

APPENDIX B

INDEPENDENT AUDITOR'S REPORT TO THE MEMBERS OF SPELTHORNE BOROUGH COUNCIL REPORT ON THE AUDIT OF THE FINANCIAL STATEMENTS

Opinion

We have audited the financial statements of Spelthorne Borough Council ('the Authority') for the year ended 31 March 2018 which comprise the Authority and Group Comprehensive Income and Expenditure Statements, the Authority and Group Balance Sheets, the Authority and Group Movement in Reserves Statements, the Authority and Group Cash Flow Statements, the Collection Fund, the related notes, and the Statement of Accounting Policies note.

In our opinion the financial statements:

- give a true and fair view of the financial position of the Authority and the Group as at 31 March 2018 and of the Authority's and the Group's expenditure and income for the year then ended; and
- have been properly prepared in accordance with the CIPFA/LASAAC Code of Practice on Local Authority Accounting in the United Kingdom 2017/18.

Basis for opinion

We conducted our audit in accordance with International Standards on Auditing (UK) ("ISAs (UK)") and applicable law. Our responsibilities are described below. We have fulfilled our ethical responsibilities under, and are independent of the Authority in accordance with, UK ethical requirements including the FRC Ethical Standard. We believe that the audit evidence we have obtained is a sufficient and appropriate basis for our opinion.

Going concern

We are required to report to you if we have concluded that the use of the going concern basis of accounting is inappropriate or there is an undisclosed material uncertainty that may cast significant doubt over the use of that basis for a period of at least twelve months from the date of approval of the financial statements. We have nothing to report in these respects.

Other information published with the financial statements

The Chief Finance Officer is responsible for the other information published with the financial statements, including the Narrative Statement and the Annual Governance Statement. Our opinion on the financial statements does not cover the other information and, accordingly, we do not express an audit opinion or, except as explicitly stated below, any form of assurance conclusion thereon.

Our responsibility is to read the other information and, in doing so, consider whether, based on our financial statements audit work, the information therein is materially misstated or inconsistent with the financial statements or our audit knowledge. Based solely on that work we have not identified material misstatements in the other information. In our opinion the other information published with the financial statements for the financial year is consistent with the financial statements.

Chief Finance Officer's responsibilities

As explained more fully in the statement set out on page 13, the Chief Finance Officer is responsible for the preparation of the Authority's 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 2017/18. They are also responsible for: such internal controls as they determine is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error; assessing the Authority's and the Group's ability to continue as a going concern, disclosing, as applicable, matters related to going concern; and using the going concern basis of accounting on the assumption that the functions of the Authority and the Group will continue in operational existence for the foreseeable future.

Auditor's responsibilities

Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue our opinion in an auditor's report. Reasonable assurance is a high level of assurance, but does not guarantee that an audit conducted in accordance with ISAs (UK) will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of the financial statements.

A fuller description of our responsibilities is provided on the FRC's website at www.frc.org.uk/auditorsresponsibilities.

REPORT ON OTHER LEGAL AND REGULATORY MATTERS

Report on the Authority's arrangements for securing economy, efficiency and effectiveness in its use of resources

Adverse conclusion

On the basis of our work, having regard to the guidance issued by the Comptroller and Auditor General in November 2017, we are not satisfied that, in all significant respects, Spelthorne Borough Council put in place proper arrangements to secure economy, efficiency and effectiveness in its use of resources for the year ended 31 March 2018.

Basis for adverse conclusion

During the course of 2017/18, the Authority borrowed over £225 million from the PWLB to fund the purchase of three properties located outside of the Borough as commercial property investments. The purpose of these purchases was to generate income for the Authority, on the basis that the rental income received from these properties would exceed the costs (including the costs of borrowing).

Our review of the processes in place for these acquisitions found that the audit trail was poor and long-term loans were used to purchase the properties, which significant exceeded the lease terms with tenants.

We also found that, at the time of the three acquisitions, the Authority had inadequate governance arrangements in place, exposing the Authority to a potentially high level of financial risk.

Based on the information we reviewed, we could not establish that the Authority had appropriate strategy, processes, and governance arrangements in place prior to investing in commercial real estate. Gaps that we have identified include:

- a lack of a defined investment strategy at the time of making the acquisitions.
- a lack of diversification in the investments;
- significant inconsistencies between the time horizon in the financial model (20 years), the debt term (50 years) and the leases (<20 years). More than £468 million of the Authority's loans are structured for repayment between 21 and 50 years as at 31 March 2018; and
- no long-term strategy underpinning the acquisitions so that risks such as diversification, liquidity, correlation and systematic risk are managed across the whole investment portfolio;
- at the time the acquisitions were made, there was a lack of in-house expertise and investment authorisation processes to invest in commercial real estate;

There are also number of financial issues that the Authority needs to address to help ensure it remains financially sustainable. The financial models that were developed by the Authority were simplistic in nature and did not follow industry best practice. Whilst we consider that the Authority was earning sufficient rental income to meet its loan obligations in the short term, we are concerned that this may not be the case in the medium to longer term.

Having considered these matters we have concluded that the Authority did not have proper arrangements in place to take properly informed decisions and deploy its resources to achieve planned and sustainable outcomes for taxpayers and local people in the year ended 31 March 2018.

Respective responsibilities in respect of our review of arrangements for securing economy, efficiency and effectiveness in the use of resources

The Authority 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(1) (c) of the Local Audit and Accountability Act 2014 to satisfy ourselves that the Authority has made proper arrangements for securing economy, efficiency and effectiveness in its use of resources. We report if significant matters have come to our attention which prevent us from concluding that the Authority 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 Authority's arrangements for securing economy, efficiency and effectiveness in its use of resources are operating effectively.

We have undertaken our review in accordance with the Code of Audit Practice, having regard to the guidance on the specified criterion issued by the Comptroller and Auditor General in November 2017, as to whether Spelthorne Borough 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 Comptroller and Auditor General determined this criterion as that necessary for us to consider

under the Code of Audit Practice in satisfying ourselves whether Spelthorne Borough Council put in place proper arrangements for securing economy, efficiency and effectiveness in its use of resources for the year ended 31 March 2018.

Statutory reporting matters

The Code of Audit Practice requires us to report to you if:

- any recommendations have been made under Section 24 of the Local Audit and Accountability Act 2014;
- an application has been made 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;
- an advisory notice has been issued under Section 29 of the Local Audit and Accountability Act 2014;
- an application for judicial review has been made under Section 31 of the Local Audit and Accountability Act 2014.

We have nothing to report in these respects

Report in the Public interest

The Code of Audit Practice also requires us to report to you if any matters have been reported in the public interest under Section 24 of the Local Audit and Accountability Act 2014 in the course of, or at the conclusion of, the audit.

On 30 November 2022, we issued a report in the public interest under Section 24 and Schedule 7 of the Local Audit and Accountability Act 2014 to the Authority. The report raised significant concerns identified in our role as independent auditor to the Authority regarding the Authority's programme of investment in commercial properties and the implications of those transactions for its overall finances. In particular, these concerns arose from the purchase of three commercial properties during the financial year 2017/18.

THE PURPOSE OF OUR AUDIT WORK AND TO WHOM WE OWE OUR RESPONSIBILITIES

This report is made solely to the members of the Authority, as a body, in accordance with Part 5 of the Local Audit and Accountability Act 2014. Our audit work has been undertaken so that we might state to the members of the Authority, as a body, those matters we are required to state to them in an auditor's report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the members of the Authority, as a body, for our audit work, for this report, or for the opinions we have formed.

CERTIFICATE OF COMPLETION OF THE AUDIT

We certify that we have completed the audit of the financial statements of Spelthorne Borough Council in accordance with the requirements of the Local Audit and Accountability Act 2014 and the Code of Audit Practice.

Joanne Lees
for and on behalf of KPMG LLP, Statutory Auditor
Chartered Accountants
15 Canada Square, London E14 SGL

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