



Audit & Governance Committee
7 December 2015

**Babcock 4S Limited – Annual Report and Financial
Statements for the Year Ended 31 March 2015**

Purpose of the report:

The Annual Report and Financial Statements of Babcock 4S for the year ended 31 March 2015 are formally presented to the Audit & Governance Committee.

Recommendations:

It is recommended that:

- i. The committee note the attached Annual Report and Statements;
- ii. The committee note the findings at the informal meeting of the Audit & Governance Committee; and,
- iii. The committee consider if it has any further questions.

Background:

1. Audit & Governance Committee has annually reviewed the Annual Report and financial statements of Babcock 4S since 2012. The documents were this year circulated privately to the committee on 21 September 2015 and are attached as Annex 1 to this report.
2. The Chairman (Stuart Selleck) and Vice-Chairman (Denis Fuller) of the committee met with representatives of Babcock 4S at their Head Office on 12 October 2015. The Cabinet Member for Schools and Learning (Linda Kemeny), Cabinet Associate (Mary Lewis), Chairman of Education and Skills Board (Mark Brett-Warburton), Kevin Kilburn (Deputy Chief Finance Officer), Julie Stockdale (Strategic Lead for School Commissioning) and Cheryl Hardman (Regulatory Committee Manager) were also in attendance from Surrey County Council. The following attended from Babcock 4S:

- JJ Bowley, Education Services Director
- Michelle deBeer, Head of Finance
- Murray Scott, Interim Corporate Services Director

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| Summary of discussion: |
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3. The discussion of the meeting on 12 October 2015 is summarised below:
- A reduction in revenue due to the ending of the Lewisham contract had resulted in a knock-on impact to profitability. The Lewisham contract had been part of Building Schools for the Future. However, requirements for schools had moved on and both parties had agreed that the contract was not fit for purpose. This was not the same contract as was in place in Surrey.
 - The annual valuation of the Surrey Pension Fund had increased liabilities for employer bodies. A further half-year valuation would take place by the end of October. There was concern about the fall from an actuarial gain of £1,931,000 in 2014 to an actuarial loss of £6,838,000 in 2015. Members queried what had happened to justify this change. Babcock officers agreed to establish how the actuary was chosen and why the change from actuarial gain to actuarial loss was so significant.
 - Babcock officers agreed that there had been a decline in income and profits but actions were being taken to address this. These included: increased staff efficiency; the use of external contractors to deliver certain services in schools; finding synergies across services; additional trading with schools; and the pursuit of larger contracts.

In response to a query about whether Babcock 4S should focus on non-Local Authority income because of ongoing austerity, Babcock officers stressed the company's expertise in school support services. The Education Services Director informed Members that he was new to the business and had been brought in to focus on growth opportunities. He had put in place a series of reviews to feed into the Department's overall strategy. This was looking at issues such as how to be less dependent on local authorities. The reviews would be completed by the end of the year. Key to the business was that it was people-centric and there was a limit as to what support could be provided online. Spreading out from Surrey as a geographic centre point would not dilute services to Surrey schools but help with sustainability and efficiencies. The Education Services Director went on to explain that it was difficult to sell services in different parts of the country without a local authority contract at the centre as otherwise the costs to deliver are too high. Academy groups were also an option as the size made greater business sense than selling services to individual academy schools.

- d) The Education Services Director explained that the nature of work being requested was changing, with less emphasis on school effectiveness and more on school support eg behavioural support. However, the level of profitability across the country was very similar.
- e) The Education Services Director discussed how Babcock 4S was engaging with its competition in the area of school support services.
- f) The Surrey County Council Shareholder Board would be appointing a representative of the Council to the Babcock 4S Board to replace an officer who recently left the Council. The next Babcock 4S Board meeting had been postponed to allow for an appointment to be made. The Board receives a quarterly update of operational and financial performance.
- g) Babcock 4S receives a half-yearly pension revaluation report from the actuaries and movement will potentially allow for an in-year dividend to be paid. It was agreed that a half-year financial accounts, reflecting the pension revaluation, will be shared with Audit & Governance Committee, along with a breakdown of services provided through contracts with other local authority areas.
- h) Audit & Governance Committee had previously recommended that more detail of services provided be included in the Annual Report. However, as part of a bigger group, the accounts template was standardised across the company. The Chairman of the Education & Skills Board confirmed that he would like more detail of services and performance at Scrutiny Board meetings.
- i) At a previous meeting of Audit & Governance Committee, it had been agreed that Babcock 4S would be asked about governing bodies' adoption and awareness of whistleblowing policies. The Education Services Director confirmed that staff were aware of Surrey County Council's whistleblowing policy and made sure that governing bodies were also aware. Members pointed out that governors receive a lot of reading and this can be missed. The Education Services Director offered to review how this was addressed with governors and suggested that the whistleblowing policy could be emphasised through the Better Governor initiative.

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| Conclusions: |
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- 4. The Annual Report and Financial Statements of Babcock 4S have been discussed in detail with representatives from Babcock. The original documents and notes of the meeting between members of Audit & Governance Committee and representatives of Babcock 4S are presented here for the information of the committee and for transparency.

5. The following actions were agreed (with subsequent responses from Babcock 4S):

- Babcock officers to establish how the Pension Fund actuary was chosen and why the change from actuarial gain to actuarial loss in the Pension Fund was so significant.

Response: "Towers Watson was appointed as the Pension Fund actuary by Babcock several years ago and has provided the advice and the consequent sums for at least 4 years. The external auditors, PwC, verify annually that they are satisfied with the assumptions and that it is reasonable. The Babcock Group Finance Director set the assumptions based on actuarial advice. The key assumption is the discount rate which is used to calculate the Net Present Value (NPV) of the future liabilities. The discount rate must be the rate available on AA rated corporate bonds and there is little leeway on this yield. The balance sheet worsened in the year to 31 March 2015 almost entirely due to yields on these bonds falling from 4.5% to 3.4%. A lower discount rate means a higher NPV and the value of the liabilities increased accordingly. A way in which to mitigate the interest rate fluctuations is by either investing in similar assets (i.e. corporate bonds) or through interest rates swaps to provide a hedge so that the assets move in line with the liabilities".

- Audit & Governance Committee to receive the half-year financial accounts, along with a breakdown of services provided through contracts with other local authority areas.

Response: "The financial accounts will be updated with the half-yearly pension fund valuation upon release of the report.

A breakdown of the services has been circulated to committee members".

Financial and value for money implications

6. There are no direct financial and value for money implications of this report.

Equalities and Diversity Implications

7. There are no direct equality and diversity implications of this report.

Risk Management Implications

8. There are no direct risk management implications of this report.

Next steps:

Review the Annual Report and financial statements of Babcock 4S for the year ended 31 March 2016 when timely.

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Sources/background papers:

- None

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