

Classification: UNCLASSIFIED

Final Internal Audit Report

Inter-Company Accounting

To: Di Smith - Chair (BFfC)
Jackie Yates - Executive Director of Resources (RBC)
Darren Carter - Director of Finance (RBC)
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From: Claire Aspell - Senior Auditor

Date: 13th March 2022



**Limited
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EXECUTIVE SUMMARY

1. BACKGROUND

- 1.1 Intercompany accounting is a set of procedures used by a parent company to manage transactions between its subsidiaries.
- 1.2 Brighter Futures for Children went live in 2018 and is a not for profit organisation, which is solely owned by Reading Borough Council and is included in its Group Accounts.
- 1.3 Whilst they share the general ledger, they have separate bank accounts and separate VAT numbers, and as such, each is a supplier of the other.
- 1.4 The Service Level Agreement (SLA) between Reading Borough Council and Brighter Futures for Children explains that the Council shall invoice (exclusive of VAT) within 5 days of the end of each month, payable on or before the 30th of the following month.
- 1.5 At the agreement of both Reading Borough Council and Brighter Futures for Children this audit has reviewed processes and controls within both the parent company, Reading Borough Council, and the subsidiary Brighter Futures for Children.

2. OBJECTIVES & SCOPE OF THE AUDIT

- 2.1 The purpose of the audit was to review the processes in place to manage and monitor intercompany charges between Reading Borough Council and Brighter Futures for Children. It included an assessment of procedures and processes at both organisations, to ensure there is comprehensive control framework for intercompany accounting arrangements.

2.2 The review encompassed the following areas and sought to establish whether:

- There is an agreed and documented schedule/protocol and procedure(s) for intercompany charges
- Roles and responsibilities of parties are understood, agreed, and documented
- Correct amounts are transferred across and within agreed timescales
- There is appropriate consistent and complete evidence to support and identify what 'payments' are for
- Transfers have been appropriately authorised
- There is a periodic reconciliation to ensure monies owed have been paid/received

2.3 This audit (and report) was undertaken in accordance with the Public Sector Internal Audit Standards (PSIAS).

3. CONCLUSIONS

3.1 In addition to the service level agreement between Reading Borough Council and Brighter Futures for Children, there is a Service Delivery Contract, although this was not provided during the audit review, which suggests that its existence was unknown to those responsible officers interviewed in both RBC and BFFC who have active roles in the inter-company accounting process.

3.2 The documentation of procedures and processes is sparse, with only one procedure and one process found to be documented by RBC, but which had been developed in collaboration with BFFC.

3.3 The 'Contract' requires there to be an appointed and appropriately qualified representative in post for each entity and of such seniority to have the authority to make decisions and have the ability to delegate this responsibility to another person. The current situation where the representative for each entity is the same person was not anticipated, so is not addressed in the Contract, hence there should be additional controls, checks and balances in place to address this.

3.4 A working structure is required to formalise roles and responsibilities that promote rigorous, cooperative, and professional working methods, with roles and responsibilities known to both entities. This need can be best highlighted when during the review it was not possible to identify the responsible (RBC) person who maintains, monitors and reconciles grant receipts and payments. Furthermore, in year reconciliations had not happened and the 2020-21 grant position was being finalised in February 2022.

3.5 The working structure should include an appropriate line of communication between the two parties, where queries and issues can be raised. Attendance at this forum should be by sufficiently senior individuals with the authority (or formally delegated) to make decisions on behalf of the organisation they represent. Whilst regular meetings are held, there is no terms of reference or documented purpose or governance document to guide this function.

- 3.6 Intercompany transfer payments for the contract, service level agreement payments and delegated schools grant funding are being paid and received monthly however, BFFC has not regularly requested RBC to transfer over any of the £1.15m of grant funding that has been received in the Council's accounts. Likewise, quarterly recharges to BFFC for statutory posts have not been transferred either. It was also found that there was some miscoding in the grants and DSG funding cost centres and £84k of cash receipting was also showing.
- 3.7 For those transfer payments that had happened, these were well supported, and descriptions were sufficiently clear to be able to determine what the payment was for. However, whilst the Accounts Payable Team does perform manual checks, there is a risk of duplicate payments being made as the financial system does not have the functionality to identify a duplicate intercompany transaction. This validates the need for quality authorisation controls and prompt payment processes.
- 3.8 Without appropriate and effective governing policies, documented and tested procedures, timely transactions, and periodic reconciliations it is likely the year-end process will be impacted and continue to drift.
- 3.9 A total of seven recommendations have been made in respect of this review, of which two are considered high priority. The recommendations and corresponding management action plan are attached at Appendix 1.

| Management Action Plan | | | | | |
|--|--|------------|---|--|-------------|
| Ref | Recommendation | Rec | Management Response | Responsible Officer(s) | Target Date |
| THERE IS AN AGREED AND DOCUMENTED SCHEDULE/PROTOCOL AND PROCEDURE(S) FOR INTERCOMPANY CHARGES | | | | | |
| <i>RISK: Strategic direction is lacking in some areas, tasks are overlooked or are inconsistent, year-end process is laborious, incorrect financial statements</i> | | | | | |
| 1 | <p>The Director of Finance (RBC) should ensure the agreed Governance documents (policies) are enhanced to include, but not be limited to:</p> <ul style="list-style-type: none"> • Outlining the high-level expectations of intercompany accounting • Treatment of VAT • Debtors • Creditors • Payment for services provided outside of those in the contract • Apportionment <p>Best practice requires a common standard across all entities.</p> | Priority 2 | <p>The inter-company guidance /policy set up by RBC will be developed to incorporate:</p> <ul style="list-style-type: none"> • Outlining the high-level expectations of intercompany accounting • Treatment of VAT • Debtors • Creditors • Payment for services provided outside of those in the contract • Apportionment <p>This will ensure best practice and a common understanding is clearly understood across RBC and BFfC.</p> <p>Once completed to be formally signed off by the Director of Finance (RBC) and the Interim Director of Finance, BFfC.</p> | <p>Financial Strategy and Planning Manager (Stuart Donnelly) RBC</p> <p>Strategic Finance Business Partner (Steve Davies) BFfC</p> | April 2022 |

| Management Action Plan | | | | | |
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| THERE IS AN AGREED AND DOCUMENTED SCHEDULE/PROTOCOL AND PROCEDURE(S) FOR INTERCOMPANY CHARGES | | | | | |
| <i>RISK: Staff are unaware of contract requirements within their areas of responsibility. There is a lack of consistency in application and tasks are overlooked. Contract conditions are breached.</i> | | | | | |
| 2 | <p>The Director of Finance (RBC) and Executive Director of Finance and Resources (BFFC) need to provide a briefing on the Service Contract, to raise awareness and guidance to those Business Partners and accounting staff with inter-company accounting responsibilities, on what is required of them to comply with the conditions of the contract.</p> <p>Allocation of responsibilities should be highlighted across both entities.</p> <p>Furthermore, there should be some consideration in providing this briefing as a joint briefing across both entities to promote a collaborative, supportive, and professional working relationship with a single aim.</p> | Priority 1 | <p>Agreed.</p> <p>An extract of the Service Contract will be communicated to all the relevant officers and included in the policy / guidance to ensure that this is clearly understood across both entities to promote a collaborative, supportive, and professional working relationship with a single aim.</p> <p>A joint briefing may be considered.</p> | <p>Director of Finance, RBC</p> <p>Interim Director of Finance, BFFC</p> | June 2022 |

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| THERE IS AN AGREED AND DOCUMENTED SCHEDULE/PROTOCOL AND PROCEDURE(S) FOR INTERCOMPANY CHARGES | | | | | |
| <i>RISK: There is a lack of consistency in application and tasks are overlooked. Contract conditions are breached, year-end process is delayed, procedures do not reflect strategy</i> | | | | | |
| 3 | <p>The (RBC) Director of Finance in collaboration with (BFFC) Executive Director of Finance and Resources should develop agreed and documented systems, procedures, and processes to further improve and manage intercompany accounting and transactions. They should include, but not be limited to:</p> <ul style="list-style-type: none"> • Being able to easily identify transactions across a common chart of accounts • To match transactions, from both sides • Identify (tag) those for elimination from financial reporting to prevent double accounting • Automate processes where possible • The use of recurring invoices/instalment payments for contract / SLA payments • Billing cut off period • Electronic approval process (Office 365) • Centralised repository (SharePoint) for intercompany financial purposes accessible by both entities and managed by permission rules • Grant funding monitoring (at both entities) • Regular reconciliations of expected income streams • Appropriate lines of communication with documented terms of reference and purpose <p>These procedures and processes should be standardised, and where there is a business need for difference, there should be compatibility.</p> | Priority 1 | <p>The (RBC) Director of Finance in collaboration with (BFFC) Executive Director of Finance and Resources will develop agreed and documented systems, procedures and processes.</p> <p>During the Advance systems implementation the following will be implemented:</p> <ul style="list-style-type: none"> • Being able to easily identify transactions across a common chart of accounts • To match transactions, from both sides • Identify (tag) those for elimination from financial reporting to prevent double accounting • Automate processes where possible • The use of recurring invoices/instalment payments for contract / SLA payments • Billing cut off period • Electronic approval process (Office 365) • Centralised repository (SharePoint) for intercompany financial purposes accessible by both entities and managed by permission rules • Grant funding monitoring (at both entities) • Regular reconciliations of expected income streams • Appropriate lines of communication with documented terms of reference and purpose | <p>Financial Strategy and Planning Manager (Stuart Donnelly) RBC</p> <p>Strategic Finance Business Partner (Steve Davies) BFFC</p> | October 2022 |

| Management Action Plan | | | | | |
|---|--|------------|---|--|--------------|
| Ref | Recommendation | Rec | Management Response | Responsible Officer(s) | Target Date |
| ROLES AND RESPONSIBILITIES OF PARTIES ARE UNDERSTOOD, AGREED AND DOCUMENTED. THERE IS APPROPRIATE CONSISTENT AND COMPLETE EVIDENCE TO SUPPORT, AUTHORISE AND IDENTIFY WHAT 'PAYMENTS' ARE FOR | | | | | |
| <i>RISK: Roles and responsibilities are duplicated or not done at all. Queries and issues take longer to resolve as roles have not been defined or allocated or are unknow. Two finance teams with different roles in the same process have opposing loyalties. A lack of transparency breeds' mistrust. Inefficient authorisation process.</i> | | | | | |
| 4 | <p>The finance structure for intercompany accounting and day to day activities should be considered, documented, authorised and agreed and shared, and aligned with strategy and policies, that also promote professional and cooperative ways of working.</p> <p>Roles and responsibilities need to be agreed, documented, and imparted to all relevant personnel.</p> <p>Some consideration should also be given to:</p> <ul style="list-style-type: none"> • The adoption of a single finance team for intercompany accounting actions supported by entity specific finance teams for the day to day financial tasks. • Shared repository for key data with appropriate permissions • Electronic authorisation process | Priority 2 | <p>Currently there are named officers from RBC and BFfC who have clarity on their roles and responsibilities with appropriate permissions and electronic authorisation.</p> <p>The policy / guidance and the Advance systems implementation will further clarify the roles and responsibilities.</p> <p>The adoption of a single finance team for intercompany accounting actions supported by entity specific finance teams for the day to day financial tasks is not appropriate within the current arrangements.</p> | <p>Financial Strategy and Planning Manager (Stuart Donnelly) RBC</p> <p>Strategic Finance Business Partner (Steve Davies) BFfC</p> | October 2022 |

| Management Action Plan | | | | | |
|---|---|------------|--|--|--------------------------------------|
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| CORRECT AMOUNTS ARE TRANSFERRED ACROSS AND WITHIN AGREED TIMESCALES | | | | | |
| <i>RISK: Delays in transferring funding could impact on cash flow. It is more difficult to resolve issues when there is a time delay. Year-end process is inefficient, more difficult and delayed</i> | | | | | |
| 5 | <p>The Director of Finance (RBC) and the Executive Director of Finance and Resources (BBFC) should remind staff to comply with timescales detailed in the agreed procedures and ensure there are controls in place that will highlight if / when there is non-conformance.</p> <p>Consideration should be given to including intercompany-tasks and responsibilities within the annual performance review goals / targets for relevant staff.</p> | Priority 2 | <p>Agreed. This will be re-iterated during the communication to staff and reinforced in the guidance / policy guidance.</p> <p>Staff will be notified of process changes, to reflect the new finance system once 'live'.</p> | <p>Financial Strategy and Planning Manager (Stuart Donnelly) RBC</p> <p>Strategic Finance Business Partner (Steve Davies) BFfC</p> | <p>June 2022</p> <p>October 2022</p> |
| 6 | <p>Work should continue to update, manage, and maintain the (RBC) grants register.</p> <p>Specific targets should be included in staff annual performance review targets to ensure that tasks are discussed regularly, and management are aware of any slippage.</p> <p>The register totals should be periodically compared and reconciled to BFfC records.</p> | Priority 3 | Agreed. | <p>Financial Strategy and Planning Manager (Stuart Donnelly) RBC</p> <p>Strategic Finance Business Partner (Steve Davies) BFfC</p> | June 2022 |

| Management Action Plan | | | | | |
|---|--|------------|--|--|-------------|
| Ref | Recommendation | Rec | Management Response | Responsible Officer(s) | Target Date |
| THERE IS A PERIODIC RECONCILIATION TO ENSURE MONIES OWED HAVE BEEN PAID/RECEIVED | | | | | |
| <i>RISK: Anomalies are not investigated and resolved promptly. The year-end process is laborious, time consuming, delayed, and inefficient.</i> | | | | | |
| 7 | <p>The Director of Finance (RBC) and the Executive Director of Finance and Resources (BFFC) need to establish co-ordinated monthly reconciliations, which should be compared for accuracy. Any anomalies should be investigated, agreed and adjustments made in a timely fashion.</p> <p>Responsibility for completing reconciliations should be allocated to an appropriate individual and include authorisation for any necessary adjustments.</p> | Priority 2 | Initially it is proposed to do quarterly reconciliations and to be reviewed at a later date. | <p>Financial Strategy and Planning Manager (Stuart Donnelly) RBC</p> <p>Strategic Finance Business Partner (Steve Davies) BFFC</p> | June 2022 |

4. FINDINGS

4.1 THERE IS AN AGREED AND DOCUMENTED SCHEDULE/PROTOCOL AND PROCEDURE(S) FOR INTERCOMPANY CHARGES

- 4.1.1 Best practice for intercompany accounting is to have agreed standardised and consistent systems, policies, and procedures with strong controls in data management. This is required to easily identify transactions across a common chart of accounts, to match transactions from both sides, and identify those for elimination from financial reporting to prevent double accounting.
- 4.1.2 There is both a service level agreement and a service contract in place between Reading Borough Council and Brighter Futures for Children however, the existence of the latter appears not to be well known. Documented procedures have been lacking until only recently (May 2021) when the document, '*RBC to BFFC Intercompany Transfer Guidance*' was produced by the (RBC) Interim Financial Planning Lead, in collaboration and consultation with (RBC) Finance Strategic and Planning Manager, (RBC) Business Partner and (BFFC) Strategic Finance Business Partner. R1, R2, R3
- 4.1.3 The guidance note explains the expectations around the transferring of funds such as types of funding, coding requirements and the use of a standard transfer template, and therefore can be classed as a procedure. An '*Intercompany Transfer Creation Process*' document written by the Exchequer Manager, dated 17 July 2021 was provided by the Financial Strategy and Planning Manager. There is notation in the document confirming this document has been signed off by a Chief Accountant.
- 4.1.4 It is right and proper that RBC (parent company) should lead on the development of such guidance and it is advisable to engage BFFC in its production to make use of the specialist knowledge and nuances of related funding and budgets.
- 4.1.5 Internal Audit have been advised that the ground-work has been put into developing the transfer guidance note, but Internal Audit have seen no evidence this has been formally reviewed or agreed by the Director of Finance or the Audit and Governance Committee, whose remit is to agree the Council's financial regulations and strategies or at Policy Committee who also provide oversight of strategy, policy and budgets.
- 4.1.6 Guidance and procedures should be produced with consideration to a strategic policy; whilst the service contract would provide some guidance the lack of awareness of its existence is somewhat concerning and it is likely that the Intercompany Transfer Guide was created without reference to it.
- 4.1.7 The Council's budget and medium-term financial strategy, presented to Policy Committee on 15th February 2021, stated that contract negotiations with BFFC were outstanding, however March's meeting included the presentation of BFFC's business plan which stated the contract sums had been agreed at contract negotiation stage. Therefore, we have ascertained that the contract sum had been negotiated and agreed.

- 4.1.8 We were advised by both entities that a consistent budget build process is not applied to both entities. Given that having standard and consistent processes is best practice it is advisable to establish what and why there are differences.
- 4.1.9 An excel spreadsheet forms the basis of the agreed payment schedule of the contract sum and the delegated schools grant (DSG) which are recorded as equal twelfths, and both entities have copies for their information.
- 4.1.10 The (RBC) Chief Accountant advised there are currently discussions between RBC and BFFC to identify an accounting process that will prevent further duplicate accounting of the DSG funding and will tag the income showing in both the grant code and the school codes, so that adjustments can be made when producing the end of year statement of accounts. R1, R2, R3
- 4.1.11 There are some grant funding streams (excluding the DSG), that are paid direct to BFFC, others are transferred from RBC to BFFC on submission of a reimbursement claim. The expected procedure is included in the guidance note, as are other anomaly payments such as staffing recharges and joint arrangement charges, however there are no specifics in terms of which staff and what apportionment basis will be used. R1, R2
- 4.1.12 In year amendments to the payment schedule are likely, given the Department for Education adjusts the level of DSG funding during the summer. There is no formal adjustment process, rather discussions happen as part of the 'regular' finance meetings between the two entities. R1, R3

4.2 ROLES AND RESPONSIBILITIES OF PARTIES ARE UNDERSTOOD, AGREED AND DOCUMENTED

- 4.2.1 Through discussion it has been ascertained there have been some key staffing changes since the commencement of the children's company, and where there was once a primary contact on both sides, this is no longer the case. R4
- 4.2.2 In the case of BFFC it seems the previous primary BFFC finance contact had a significant hands-on role which has, from the beginning of the current financial year, been shared amongst others. This is a positive step towards mitigating the risk of having a single point of failure when one person has all the knowledge and responsibility.
- 4.2.3 These staffing changes have caused some uncertainty over roles and responsibilities across each entity, and whilst BFFC has allocated specific areas of responsibility to individuals (grants, DSG and contract payments for example) there is some uncertainty in terms of the detail and communicating these responsibilities across both entities. R2, R4

- 4.2.4 Roles and responsibilities are less clear and more confused in the case of RBC. Defining and allocating roles and responsibilities within RBC may have been impacted by the significant amount of work done by existing staff that has been ongoing with closing of historic accounts and more recently in the procurement of a new finance system and filling of vacant posts. R4
- 4.2.5 Regular, at least monthly, meetings are held between RBC and BFFC finance partners. However, there are no terms of reference for this group nor are agendas or minutes taken. We were advised the purpose of these meetings is to discuss current issues. R3
- 4.2.6 Recently the issues discussed have been around the closing of the 20-21 accounts and agreeing a balancing figure of monies owed and monies due, on both sides. An agreed balancing figure of circa £3.2m has been documented in a letter from the Council's S.151 Officer, and these funds are in the process of being transferred to BFFC.

4.3 CORRECT AMOUNTS ARE TRANSFERRED ACROSS AND WITHIN AGREED TIMESCALES

- 4.3.1 The transfer guidance document and payment schedule quote the following timescales and coding:

| Type of Payment | Regularity | RBC Code | BFFC Code |
|--------------------------|----------------------|--|-----------|
| Contract payment | Monthly | R-5430 | B-3636 |
| SLA | Monthly | Various service codes | B-3613 |
| DSG | Monthly | R-5432 + ZA corporate code (was R-3995 but is now closed) | B-3995 |
| Grants - passported | 'Promptly' | R-5431 with use of FA codes to differentiate between grants | |
| Grants - other | BFFC to request | | |
| Statutory Staffing costs | Quarterly - recharge | R-5430 | |
| Joint arrangements | Year end | R-5430 | |

We can see from the above table the guidance is incomplete. R1, R2, R3

4.3.2 Testing payments (in the current financial year to October) found:

- All contract and SLA payments had been made monthly against individual invoice numbers to October 2021
- All DSG payments had been made although some had been miscoded to R-5431
- No grant payments had been requested/made
- There is currently £42.1m of grant receipts held in R-5431
- There has been no apportionment of statutory staffing costs to date
- Circa £84k of cash receipts are showing in R-5430 (contract payments)

4.3.3 To summarise, contract, SLA and DSG payments are being requested, paid, and received within agreed timescales but other payments are not. R5

4.4 **THERE IS APPROPRIATE CONSISTENT AND COMPLETE EVIDENCE TO SUPPORT, AUTHORISE AND IDENTIFY WHAT 'PAYMENTS' ARE FOR**

4.4.1 At the time of testing there had been 40 intercompany invoices raised by BFFC for payment by RBC and 42 invoices raised by RBC for payment by BFFC.

4.4.2 Each invoice was well supported with authorising email trails, system prints, excel calculations, a copy of the payment schedule and a completed transfer proforma (where applicable). This finding relates to post payment and any issues around supporting documentation would have been resolved. The Exchequer Manager advised that generally supporting evidence is good, but there remains an issue that the VAT code is not always included on the proforma, delaying the process. This brings into question the quality of the checking process and the understanding of the VAT treatment of different incomes in an intercompany transaction of those involved in the process. R1, R2,R4

4.4.3 Generally, testing found the line description sufficiently identified what the payment was for. This is a critical requirement as there is no system control to identify duplicate intercompany transactions. The control sits with both authorising officers to thoroughly check the payment request when authorising the payment. The Exchequer Manager advised that some limited manual checks are performed at the point of processing. This is another reason why transfer requests and payments should be made promptly and periodically reconciled. R7

4.4.4 The use of an instalment invoice could also provide an indication of whether a duplicate payment had been made and could reduce the processing time for the Accounts Payable team. R3

4.4.5 There are five official purchase orders raised by RBC with BFFC as the supplier, and four raised by BFFC with RBC as the supplier during the current financial year. This is not the expected method for requesting payments between the two entities, however it does provide (evidence of) the authority to pay. R2, R3

- 4.4.6 The authorising process could potentially be further improved by utilising a common SharePoint and the Approvals function which could allow electronic approval by more than one approver, i.e. one from each entity. R4
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4.5 THERE IS A PERIODIC RECONCILIATION TO ENSURE MONIES OWED HAVE BEEN PAID/RECEIVED

- 4.5.1 There is no policy, guidance, or documented process that refers to the need for periodic reconciliation. Whilst the intercompany transfer guidance does encourage 'regular' transfers, this is not happening for some types of payments. The primary benefits of timely payments and having assurance via periodic reconciliations would have the benefit of and result in the timely resolution of queries, which in turn would have a positive impact on the year-end process. R7
- 4.5.2 Through discussion there is ongoing monitoring of the receipt of contract and SLA payments, and DSG funding at BFFC. This is done by two Business Partners who monitor allocated cost centres to ensure these payments have been transferred.
- 4.5.3 Similarly, BFFC monitors the (RBC) grant code for receipts and records those monies received and outstanding for specific expected grants onto a grant register. BFFC Business Partners contribute grant funding details to the register and evidence such as the grant notification (to BFFC) is expected to be saved on the shared drive, to be used to 'claim' funding from RBC. Testing showed that no claims had been submitted during this financial year. R5
- 4.5.4 RBC receives the grant remittance slip(s) which are held and accessible only by RBC. RBC provide the transaction listing to enable (BFFC) monitoring. At the time of the audit the register showed BFFC had received £100k of £1.15m of grant funding in 2021-22, but this related to 2020-21 reserves. Therefore, none of the current year grant funding received in the grant cost centre has been transferred.
- 4.5.5 Despite being advised there was no grant register at RBC, the existence of one was highlighted during the closure meeting of the audit. We have been advised that the register was incomplete and out of date at hand over (March 2021) to the recently appointed owner. The reconciliation of 2020-21 grants is nearing completion (February 2022). We have been advised that grant documentation relating to 2021-22 has been saved and work on recording these to the grant register is commencing. R6, R7
- 4.5.6 This is another area where consideration for adopting a finance team specifically for intercompany transactions and accounting, professionally supported by entity specific finance teams, and/or a shared repository would benefit both entities. This would allow for more cooperative and transparent ways of working across both companies of the same organisation. R4