

Councillor John Worrow
Chair of Governance and Audit Committee
Thanet District Council
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28 January 2014

Dear Councillor Worrow

Thanet District Council: audit response to objection on the 2012/13 accounts in respect of Transeuropa Ferry Service

During the audit of the 2012/13 financial statements, we received objections on the accounts from three local electors in respect of Transeuropa Ferry Service and associated companies (TEF). Whilst we were satisfied that the issue did not impact on our opinion on the accounts or value for money conclusion, we did need to hold open the certificate of closure on the audit pending completion of our review.

We have now concluded our work and issued our formal statement of reasons. This letter sets out for you the results of our work as well as the recommendations arising.

The objection

We received objections to the accounts from the following local electors:

- Councillor I Driver: 12 August and 9 September 2013
- Mr M Kirkaldie: 17 August 2013
- Mr P Miles: 4 September 2013

For simplicity and ease of reference, we have considered all the objections raised within this letter. The following assertions have been made by the three local electors:

- The Council acted unlawfully in making a fees and charges agreement with TEF and associated companies, which is contrary to Article 107 of the Consolidated Treaty on the functioning of the European Union.
- The Council failed to recognise expenditure relating to TEF in the 2012/13 accounts.
- The Council has failed to achieve value for money in its dealings with TEF. In particular:
 - the payment deferral and repayment arrangements are not supported by contractual agreements;
 - the Council failed to undertake an assessment of the risk of deferring harbour duties and related charges to TEF;

- the Council's section 151 officer failed to provide an adequate response to Councillors on the robustness of estimates made in the 2012/13 budget;
 - the Council has incurred a financial loss by allowing a large debt to build up unnecessarily and by failing to secure a charge on the assets of the company.
- The Council has failed in its corporate governance/transparency in that
 - there was a lack of transparency throughout the decision making process, with decision taking limited to a small group of officers, the Leader and the Portfolio Holder;
 - the debt deferral and repayment agreements with TEF had significant financial implications and should have been reported to Members as a Key Decision;
 - significant budget variations should have been reported to Members.

They asked us to:

- apply to the court for a declaration that the Council has incurred unlawful expenditure by making a fees and charges agreement with TEF;
- issue a report in the public interest regarding the failure of the Council to account for the expenditure in respect of TEF;
- issue a report in the public interest regarding the failure of the Council to achieve value for money.

Background

On 25 April 2013 the Council received notification of the collapse of TEF following the seizure of two vessels in Ostend, forcing the company to file for bankruptcy.

TEF had traded with both Thanet and the Port of Ostend for over fifteen years. For most of this period the business had been a profitable one and the company was regarded as a valuable partner by the Council. However since 2010 the cross channel ferry business had become much more difficult, with significant fuel price increases and what appeared to be predatory pricing from competitors.

In November 2010 TEF alerted the Council to its financial difficulties. The two parties began a series of discussions intended to share an understanding of the current position, and the actions which TEF proposed to return to profitable trading.

Over the next two and a half years, whilst the company explored a range of options for recovery including potential new investment, it remained in trading difficulties. In December 2012 the company succeeded in bringing a new vessel into service, and in January 2013 it agreed revised 'Heads of Terms' (a trading agreement) with the Council.

Unfortunately TEF was unable to secure the full planned investment and in April 2013 the company went into liquidation. At the time of its demise TEF owed the Council £3.4 million. The Council is taking legal action to attempt to recover the debt. It made a provision in full for the debt in its 2012/13 accounts.

Work carried out

We have undertaken the following work:

- We reviewed the written submissions from local electors
- We reviewed internal Council reports taken to Management Team or Cabinet;
- We reviewed correspondence between the Council and TEF;
- We made some enquiries of the Council.

We also took our own legal advice.

Findings

Our conclusion is that we do not consider that the items of account were unlawful and we have decided not to issue a report in the public interest. We do however have some specific recommendations for the Council, which we set out at the end of this letter.

We have set out our reasons for this view and our response to the detailed issues the electors have raised below:

- a) The electors assert that the Council acted unlawfully in making a fees and charges agreement with TEF, which is contrary to Article 107 of the Consolidated Treaty on the functioning of the European Union.

In making a fees and charges agreement, the Council deferred the timescale for repayment of the debt. It did not however waive any of the debt. We consider this is an important distinction, as deferring the timescale for repayment of debt is often used by both public and private sector bodies as a means of increasing the chances of repayment, for example by reducing the likelihood of a company going into liquidation. In this sense, debt deferral is very different from deficit funding, which could be construed in some circumstances as unlawful. From our review of contemporaneous papers, including the reports to the Council's Management Team of 22 and 29 March 2011, lawful debt deferral would clearly appear to be the intent in this instance.

We are aware that a submission has been made by a number of individuals to the European Commission (EC), arguing that the payments to the company represented State Aid. At the date of this letter, no decision has been made by the EC although we are aware of a provisional decision that it is not considered to be contrary to the State Aid rules. You will see from the conclusions below that we have decided not to take any further formal audit action. Whether or not the fees and charges agreement is contrary to State Aid rules and whether or not this gives rise to an item of account contrary to law, we would not be seeking a declaration from the court/issuing a public interest report. In our view, this particular aspect may subsequently and definitively be ruled upon by the EC and this presents an alternative route for the objectors. Given the expense involved in the auditor pursuing this particular aspect (which ultimately falls on local tax payers), and given the EC engagement, we do not propose to take this particular issue any further.

- b) The electors assert that the Council failed to recognise expenditure relating to TEF in the 2012/13 accounts.

As part of our year end accounts audit, we specifically considered the transactions relating to TEF. In our view expenditure has been properly recorded in the 2012/13 financial statements. We note that:

- The Council maintains a Maritime Debtor account where all income and expenditure relating to the port is recorded.
- Outstanding debt with TEF was disclosed in full in the Explanatory Foreword to the financial statements
- The balance due in respect of TEF was included in full within the Balance Sheet, under the 'Short Term Debtors' heading
- The balance was also provided for in full within the Balance Sheet within the 'Impairment Provision.'

We therefore disagree with the assertion made.

- c) The electors assert that the Council has failed to achieve value for money in its dealings with TEF. In particular that:
- the payment deferral and repayment arrangements are not supported by contractual agreements;
 - the council failed to undertake an assessment of the risk of deferring harbour duties and related charges to TEF;
 - the Council's section 151 officer failed to provide an adequate response to Councillors on the robustness of estimates made in the 2012/13 budget;
 - the Council has incurred a financial loss by allowing a large debt to build up unnecessarily and by failing to secure a charge on the assets of the company.

We consider each of these issues in turn below:

Assertion: The payment deferral and repayment arrangements are not supported by contractual agreements.

Finding: Transactions with TEF were subject to a contractual agreement. Under this agreement, TEF was charged for the use of the port in line with the Council's standard tariff rate.

Once TEF got into financial difficulties, a number of meetings were held by the Council with TEF and its representatives, and revised arrangements for repayment were agreed. These did not result in any reduction in payment due to the Council, but rather adjustments to the timing of the payments made. The terms of the revised repayment arrangements are set out in, amongst others, a letter from the Director of Regeneration to TEF on 11 April 2011 and the letter of 9 January 2013 containing Heads of Terms.

We therefore conclude that whilst a separate contractual agreement was not drawn up, revised repayment arrangements ('Heads of Terms') were agreed. In our view this was a reasonable approach for the Council to take and we do not propose to issue a report in the public interest on this matter. In the course of our review we did however note that full minutes have not been kept of the meetings with TEF. Given the sensitivity of the issue, we would have expected a better record to be kept of these discussions and we will make a specific recommendation to the Council on this point.

Assertion: The council failed to undertake an assessment of the risk of deferring harbour duties and related charges to TEF. The Council's section 151 officer failed to provide an adequate response to Councillors on the robustness of estimates made in the 2012/13 budget.

Finding: Section 25 of the Local Government Act 2003 places a statutory obligation on the Section 151 Officer at budget setting time to report on the robustness of the estimates used for calculating the budget.

We have reviewed the 2012/13 budget report submitted to the extraordinary council meeting on 9 January 2012 and are satisfied that it sets out adequately the Council's arrangements to ensure the robustness of estimates. We note that the detailed calculations include allowance for the risk of bankruptcy of a major customer, and the Council added this risk to its risk register. TEF was not separately identified in the report for reasons of commercial sensitivity, but the report did highlight the broader risk of the failure of a major customer. In our view there has been no breach of section 25 of the Local Government Act 2003. We do not therefore propose to issue a report in the public interest on this matter.

Assertion: The Council has incurred a financial loss by allowing a large debt to build up unnecessarily and by failing to secure a charge on the assets of the company.

Finding: Our review of the documentation provided by the Council shows that there were ongoing discussions from the point when TEF first got into financial difficulties in November 2010 through to its collapse in April 2013. The Council's internal reports – such as for example the report to Corporate Management Team of 22 and 29 March 2011 – demonstrate that the Council considered a range of alternative options, including cessation of the service. Overriding considerations were judged to be the regular contribution from the service to the Council of £1.2 million a year, and the difficulty of finding immediate replacements or alternative operators. This latter point is demonstrated by the fact that no alternative supplier has yet been found, nearly nine months after TEF's demise.

During 2012, our review of the documentation provided by the Council shows that the Council continued its regular dialogue with TEF and a potential new group of investors. In July 2012 TEF began making repayments to the Council of £85,000 per month and in December 2012 it acquired a new vessel (the Ostend Spirit) which the Council believed to be a positive sign of the firm's potential future viability. We consider this a reasonable judgement to have reached.

The Chief Executive and Monitoring Officer state that they did consider options such as taking a charge on or seizing the assets of TEF. They argue that a consequence of doing so would have been the likely liquidation of the company, with impact on jobs and future income stream. As above, we believe this is a reasonable position to take, especially as debts would be required to be linked to specific ships, meaning that the amount the Council could claim back from seizing one ship would be limited. In this regard we have taken into account the report to Transeuropa Debt Review TFG dated 20 January 2014, which whilst confirming that the Council is unlikely to recover the debt owed to the Council by Transeuropa creditors does not change our view that the Council acted reasonably in its dealings with this matter.

We therefore consider overall that the Council has taken reasonable action in this area and we do not propose to issue a report in the public interest on this matter. We note however that, given the magnitude of the transactions involved, and the complex nature of the discussions, the Council's in house resources will have been stretched by having to deal with the issue. With the benefit of hindsight, there would have been merit in the Council obtaining specialist external legal advice sooner than it did on this issue, although we accept that had it done so it would not necessarily have taken any different steps. This would however have provided further assurance in terms of the appropriateness of the Council's actions. We will make a recommendation to this effect to the Council.

d) The electors have asserted that the Council failed in its corporate governance/transparency in that:

- there was a lack of transparency throughout the decision making process, with decision taking limited to a small group officers, the Leader and the Portfolio Holder;
- the debt deferral and repayment agreements with TEF had significant financial implications and should have been reported to Members as a Key Decision;
- significant budget variations should have been reported to Members.

These are considered in turn:

Assertion: There was a lack of transparency throughout the decision making process, with decision taking limited to a small group officers, the Leader and the Portfolio Holder.

Finding: Regular meetings were held by the Council's senior management with the Leader and Portfolio Holder throughout the discussions with TEF. Formal reports were also considered for example at Corporate Management Team on 22 and 29 March 2011 and at a joint Cabinet/ Senior Management Team meeting on 11 October 2011. Detailed reports were not however put in the public domain, either via Cabinet or Council, and TEF was not specifically identified on the Council's risk register. The report to Corporate Management Team of 22 March 2011 notes the 'huge commercial confidentiality' of the issue, with both officers and Cabinet members being of the view that putting the discussions in the public domain could jeopardise TEF's chances of commercial recovery. The most relevant decision for the purposes of this objection in our view, is that taken by the Director of Corporate Services on and communicated to TEF in the letter dated 9 January 2013 enclosing the Heads of Terms of the deferred fees and charges contract variation.

The high sensitivity and commercial confidentiality of this matter and its significance to the Council and local taxpayers were negative publicity to have jeopardised TEF's continued operation must be considered here. In this context, in our view it was reasonable, subject to the paragraphs below with regard to Overview and Scrutiny, for the decision making to be at senior officer level and member involvement to be limited to the Leader and Executive. The letter from TEF of 11 March 2011 highlights the importance to TEF of commercial confidentiality.

Assertion: The debt deferral and repayment agreements with TEF had significant financial implications and should have been reported to Members as a Key Decision.

Finding: We note the assertion that the discussions with TEF should have been treated as a 'Key Decision' and therefore reported to full Council. The relevant debt deferral and

repayment agreement in the 2012/13 period was, as noted above, made in January 2013, following a meeting with TEF and investors in October 2012. As such, the relevant rules on 'Key Decisions' in this instance are governed by the Local Authorities (Executive Arrangements) (Meetings and Access to Information) (England) Regulations 2012, SI 2012/2089 ("the 2012 Regulations"), which replaced the Local Authorities (Executive Arrangements) (Access to Information) (England) Regulations 2000, SI 2000/3272 ("the 2000 Regulations") on 10 September 2012. It should be noted that, unlike the 2000 Regulations, the 2012 Regulations contain no requirement to include Key Decisions in a forward plan.

Under Regulation 8(1) of the 2012 Regulations (which is materially similar to Regulation 8 of the 2000 Regulations), a 'Key Decision' means an executive decision, which is likely:

- (a) to result in the relevant local authority incurring expenditure which is, or the making of savings which are, significant having regard to the relevant local authority's budget for the service or function to which the decision relates; or*
- (b) to be significant in terms of its effects on communities living or working in an area comprising two or more wards or electoral divisions in the area of the relevant local authority.*

The Council's Executive and Management Team did not consider the issue to fall into (a), as the debt deferral did not result in any reduction in the amount owed by TEF, but rather extended the period for repayment. Regardless of the merits of this argument, given the value that the cross-channel ferry operation added to the district in terms of supporting local employment and the supply chain benefits that it brought, it seems likely that the decision would fall into (b). In this regard, we have taken into account Article 13 of the Council's constitution, which covers decision making. It seems to us that this contract variation was designed to sustain TEF's ability to continue with the contractual arrangements with the Council and thereby to safeguard the significant local employment and income both locally and to the Council itself. The impact of the decision should have been measured against the alternative, that is the potential failure of TEF if the contract variation was not pursued.

Under Regulation 9 of the 2012 Regulations, there are publication requirements before Key Decisions may be made, providing the details set out in Regulation 9(1). Although provisions are made in respect of confidentiality in Regulations 9(3) and 20, and exceptions to the requirement of publication are provided for in Regulation 10 (where publication is impracticable) and Regulation 11 (cases of special urgency), the Executive and Management Team did not consider that this was a Key Decision at all. We accept that the matters under consideration were highly sensitive and in all likelihood commercially confidential. Thus, it may well be the case that the net effect of regulations 9(3), 10(1) and 20 are that no publication was required; it appears to us however that this is likely to have been a "Key" decision which at least required that the Chair of the Overview and Scrutiny Committee was informed in accordance with regulation 10(1) before the decision was taken. This did not happen. Indeed, given that Councillor Driver was at the relevant time the Chair of the Overview and Scrutiny Committee, we do understand why he has raised concerns.

The consequences of failing to treat a decision as a Key Decision are set out in Regulation 18 of the 2012 Regulations. Where the relevant Overview and Scrutiny Committee are of the opinion that the decision should have been treated as a Key Decision, that Committee may require the Executive which is responsible for the decision to submit a report to the relevant local authority within such reasonable period as the Committee may specify. We do not consider that failure to comply with the requirements of regulations 9 and 10 in and of itself renders the decisions taken unlawful.

As such, we do not propose to seek a declaration under section 17 or, given the amount of public information in relation to this matter already in the public domain, to issue a report in the Public Interest on this matter. We do however make recommendations in this regard below.

Finally under this heading, in the course of our review, we noted that the minting of discussions between the senior management team and members of the Executive was limited. Given the sensitivity of the issue, we would have expected a better record to be kept of these discussions and we will make a specific recommendation to the Council on this point.

Assertion: Significant budget variations should have been reported to Members

Finding: Until September 2013 the Council had no requirement within its Financial Procedure rules for the reporting of large outstanding debts to Council. In our view, the rescheduling of the debt did not amount to a budget variation that required, in accounting terms or under any provision of the Council's constitution, reporting to full Council. In this regard, we have considered all those provisions mentioned in paragraph 6 of Councillor Driver's letter of 12 August 2013. In particular, we have accepted the Council's assertion that whether or not something does amount to a budget variation is a question of fact for the Council. In the event, we agree with the Council's view of this matter such that it was not obliged to report the contract variation to Council.

In a report to Governance and Audit Committee the Council acknowledged the need to strengthen its regulations in respect of aged debts. It has introduced revised Financial Procedures requiring the reporting of aged debts over £150,000 to Council.

In our view, the strengthening of the reporting requirements through the revision of the Financial Procedures to require the reporting of aged debts over £150,000 to Council is both necessary and appropriate. We are satisfied that now that the Council has taken action to strengthen its debt reporting requirements, little or no purpose would be served by us issuing a report in the public interest on this matter.

We note however that had these reporting requirements been in place during 2012/13, the Council would have had to judge whether the commercial sensitivity of the debt outweighed the importance of keeping Members informed about significant financial matters. We recommend that the Council explores ways to share commercially sensitive information with Members without confidentiality being breached. This may require, for example, the increased use of confidentiality clauses for sensitive information. It will also require all Members to respect the sensitive nature of the information they have been given, and not to use the information provided for political purposes.

Conclusion

In summary, we do not consider that the items of account were unlawful and we do not intend to issue a report in the public interest. We do however have some specific recommendations for the Council which are set out below.

Application to the Court

We do not propose to seek a declaration under section 17 of the Audit Commission Act. As explained above, there is an alternative route for this issue to be determined.

Report in the Public Interest

Whether or not to issue a report in the public interest is a matter for us in the exercise of our discretion. We have decided not to issue such a report because:

- we do not consider that the Council failed to account properly for the transactions relating to TEF;
- we have no concerns about the processes followed by the Council which are significant enough to require us to issue a report in the public interest.

We do however have some recommendations for the Council which we are reporting to you as the Chair of the Council's Governance and Audit Committee. Specifically these are in respect of:

- the need to ensure that the 2012 Regulations are complied with, in particular the notification to the Chair of Overview and Scrutiny even where a Key Decision is confidential in nature;
- the need to keep contemporaneous notes of key discussions with commercial partners;
- the need to keep notes of key discussions between the senior management team and members of the executive;
- the need to consider the use of external advice for complex or specialist legal areas.

We are concerned that the deferred fees and charges contract variation was not brought to the attention of the Overview and Scrutiny Committee, either through its Chair or its members. It may be that there was concern that confidentiality would be difficult to maintain and for this reason Member scrutiny was constrained. We have some sympathy for this position given the high sensitivity and commercial confidentiality in this matter and that there have been recent examples at the Council of confidential matters being leaked to the media. This may be a matter of wider concern that the Council should consider as the requirements for Council reporting, Overview and Scrutiny and consideration of matters in the private part of meetings are extremely important aspects of ensuring good corporate governance and appropriate accountability. We recommend therefore more generally:

- that the Council considers ways in which it may raise confidence in the maintenance of confidentiality within its decision making and reporting structures.

Yours sincerely

Grant Thornton UK LLP

cc

Dr Sue McGonigal, Chief Executive, Thanet District Council

Mr Harvey Patterson, Monitoring Officer, Thanet District Council