

AUDIT COMMITTEE
29 SEPTEMBER 2016
ANNUAL GOVERNANCE REPORT 2015/16

Report from: Phil Watts, Chief Finance Officer

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Summary

This report considers the issues raised in the Council's External Auditor's Annual Governance Report, which incorporates the findings following the 2015/16 audit of the Statement of Accounts.

The Accounts and Audit Regulations 2015 (as amended) require that the Audit Committee consider these issues prior to publication by 30 September 2016.

1. Budget and Policy Framework

- 1.1 The Audit Commission's Code of Audit Practice and International Standard of Auditing (ISA 260) requires the results of the audit to be reported to those charged with governance. This Committee has been delegated with the responsibility for considering these reports and agreeing the Council's response. In addition, the Committee, on behalf of the Council, must explain reasons for not adjusting the Statement of Accounts for the issues raised within the auditor's report. All amendments to factual data have been made.
- 1.2 The Accounts and Audit Regulations 2015 (as amended) require that the Audit Committee consider these issues prior to 30 September 2016.

2. Background

- 2.1 The draft Statement of Accounts for 2015/16 was considered and approved by this Committee on 30 June 2016. At that stage the accounts were subject to final verification and Members were advised that any proposed changes as a result of the audit would be reported at a later stage.
- 2.2 The audit commenced in mid July and together with the audits of various grant claims has continued through September. An objection to the statement of accounts was received by the external auditor. This is detailed within the Auditor's Annual Governance Report attached at Appendix 1 to this report, however the issue is still being investigated. The Auditor will update Audit Committee on progress at the meeting on 29 September 2016.

3. Auditors Report 2015/16

3.1 The Auditor's Annual Governance Report (AGR) is attached at Appendix 1 and contains the Auditor's review of:

- Financial Statements;
- Control Environment;
- Governance Reporting;
- Whole of Government Accounts (WGA);
- Use of Resources; and
- Associated appendices.

3.2 Management's response to the issues raised is included in the Appendix III of the AGR.

4. Financial Statements

4.1 The overview of the AGR states that, subject to satisfactory conclusion of outstanding work, an **unqualified** audit opinion will be issued in relation to the financial statements. However, the main issues arising from the audit are summarised in paragraph 4.2 below. Section 4.2.1 explains the omission of an audit opinion at this stage.

4.2 Accounting practices and financial reporting

4.2.1 Material errors: The Auditor has received an objection relating to the lawfulness of the decision to borrow monies through Lender Offer, Borrower Offer "LOBO" loans and whether:

- Local authorities are able to take out LOBO loans
- It was reasonable to take this form of borrowing
- The advisors were acting independently and were not conflicted by commissions received.

4.2.1.1 The Auditor has requested information from the Council to support the decisions to take out LOBO loans between 2003 and 2008, totalling £102 million.

4.2.1.2 Legal advice obtained by the Auditor suggests that, whilst LOBOs are not inherently illegal, their legality is dependent upon the nature and basis of the decision to take out the loans. Should they conclude that Medway's LOBOs are illegal, there is a possibility (which would be determined by the Courts) that restitution for the lender could be required. By way of context some 240 local authorities currently hold LOBOs and 24 of these have received objections to their accounts.

4.2.1.3 The potential need for amendments to the 2015/16 accounts in the form of a contingent liability is being considered.

4.2.1.4 The Auditor is unable to provide an opinion on the financial statements until they have been able to conclude this work.

4.2.2 Non-Trivial errors: There were a few non-trivial errors within the Statement of Accounts which have, for the most part, now been corrected.

4.2.3 Trivial errors: The AGR does not set out trivial errors found during the audit. However, officers have adjusted the accounts to recognise all trivial errors.

4.3 Annual Governance Statement

- 4.3.1 The Auditor is satisfied that the Annual Governance Statement is consistent with the financial statements and complies with “Delivering Good Governance in Local Government” (CIPFA/SOLACE)

5. Use of Resources

- 5.1 The Auditor is required to satisfy himself that, 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.
- 5.2 The Auditor will be issuing an unqualified value for money conclusion as indicated in the AGR.

6. Management Representations Letter

- 6.1 To comply with regulations, the Chief Finance Officer of the local authority must provide the external auditors with a signed declaration which supports their work in relation to the audit of the annual accounts.
- 6.2 The Draft Management Representations Letter is attached at Appendix VII of the AGR and the Committee is required to consider the content of the letter in the context of the issues raised in this report. Once agreed, the letter will be submitted to the Auditor.

7. Audit Fees

- 7.1 The final audit fee is £152,307 consisting of £142,451 audit fees and £9,856 certification fees. These fees are broadly in line with the report to this committee on 19 March 2015.

8. Financial and Legal Implications

- 8.1 The financial implications are contained within the body of the report.
- 8.2 Auditors are required to comply with the Statement of Auditing Standards, and thus provide an opinion on the Council’s Statement of Accounts.
- 8.3 The legal implications are set out in the body of the report.

9. Audit Completion

- 9.1 The Auditor has indicated that they will not be able to issue an audit opinion by 30 September 2015.

10. Risk Management

- 10.1 There is a risk around the outcome of the Auditor’s investigation into the objection received in relation to the lawfulness of the decision to borrow monies through LOBO loans.

11. Recommendations

- 11.1 That the Audit Committee notes the issues raised and judgements made by the Auditor as presented in Appendix 1, and agrees the proposed response as set out at Appendix III to the External Auditor's Annual Report to the Audit Committee.
- 11.2 That the Audit Committee approve the Statement of Accounts, subject to finalising any necessary disclosures relating to the LOBOs, as set out in Appendix 1.
- 11.3 That the Audit Committee agree the Management Representations Letter, attached at Appendix VII of the External Auditor's Annual Report to the Audit Committee.

Background papers

Medway Council's Draft Statement of Accounts for 2015/2016

Report on Draft Statement of Accounts to this Committee 30 June 2016

<https://democracy.medway.gov.uk/mgconvert2pdf.aspx?id=31566>

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