

Audit Committee – Supplementary agenda

A meeting of the Audit Committee will be held on:

Date: 29 September 2016

Time: 7.00pm

Venue: Meeting Room 2 - Level 3, Gun Wharf, Dock Road, Chatham ME4 4TR

Items

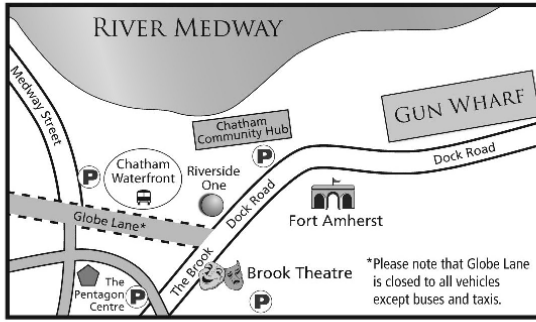
6. Annual Governance Report 2015/16

**(Pages
3 - 10)**

This addendum report updates the Committee on the latest position in respect of the on-going investigation into the objection received by the Auditor. It then summarises the changes required to the Statement of Accounts in order to secure an audit opinion.

For further information please contact Michael Turner, Democratic Services Officer on Telephone: 01634 332817 or Email: democratic.services@medway.gov.uk

Date: 28 September 2016



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AUDIT COMMITTEE
29 SEPTEMBER 2016
STATEMENT OF ACCOUNTS 2015/16
ADDENDUM REPORT

Report from: Phil Watts, Chief Finance Officer

Author: John Chance, Head of Finance Strategy

Summary

This addendum report updates Audit Committee on the latest position in respect of the on-going investigation into the objection received by the Auditor. It then summarises the changes required to the Statement of Accounts in order to secure an audit opinion.

1. Introduction

- 1.1 In the Independent Auditor's Report, which accompanied the Annual Governance Report in the original agenda despatch, the Auditor was prevented from issuing an opinion, pending on-going work in respect of the objection received regarding LOBO loans. He did however anticipate issuing an unqualified opinion in due course.
- 1.2 Following his investigation, the Auditor has been able to agree amendments to the notes to the Council's Statement of Accounts, which will enable him to issue an unqualified audit opinion.

2. Details of adjustments made and future actions

- 2.1 The Independent Auditors Report (appendix 1) outlines the legal duties of the external auditor, provides an opinion on the accounts and stipulates any outstanding arrangements which prevent the certificate from being finalised at this stage.
- 2.2 In order to assist the Auditor in arriving at the unqualified opinion referred to in the revised Independent Auditor's Report, officers have made amendments to notes 19 and 34 of the Statement of Accounts and these are attached at appendix 2. The adjustments concern the treatment of the Council's LOBO loans. Paragraph 4.2.1 of the Annual Governance Report (agenda item 6) explains the issue in more detail.

- 2.3 In order to legitimise the adjustments made to these two notes, Council will need to review the Treasury Management Strategy. The revised strategy will need to amend the proportions of loans permitted at fixed and variable rates respectively and the application of these limits in respect of LOBO loans. A revised Treasury Management Strategy will be taken to full Council on 23 February 2017.

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Appendices

Appendix 1 – Auditor’s Opinion on the Council’s Financial Statements

Appendix 2 – Revised Notes to the Statement of Accounts

Background Papers

None

INDEPENDENT AUDITOR'S REPORT TO THE MEMBERS OF MEDWAY COUNCIL

Opinion on the Council's financial statements

We have audited the financial statements of Medway Council for the year ended 31 March 2016 under the Local Audit and Accountability Act 2014. The financial statements comprise the Movement in Reserves Statement, the Comprehensive Income and Expenditure Statement, the Balance Sheet, the Cash Flow Statement, the Collection Fund Statement, the Housing Revenue Account Income and Expenditure Statement and the Movement on the Housing Revenue Account Statement and the related notes. The financial reporting framework that has been applied in their preparation is applicable law and the CIPFA/LASAAC Code of Practice on Local Authority Accounting in the United Kingdom 2015/16.

This report is made solely to the members of Medway Council in accordance with Part 5 of the Local Audit and Accountability Act 2014 and for no other purpose, as set out in the Statement of Responsibilities of Auditors and Audited Bodies within Chapter 2 of the Code of Audit Practice published by the National Audit Office in April 2015. Our work has been undertaken so that we might state to the members of the Council those matters we are required to state to them in an auditor's statement and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the Council and the Council's members as a body, for our audit work, for this report, or for the opinions we have formed.

Respective responsibilities of the Chief Finance Officer and auditor

As explained more fully in the Statement of the Chief Finance Officer's Responsibilities, the Chief Finance Officer is responsible for the preparation of the Statement of Accounts, which comprises the financial statements, in accordance with proper practices as set out in the CIPFA/LASAAC Code of Practice on Local Authority Accounting in the United Kingdom, and for being satisfied that the financial statements give a true and fair view. Our responsibility is to audit and express an opinion on the financial statements in accordance with applicable law and International Standards on Auditing (UK and Ireland). Those standards require us to comply with the Auditing Practices Board's Ethical Standards for Auditors.

Scope of the audit of the financial statements

An audit involves obtaining evidence about the amounts and disclosures in the financial statements sufficient to give reasonable assurance that the financial statements are free from material misstatement, whether caused by fraud or error. This includes an assessment of: whether the accounting policies are appropriate to the Council's circumstances and have been consistently applied and adequately disclosed; the reasonableness of significant accounting estimates made by the Chief Finance Officer; and the overall presentation of the financial statements. In addition, we read the financial and non-financial information in the Narrative Report and Annual Governance Statement to identify material inconsistencies with the audited financial statements and to identify any information that is apparently materially incorrect based on, or materially inconsistent with, the knowledge acquired by us in the course of performing the audit. If we become aware of any apparent material misstatements or inconsistencies we consider the implications for our report.

Opinion on financial statements

In our opinion the financial statements:

- give a true and fair view of the financial position of Medway Council as at 31 March 2016 and of its expenditure and income for the year then ended; and

- have been prepared properly in accordance with applicable law and the CIPFA/LASAAC Code of Practice on Local Authority Accounting in the United Kingdom 2015/16.

Opinion on other matters

In our opinion, the information given in the Narrative Report and Annual Governance Statement for the financial year for which the financial statements are prepared is consistent with the financial statements.

Matters on which we report by exception

We have nothing to report in respect of the following other matters which the Code of Audit Practice (April 2015) requires us to report to you if:

- the Annual Governance Statement is misleading or inconsistent with other information that is forthcoming from the audit;
- we issue a report in the public interest;
- we designate under section 24 of the Local Audit and Accountability Act 2014 any recommendation as one that requires the Council to consider it at a public meeting and to decide what action to take in response;
- we make an application to the court for a declaration that an item of account is contrary to law under Section 28 of the Local Audit and Accountability Act 2014;
- we issue an advisory notice under Section 29 of the Local Audit and Accountability Act 2014; or
- we make an application for judicial review under Section 31 of the Local Audit and Accountability Act 2014.

Conclusion on the Council's arrangements for securing economy, efficiency and effectiveness in the use of resources

Respective responsibilities of the Council and auditor

The Council is responsible for putting in place proper arrangements to secure economy, efficiency and effectiveness in its use of resources, to ensure proper stewardship and governance, and to review regularly the adequacy and effectiveness of these arrangements.

We are required under Section 20 of the Local Audit and Accountability Act 2014 to satisfy ourselves that the Council has made proper arrangements for securing economy, efficiency and effectiveness in its use of resources. The Code of Audit Practice issued by the National Audit Office requires us to report to you our conclusion relating to proper arrangements, having regard to relevant criteria specified by the National Audit Office.

We report if significant matters have come to our attention which prevent us from concluding that the Council has put in place proper arrangements for securing economy, efficiency and effectiveness in its use of resources. We are not required to consider, nor have we considered, whether all aspects of the Council's arrangements for securing economy, efficiency and effectiveness in its use of resources are operating effectively.

Scope of the review of arrangements for securing economy, efficiency and effectiveness in the use of resources

We have undertaken our audit in accordance with the Code of Audit Practice, having regard to the guidance on the specified criteria, published by the National Audit Office in November 2015, as to whether in all significant respects, the Council had proper

arrangements to ensure it took properly informed decisions and deployed resources to achieve planned and sustainable outcomes for taxpayers and local people.

The National Audit Office has determined this criterion as that necessary for us to consider under the Code of Audit Practice in satisfying ourselves whether the Council put in place proper arrangements for securing economy, efficiency and effectiveness in its use of resources for the year ended 31 March 2016.

We planned our work in accordance with the Code of Audit Practice. Based on our risk assessment, we undertook such work as we considered necessary to form a view on whether, in all significant respects, the Council had put in place proper arrangements to secure economy, efficiency and effectiveness in its use of resources.

Conclusion

On the basis of our work, having regard to the guidance on the specified criterion published by the National Audit Office in November 2015, we are satisfied that, in all significant respects, Medway Council put in place proper arrangements to secure economy, efficiency and effectiveness in its use of resources for the year ended 31 March 2016.

Delay in certification of completion of the audit

We cannot formally conclude the audit and issue an audit certificate until we have completed the work necessary to:

- issue our assurance statement in respect of the Council's Whole of Government Accounts consolidation pack;
- conclude on an objection to the accounts received from a local government elector relating to the lawfulness of Lender Option, Borrower Option (LOBO) loans. This issue is referred to in note 34 to the financial statements.

We are satisfied that these matters do not have a material effect on the financial statements or on our value for money conclusion.

David Eagles
For and on behalf of BDO LLP, Appointed Auditor

Ipswich, UK

30 September 2016

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REVISED NOTES TO THE STATEMENT OF ACCOUNTS

19. Nature and Extent of Risks Arising from Financial Instruments – Interest Rate Risk (G3 – Notes Supporting the Balance Sheet – agenda page 181)

The Authority has a number of strategies for managing interest rate risk. The Annual Treasury Management Strategy draws together Authority's prudential and treasury indicators and its expected treasury operations, including an expectation of interest rate movements. From this Strategy a treasury indicator is set which provides maximum limits for fixed and variable interest rate exposure. Current Authority policy is to not exceed a maximum of 40% of borrowings in variable rate loans.

The Authority has a mixture of standard fixed rate borrowings and LOBO (lender option borrower option) loans. The LOBO loans were taken out between 2003 and 2008 with maturity periods of between 35 and 60 years. The interest rates payable on these loans could be changed at specified dates during the life of the loan at the lender's option. The specified dates vary from loan to loan but occur at intervals of between six months and five years from the initial advance according to the individual loan contract. If a lender chose to vary the interest payable then the Authority would have the option to repay the loan without penalty. In practice the lender would only exercise their option if market rates were to increase above the current rate.

The Authority's long-term and current borrowing can be analysed as follows:

Borrowing Analysis	Fixed or Variable Rate	Borrowing as at 31 March 2016
Long-Term Borrowing:		£'000
PWLB Loans (Principal)	Fixed	60,524
LOBO Loans (Principal)	Variable	101,800
Other Loans & Accounting Adjustments	Fixed	9,202
Total Long-Term Borrowing		171,526
Current Borrowing:		
Other Local Authorities	Fixed	9,183
Other Short Term Borrowing & Accrued Interest	Fixed	88
Total Short Term Borrowing		9,271

Other loans and accounting adjustments (£9,202,000) includes an accounting adjustment of £1,704,158 in respect of LOBO loans. This technical accounting adjustment represents the cash benefit obtained by paying lower interest payments over a specified initial period on some of the LOBO loans. The adjustment is shown in the balance sheet as an addition to the value borrowed but is reduced by way of a credit to the income and expenditure account each year over the full term of the relevant loans. The adjustment has been included above as being at fixed rates because the value will not be affected even if the LOBO lenders exercise their option to change the rates of interest on the underlying loans.

During periods of falling interest rates, and where economic circumstances make it favourable, fixed rate loans will be repaid early to limit exposure to losses. The risk of loss is ameliorated by the fact that a proportion of government grant payable on financing costs will normally move with prevailing interest rates or the Authority's cost of borrowing and provide compensation for a proportion of any higher costs.

The treasury management team has an active strategy for assessing interest rate exposure that feeds into the setting of the annual budget, this strategy is then used to monitor against the budget throughout the year. This allows for any adverse changes to be accommodated. The analysis will also advise if new borrowing is taken out whether it is fixed or variable.

34. Contingent Liabilities (G5 – Other Notes – agenda page 203)

At 31 March 2016, the Authority had the following significant contingent liabilities:

A group of property search companies is seeking the refund of fees paid to the Council to access land charges data. The parties have agreed to pay the property search companies legal costs to be subject to a detailed assessment by way of costs only proceedings if not agreed. The council is in discussion with the claimants about the costs aspect of the claim. At present it is not possible to put a final value on these potential liabilities but the Council estimates the contingent liability at £100,000.

The Council has £101.8m of Lender Option Borrower Option loans (LOBOs), taken out between 2003 to 2008, with terms of 30 to 60 years. Information on the Council's borrowings, including LOBO loans, is included in Note 18. A number of local authorities, including this Council, have received objections from local electors as to the lawfulness of local authorities obtaining borrowings through LOBO loans. Whilst the LOBO loans held by this Council have not currently been found to be unlawful, there is on-going analysis of LOBOs generally by councils affected, their auditors and specialist lawyers. The law in relation to this matter is complex and there is uncertainty as to what the consequences could be should a local authority have obtained borrowing through a LOBO that was found to be unlawful. In the event of a LOBO loan being found to be unlawful, restitutionary remedies may result in the outstanding balances on these loans having to be repaid in full to the lender and may result in additional costs resulting from losses incurred by the lender.