NEWS FROM THE LATCO TEAM AT
ENSORS CHARTERED ACCOUNTANTS

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LOOKING AT LATCOs

Carbon Reporting

Carbon reporting is not new, and it's not just a LATCO requirement. However, what makes this topical is the increased focus on climate change and the expectations from a wide range of stakeholders, to see these disclosures in the accounts.

There are numerous voluntary frameworks on climate reporting. The most prominent of these initiatives is the recommendations of the Task Force on Climate-related Financial Disclosures (TCFD).

It is therefore worth being aware of the mandatory current disclosure requirements, even if your organisation is currently not required to report.

The requirements

For reporting periods starting on or after 1 April 2019, large companies, quoted companies, and large LLPs, who have consumed more than 40,000 kilowatt-hours (kWh) of energy in their reporting period, were required to comply with streamlined carbon and energy reporting requirements (SECR).

The 2018 Regulations require large unquoted companies to include energy and carbon information within their directors' report, for any period beginning on or after 1 April 2018. For LLPs, the associated disclosures must be included in a new Carbon and Energy report which will form part of the annual report.

Continued overleaf

Ensors

Making you more than just a number

Carbon reporting *continued*

Is my LATCO large?

The requirements at this stage only relate to quoted entities, or ones defined under the Companies Act as large.

The current size limits are:

- Turnover of more than £36m
- Balance sheet total of more than £18m
- More than 250 employees

Those that meet at least two of these criteria qualify as large.

The criteria need to be met for two consecutive years, except for a LATCO in its first year of incorporation, which only needs to meet the criteria in that incorporation year.

Note that any 'other income' (such as rental income and other gains) is not included in turnover for this purpose.

Another common mistake is to use the net asset position for the balance sheet test. It is important to note that the balance sheet total, is the total of all assets in the balance sheet without any deductions.

In calculating the average employees, this is not the number of full-time equivalents or similar. Companies Act 2006 does not differentiate between part- or full-time employees.

This means any part-time employees are given the same weighting as if they were full-time.

How to calculate?

The Gov.UK website has several pages of useful guidance in this area to help you calculate the required disclosures.

- Guidance on how to measure and report your greenhouse gas emission
- Small business user guide: Guidance on how to measure and report your greenhouse gas emissions
- Greenhouse gas reporting: conversion factors 2021

Other considerations

In addition to the climate-related disclosures, all companies need to ensure that they have assessed the current or future impacts of climate change and these are reflected appropriately in their financial statements. Examples would include the valuation of assets, and the assumptions used in impairment testing and depreciation rates.

Why report?

SECR is part of the government's drive to reach net zero, and reporting is a way to get companies thinking about their energy and carbon in a similar way that they do their finances.

SECR disclosures give prospective customers or investors a new tool with which to evaluate companies, and for this reason, many eco-friendly companies have chosen to disclose voluntarily in their accounts and/or on their website. Others have chosen to disclose simply because they feel it's the right thing to do.

Whatever your thoughts on this increased disclosure, it is expected that the disclosure requirements going forward, are only set to increase for all companies.

Structure: the most common pitfall

Over the course of the last few years, most, if not all local authorities have considered or created wholly-owned Local Authority Trading Companies (LATCOs).

These LATCOs have normally been created to service specific needs within the community, or to create a good investment vehicle that can return profits and dividends to the council in future.

Having been involved with numerous LATCOs, experience has shown that these companies often suffer from similar challenges and many of those challenges are made trickier due to a lack of planning ,or understanding of the ultimate goals for these companies, or the private sector environment in which they will exist.

So, what are these challenges and what potential lessons can be learnt from the pitfalls others may have fallen into previously? If one word could sum up where pitfalls have most often been encountered, it would probably be 'Structure'.

- Structure of governance (i.e. how the LATCO will be run, how much autonomy it will have from the council etc)
- Structure of funding
- Structure of the ultimate commercial intentions for the LATCO

There are many options for how a LATCO can be created, the question of whether a company limited by shares, a company limited by guarantee, a community interest company, or even a charity, is a fundamental one to answer before anything is created. Each of these options will be more or less appropriate depending on what the LATCO will actually do, and what the council wishes to achieve.

Therefore the three points need to be addressed simultaneously at the very start of the creation process.

One of the most common pitfalls in creating a local authority trading company, is not to consider the structure of the entity at the very beginning, but merely 'lift and shift' the activity of an existing council department into a new entity. There are vast differences between operating under the auspices of the local authority, and carrying out the same activities as a LATCO. These differences might arise for example in:

VAT | INSURANCE REQUIREMENTS | PROCUREMENT REGULATIONS

All of these, and more need to be considered at the start of a LATCO's life, failure to do so, often leads to an inappropriate structure being created, if not for the present, but for future aspirations.

The challenges and potential pitfalls that exist can normally be successfully dealt with, and a structure created with transactions most efficiently structured, if the creation process includes experienced understanding of the relevant issues.

7 questions to ask when creating a LATCO

The consideration of the long-term goal for the LATCO is vital to its success and being clear on this question is key.

For example, why is the LATCO being created?

Does the council merely wish to ring-fence an activity that is currently being undertaken as a council department, perhaps to give greater focus on the cost of the activity, or is there an objective to expand the services of the LATCO to surrounding areas and/or into the commercial marketplace?

Detailed below are the questions you should be asking to help form your decisions at the start of the LATCO creation process.

1. WHAT IS THE LONG-TERM GOAL FOR THE LATCO?

Is this about cost clarity/saving, or a wish to generate a future investment return?

2. WHAT ARE THE BOUNDARIES?

Will the LATCO only operate within the boundaries of the previous council department, or for example, will it seek to extend its geographical boundaries or areas of service?

3. HOW WILL THE NEW LATCO BE FUNDED?

LATCOs are very diverse in their activities doing everything from street sweeping, social care, all the way through to property investment portfolios. The diverse nature of their activities means that there can be no one size fits all for the funding structure. However, the funding structure is where a lot of LATCOs can get into unexpected difficulties, particularly with unfamiliar tax regulations.

There are often parallels between LATCOs and privately-owned companies for example, investment in, and provision of, residential accommodation. In essence those councils carrying on these activities with a LATCO, are acting as 'Buy to Let' landlords and are therefore, directly comparable with any number of existing commercial companies. In this area therefore there is a well-trodden norm in terms of how such investments might be funded. In the private sector one might expect a mix of mortgage and equity capital from the owners of perhaps two thirds to one third.

This is an important consideration when thinking about how much of the council's funding should be in the form of share capital and how much as interest bearing loans. There are a number of specific tax regulations that apply in this situation and areas such as thin capitalisation, and transfer pricing need to be considered.

4. ARE THE VAT IMPLICATIONS OF THE PLANNED ACTIVITY FULLY UNDERSTOOD?

The LATCO will be in a different VAT position to a council department. The council benefits from a statutory exemption as far as VAT is concerned which the LATCO will not enjoy. Therefore, you need to consider, for example, how will staff who work within the LATCO be remunerated? Will they be employees of the LATCO or remain with the council and be the subject of a cost recharge between the LATCO and the council? A charge from the council will almost certainly be subject to VAT and if the LATCO is carrying on in trade that does not permit VAT registration for example, residential property lettings, the VAT will add 20% to those costs.

5. WILL THE LATCO MIX ACTIVITIES?

Beware of mixing activities in the same LATCO, for example, the construction and subsequent rental of residential accommodation or activities with very different risk profiles

6. HAVE YOU UNDERSTOOD THE IMPACT OF THE TECKAL REGULATIONS?

A thorough understanding of applicable directives is important to avoid any potential problems.

7. WHERE WILL THE LATCO GENERATE INCOME FROM?

If the LATCO is going to work wholly for the council then has consideration been given as to whether the structure could be made compliant with the mutual trading tax exemptions?

Ultimately care is needed in respect of considering not just what the new entity will be doing today, but also the aspirations for its future, it is vital in constructing a new LATCO that those involved have a long-term view. It is unlikely that the LATCO will be a success if it has a short lifespan, will there be a cost for its creation, as well as a wealth of teething troubles with regulations, accounting rules and insurance procedures which will take some time and cost to settle down.

The most successful LATCOs are those that are created not for short-term gain, but for long-term benefit, with a timeframe in excess of five years which have the positive ongoing support and commitment of the parent council irrespective of any changes in the political colour of the council.

Meet the team

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LATCo™ network
enabling innovation

Ensors are proud to be working closely with the LATCO network – "the first membership organisation founded entirely by LATCOs for LATCOs to provide a sector voice and enable support to members delivering public services commercially."
https://latco.network/

We are providing the Network's members with initial free-of-charge meetings from across our comprehensive range of accounting and tax professionals.

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