committee and implementation of the ASDV Change Programme – it is timely to review the purpose of the Reserve.
- 3.2. With the balance of the Reserve totalling £2.161m at 31 March 2019, the proposals and recommendations set out in the report will help to ensure that those resources are best used to meet the strategic needs of the Council, and also that robust consideration is given to the future investment and development plans of the companies.

4. Other Options Considered

- 4.1. The alternative would be for the Trading Reserve to remain in place. However it is considered that transferring the monies to the General Fund Balance will help to ensure that Cheshire East Group resources are used to best strategic effect; and that companies will also focus on the utilisation of their own reserves as a key part of their future development plans.

5. Background

- 5.1. Since the formation of each company, their financial outturn has been subject to a “profit/ loss sharing” calculation, in respect of the year-end position on their respective contracts with the Council. By way of simple illustration in respect of profits, the legal agreement is typically such that:

- a) 25% of profit is retained by the Company
- b) 50% of profit is held by the Council in the Trading Reserve
- c) 25% of profit is paid over to the Council (though in practice this share of profits has also been added into the Trading Reserve)

NB. There are also arrangements for sharing year-end losses; they are more “unique” to each company (their operations; scale, etc.)

- 5.2. Following several years of trading there is a balance reported on the Council’s Balance Sheet as the earmarked Trading Reserve of £2.161m as at 31 March 2019.
- 5.3. It should be noted that in setting the Council’s budget for 2019/20, a “dividend” payment of £500,000 was included; this may be realised from

either a share of profits made in the financial year, or a transfer from the Trading Reserve at year-end.

Current Arrangements and Proposals for Change

- 5.4. The contractual agreements between the Council and each Company include the following terms, as part of the Schedule relating to the Payment and Performance Monitoring System:

SCHEDULE 6 PART 2 RING FENCED FUND

1. The portion of any Underspend specified in paragraph 7 [relating to year end profit/ loss sharing arrangements] of Part 1 of this Schedule 6 to be paid to the Ring Fenced Fund is to be paid into an account in the name of the Contractor in the books of the Authority ("Ring Fenced Fund" [i.e. the Trading Reserve])
2. The Ring Fenced Fund may only be spent in furtherance of the objectives of the Contractor; it may not be used to defray any expenses of the Authority or of any other entity.
3. The Contractor may from time to time apply for monies to be paid from the Ring Fenced Fund to be applied in furtherance of the objectives of the Contractor and if agreed the Authority shall release the agreed amount from the Ring Fenced Fund and pay the same to the Contractor
4. Any monies standing to the credit of the Ring Fenced Fund at the Expiry Date or earlier termination of this Agreement will be paid to the Authority
5. The provisions paragraphs 7 and 8 [relating to year end profit/ loss sharing arrangements] of Part 1 of this Schedule 6 and paragraphs 1 to 4 of Part 2 of this Schedule 6 may be reviewed from time to time with the agreement of both parties in accordance with Schedule 7 (Variation Procedure).

SCHEDULE 7 VARIATION PROCEDURE

.. no amendment or variation to this Agreement shall be effective unless it is in writing and signed by or on behalf each of the parties hereto.

- 5.5. Following several years of trading, rather than continue to ring-fence a significant reserve for the furtherance of the objectives of the wholly owned companies, it is proposed that:

- a) The Trading Reserve be closed and the monies transferred to the Council's General Fund Balance
 - b) Companies are encouraged to utilise their own retained reserves in respect of funding initiatives that are aimed at developing their business
 - c) In the event that development finance is required from the Council, companies may make a bid, via the Shareholder Committee, for support on an "invest to save" basis, for inclusion in the Medium Term Financial Strategy, as part of the Council's business planning and in-year review processes
- 5.6. It is also worthy of note that, relating to this proposal, as part of the review of their business plans for 2020/21 each company will be asked to establish appropriate minimum levels of retained reserves, on a risk assessment basis, mindful of the nature of their operations and financial commitments and that there will no longer be a Trading Reserve to "absorb" any share of a year-end loss.
- 5.7. As regards the year-end profit/ loss sharing arrangements described in paragraph 5.1, it is proposed that:
- a) The approach to profit/ loss sharing be considered as part of the ASDV Review and a further report be prepared in the event that any changes are proposed
 - b) That pending any review outlined in 5.7a the contracts be amended to reflect that there will not be a Trading Reserve and that:
 - 5.7.b.1. Any share of profits that would have been paid into the Trading Reserve are paid into the Council's General Fund Balance
 - 5.7.b.2. Any share of losses that would have been paid into the Trading Reserve are retained by the company
- 5.8 To effect the above proposals, the contractual agreements between the Council and each Company will need to be amended and agreed by all parties, in accordance with the Variation Procedure.

6. Implications of the Recommendations

6.1. Legal Implications

- a) The recommendations will require amendment to the contractual agreements with the Companies and will need to be agreed by all parties, in accordance with the Variation Procedure

6.2. Finance Implications

- a) The report relates to the transfer of monies in an existing earmarked reserve into the General Fund Balance of the Council, and proposes alternative approaches to the financing of future investment in the development of companies – i.e. utilisation of company retained reserves, and/ or requests for funding support from the Council on an invest-to-save basis, as part of the Council's regular business planning and reporting processes.
- b) As the Trading Reserve has, in part, "received" a share of year-end losses of companies (as well as profits), it will be important for companies to develop sound approaches to the determination of their required minimum level of retained reserves; and also to devise robust plans for recovery in the event of having a retained loss Balance Sheet position.

6.3. Policy Implications

- a) There are no policy implications relating to the recommendations contained in the report.

6.4. Equality Implications

- a) There are no implications relating to the report that require an Equality Impact Assessment to be prepared.

6.5. Human Resources Implications

- a) There are no HR implications

6.6. Risk Management Implications

- a) As described in the Financial Implications section at 6.2 above, removal of the Trading Reserve will mean that a different approach to financial risk management should be taken by companies, placing greater significance on their need to establish minimum levels of retained reserves; and where applicable to devise plans to recover from any retained loss position.

6.7. Rural Communities Implications

- a) There are no direct implications for rural communities.

6.8. Implications for Children & Young People

- a) There are no direct implications for children and young people.

6.9. Public Health Implications

- a) There are no direct implications for public health.

6.10. Climate Change Implications

- a) There are no direct climate change implications.

7. Ward Members Affected

- 7.1. All

8. Consultation & Engagement

- 8.1. It is proposed that, in consultation with the Shareholder Committee, arrangements be made to consult with Company Chairmen and Managing Directors with regard to the recommendations set out in the report, particularly with respect to making the changes to the contractual agreements with Companies relating to the proposals, and as required by the Variation Procedure.

9. Access to Information

- 9.1. There are no supporting documents relating to this report.

10. Contact Information

- 10.1. Any questions relating to this report should be directed to the following officer:

Name: Paul Goodwin

Job Title: Finance Manager (Commercial & Project Accounting)

Email: paul.goodwin@cheshireeast.gov.uk