



Spelthorne Borough Council

Combined Annual Audit Letters for the years ended: 31 March 2019 and 31 March 2020 and
Auditor's Annual Reports for the years ended: 31 March 2021, 31 March 2022 and 31 March 2023

Report to the Audit Committee

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Purpose of the Annual Audit Letter and Auditor's Annual Report

This summarises the key issues arising from the work that we have carried out in respect of the years ended 31 March 2019 to 31 March 2023.

We are required to issue an Annual Audit Letter for the years ended 31 March 2019 and 31 March 2020 and issue an Auditor's Annual Report for the years ended 31 March 2021, 31 March 2022 and 31 March 2023. We have included our findings in a combined report as many of the issues found cover more than one year.

It is addressed to the Council but is also intended to communicate the key findings we have identified to key external stakeholders and members of the public.

Responsibility of auditors and the Council

It is the responsibility of the Council to ensure that proper arrangements are in place for the conduct of its business and that public money is safeguarded and properly accounted for.

Our responsibility is to plan and carry out an audit that meets the requirements of the National Audit Office's (NAO's) Code of Audit Practice (the Code). Under the Code, we are required to report:

- Our opinion on the Council's financial statements
- Whether the Council has made proper arrangements for securing economy, efficiency and effectiveness in its use of resources.

Circumstances that have affected our work

There has been a deterioration in the timeliness of local audit in recent years leading to a persistent and significant backlog of audit opinions. Across England, the backlog of outstanding audit opinions stood at 771 at 31 December 2023 and increased to almost 1,000 at 30 September 2024. In February 2024, the Department for Levelling Up, Housing and Communities published 'Local audit delays: Joint statement on update to proposals to clear the backlog and embed timely audit'.

This joint statement confirmed that:

"The issues facing local audit are widely recognised as multi-faceted and complex with no single cause or solution".

The factors contributing to the delay in issuing audit opinions on the financial statements of Spelthorne Borough Council include, but are not limited to:

- Increased regulator expectations on auditors
- Difficulties in attracting, developing and retaining staff to perform local audit work
- Impact of the Covid-19 pandemic
- Delayed conclusion of the 2017/18 financial statements audit and value for money work by the predecessor auditor.

During 2024, organisations involved in the regulation and oversight of local body financial reporting and audit worked collectively to agree a proposed solution to clear the outstanding historical audit opinions and ensure that delays do not return.

To clear the backlog of historical accounts and 'reset' the system, the Accounts and Audit (Amendment) Regulations 2024 required local bodies to publish audited financial statements for all outstanding years up to and including 2022/23 by 13 December 2024 ('the backstop date'). In addition, the National Audit Office made changes to the Code of Audit Practice to require local auditors to comply with backstop dates by giving their opinions in time for audited accounts to be published.

The backstop date created time constraints that prevented us from completing all necessary procedures to obtain sufficient, appropriate audit evidence to support the opinion and fulfil the objectives of auditing standards. Therefore, the backstop date created circumstances which required us to modifying our opinion on Spelthorne Borough Council's financial statements.

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Audit Conclusions

Audit opinions on the Council's financial statements

The Accounts and Audit (Amendment) Regulations 2024 require Spelthorne Borough Council to publish audited financial statements for all years to 31 March 2023 by 13 December 2024.

We were not able to obtain all the necessary audit evidence upon which to form an opinion since there was insufficient time to perform all necessary audit procedures by that date. As a result, we were unable to conclude that Spelthorne Borough Council's financial statements for the years ended 31 March 2019, 31 March 2020, 31 March 2021, 31 March 2022 and 31 March 2023 as a whole were free from material misstatement. We concluded that the possible effects on the financial statements of undetected misstatements arising from this matter could be both material and pervasive.

Therefore, we issued a disclaimer of opinion on the financial statements for each of the five years referred to in the previous paragraph on 13 December 2024.

When we disclaim an opinion on the financial statements, we are required to describe in our opinion the reasons for any other matters of which we are aware that would have required a modification to the opinion and the effects thereof.

For the years ending 31 March 2020, 31 March 2021, 31 March 2022 and 31 March 2023 our opinions on the financial statements included details of material inconsistencies between comparative figures in that year's financial statements and corresponding figures in the prior year financial statements. The financial statements did not include any information explaining these inconsistencies and it is unclear whether they were identified by officers during the production of the financial statements.

Conclusion on the Council's use of resources

Our work on the Council's value for money arrangements identified significant weaknesses in a number of areas.

We were unable to conclude that, in all significant respects, the Council had put in place proper arrangements to secure economy, efficiency and effectiveness in its use of resource for the years ended 31 March 2019, 31 March 2020, 31 March 2021, 31 March 2022 and 31 March 2023.

Further information on the weaknesses identified are included on page 6 onwards.

As required by the 2015 Code of Audit Practice, we issued an adverse conclusion on the Council's use of resources for the years ended 31 March 2019 and 31 March 2020 on 25 September 2025.

The 2024 Code of Audit Practice removed the requirement to issue a separate conclusion on the Council's use of resources and our findings, including the significant weaknesses on arrangements identified, are reported in this Annual Auditor's Report.

Audit Certificate

We issued our audit certificates for the completion of the audits for each year on 25 September 2025.

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Audit opinion on the financial statements

We issued a disclaimer of opinion on the financial statements for the years ended 31 March 2019, 31 March 2020, 31 March 2021, 31 March 2022 and 31 March 2023. because of the conditions created by the backstop arrangements described on pages 3 and 4.

In the remainder of this report, we quote both financial and non-financial information from various sources, including the Council's Statement of Accounts for the year's ended 31 March 2019, 31 March 2020, 31 March 2021, 31 March 2022 and 31 March 2023. For the avoidance of doubt, we have not completed any audit work in respect of any information quoted from these Statement of Accounts and its inclusion in this report should not be used to infer otherwise.



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Scope

We are required to be satisfied that proper arrangements have been made to secure economy, efficiency and effectiveness in the use of resources (value for money).

When performing our value for money work, we are required to have regard to the Code of Audit Practice and other guidance issued by the NAO. Due to the circumstances described on pages 3 and 4, the guidance which describes the matters we are required to consider have changed, as has the way in which we report these matters.

Value for money (2018/19 and 2019/20)

For the years ending 31 March 2019 and 31 March 2020, we are required to report to you on an 'except for' basis. This is based on the following reporting criterion (as determined by the 2015 Code of Audit Practice):

"In all significant respects, the audited body had proper arrangements to ensure it took properly informed decisions and deployed resources to achieve planned and sustainable outcomes for taxpayers and local people".

There are three sub-criteria that we consider as part of our overall risk assessment:

- Sustainable resource deployment
- Informed decision making
- Working with partners and other third parties.

We have issued an adverse conclusion on the Council's arrangements for securing economy efficiency and effectiveness.

This means that we have been unable to conclude 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.

Value for money (2020/21, 2021/22 and 2022/23)

The 2024 Code of Audit Practice reduced the scope of our value for money work for the years ending 31 March 2021, 31 March 2022 and 31 March 2023. The sub-criteria we are required to consider were amended by Schedule 3 of the 2024 Code of Audit Practice to the following:

- Financial sustainability
- Governance
- Other matters that have come to our attention.

The way in which we report our findings for the years ending 31 March 2021, 31 March 2022 and 31 March 2023 has also changed. Instead of issuing a conclusion on the Council's arrangements for securing value for money, we present a narrative commentary on our findings and, where appropriate, make recommendations regarding any significant weaknesses in arrangements identified.

The changes introduced by the 2024 Code of Audit Practice also permit auditors to combine the reporting for multiple years into one document, which we have done in this report.

We set out the context in which our value for money work has taken place on the following pages.



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Context and background

The Council has acquired a significant commercial property portfolio in recent years. The programme of commercial investment commenced in September 2016 with the purchase of BP's Headquarters at Sunbury for £385 million. To finance the purchase the Council drew down loans of £405 million, all of which were provided by the PWLB.

The predecessor auditor (KPMG) raised concerns regarding the governance arrangements in relation to this purchase, ultimately leading to an adverse use of resources conclusion for 2016/17. KPMG's intention to issue an adverse conclusion was verbally reported to the Audit Committee at its meeting on 26 July 2018. The work supporting the conclusion was not concluded until early 2019, with findings reported to the Audit Committee on 5 February 2019. In summary, the reasons for adverse conclusion were as follows:

- An inadequate trail supporting the decision-making process underpinning the purchase leading to uncertainty whether all associated risks had been properly considered
- No scenario analysis to determine the financial impact were BP not to renew its lease or agree different lease terms
- Failure by the Council to publish the associated decision made by the Chief Executive in a timely manner as required by legislation.

The minutes of the Audit Committee on 5 February 2019 record that the Council disagreed with the findings. The Council's detailed responses to the recommendations raised by KPMG are included in the External Audit Report 2016/17.

The Council made further acquisitions of commercial property during 2017/18 (purchase price in brackets):

- 3 Roundwood Avenue, Stockley Park in July 2017 (£21.4 million)
- World Business Centre 4, Heathrow in September 2017 (£47.2 million)
- 12 Hammersmith Grove, Hammersmith, London in January 2018 (£160 million)

These acquisitions were financed by PWLB loans totalling £225 million.

KPMG performed work on the arrangements relating to the acquisitions made in 2017/18, culminating in a Public Interest Report (PIR) issued in November 2022 and a second adverse conclusion on the Council's use of resources for that financial year.

While work on the PIR was ongoing, the Council purchased its final tranche of commercial properties in August 2018, comprising the following (purchase price in brackets):

- The Charter Building, Uxbridge (£136 million)
- Thames Tower, Reading (£119 million)
- The Porter Building, Slough (£66 million)

The Council borrowed £332 million from the PWLB to finance the purchases.



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The Council's 2016-2019 Corporate Plan set out Housing and Economic Development as two strategic priorities for the Council. To support delivery of these priorities, the Council also commenced a programme of property acquisitions to facilitate the creation of additional housing and regeneration of town centres within the borough. The first of these took place July 2018, when Communications House in Staines was purchased for £11 million.

The commercial and regeneration property acquisitions completed in 2018/19 were financed by PWLB borrowing.

Following publication of the PIR, the Department for Levelling Up, Housing and Communities (DLUHC, now MHCLG) commissioned a review into the Council's indebtedness (undertaken by CIPFA). The scope of this review set out the following areas of focus:

- An assessment of the Council's financial risk due to its profile of investments and debt (current and planned)
- An assessment of the Council's capacity, capability and arrangements for managing its investment and debt risks, and whether these are sufficient and appropriate for the council's activity
- An assessment of actions the Council can reasonably take to reduce its debt and commercial exposure, or other actions it can take, with respect to reducing its overall level of risk over the short, medium and long-term.

This review was completed in March 2023 and the report was shared with the Council (via DLUHC) in July 2023.

The review raised a number of concerns.

In response, DLUHC initiated a Best Value Inspection in May 2023. This concluded in February 2025 and the report was published by the government on 17 March 2025.

In addition to the above, the Council also commissioned two Local Government Association (LGA) Peer Challenge reviews. The first of these took place in 2020 and focused on corporate finance. The second took place in 2022 and looked at a range of areas across the Council.

For the reasons set out on pages 3 and 4 of this report, our value for money work in relation to arrangements in place during the years ended 31 March 2019, 31 March 2020, 31 March 2021, 31 March 2022 and 31 March 2023 did not commence until October 2024.

We are required to consider arrangements in place during each relevant year (2018/19 to 2022/23). While some of the work supporting the external reviews took place after relevant periods, in some areas the arrangements in place remained the same throughout and the findings and observations provide insight into the effectiveness of the arrangements in place during each year.

We have therefore drawn on these reviews when performing our risk assessment, further audit work in relation to the matters above and in forming our conclusion on whether the Council had proper arrangements in place to secure value for money.

Risk assessment

We have undertaken a risk assessment to establish whether there are aspects of the Council's operations where further audit work is required to allow us to determine whether the arrangements in place are adequate or where there is a significant risk of weaknesses in those arrangements.



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This risk assessment identified that further work was required in the following areas:

- Medium Term Financial Sustainability focus on income from commercial properties
- Quality and robustness of information used for decision making
- Governance of Knowle Green Estates Ltd (KGE Ltd)
- Introduction of the committee system
- Viability of the Council's housing delivery programme.

The above areas are considered in further detail on pages 10 to 44 of this report.

Legality of commercial property acquisitions

As described on pages 7 and 8, KPMG performed work on the arrangements relating to the commercial property acquisitions made in 2017/18, culminating in the Public Interest Report (PIR) issued in November 2022 and an adverse conclusion on the Council's use of resources.

Section 4 of the PIR relates to legal issues in relation to the commercial property acquisitions. Given similar acquisitions were made during 2018/19, we have considered the implications for our own reporting.

In summary, KPMG obtained Queen's Counsel (QC) legal advice regarding the Council's powers to borrow and invest and how those powers, where they exist, interact with each other. They concluded that the Council did not have a legal basis for either purchasing the commercial properties or financing those purchases by borrowing.

KPMG further observed that the Council did not have regard to the DCLG Guidance and Prudential Code, meaning that even if powers had existed, the Council exercised them unlawfully.

In its response to the PIR, the Council strongly disputed the matters raised, noting that it had also obtained its own QC's advice which confirmed that the purchases were lawful. The Council also highlights that it obtained further legal advice following the publication of the PIR which reinforced this view.

Subsequent external reviews have not commented on the legality of the commercial property acquisitions, although the BVI Report does note the following at para 7.9:

"...no specific QC opinion was sought for the decision to acquire three investment properties at the Cabinet meeting in July 2018. Legal advice referenced a previous QC opinion from 2016, despite new statutory guidance on Local Authority Investments that took effect in April 2018. The report to Cabinet did not mention this change in guidance."

It is clear from the PIR and the Council's response that the legal framework which governs a local authority's power to invest and borrow is subject to differing legal opinions and as such it would be for the courts to decide whether the Council acted lawfully. Both KPMG and the Council acknowledged this at the time.

Given the time that has elapsed since the final purchases of commercial property (which took place in August 2018), the absence of any intention by the Council to pursue further such acquisitions, and the significant cost to the taxpayer which would be incurred were an application to be made to the court, we do not consider an application to the court to be a proportionate course of action.

We also note that the government has updated its statutory guidance on investing and borrowing by local authorities since 2018, effectively prohibiting similar transactions in the future.



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Financial Sustainability

The Medium Term Financial Strategies (MTFS) presented to Council in December 2018 and December 2019 identified that commercial properties were expected to generate approximately £50 million of income per annum over the four years covered by the MTFS (2019/20 to 2022/23). Of this, approximately £9 million was to be used to fund the cost of providing day to day services. The remainder was to be used to service the debt raised to fund the commercial property acquisitions, set aside a minimum revenue provision (MRP) and build up 'sinking funds'.

The MTFS presented to Cabinet in January 2021 identified that commercial properties were expected to generate approximately (gross rents) £53 million of income per annum over the four years covered by the MTFS. Of this, between £8.8 million and £10.4 million per annum would be used to fund the cost of providing day to day services.

The MTFS referred to above also highlighted significant budget gaps in each of the four years covered by the forecasts.

There is a risk that the Council is both over-reliant on income from commercial properties to support its revenue budget and is setting aside insufficient amounts in its sinking funds and for MRP. Should this be the case, the Council may need to identify savings and efficiencies in existing services to address the budget gaps identified in the MTFS.

We have considered whether the planned annual contributions to the sinking funds are sufficient in the context of the wider property portfolio and whether the level at which MRP is being charged is appropriate.

Our work has been informed by the findings of external reviews in relation to the sinking fund strategy and MRP (both of which are directly related to the Council's investment property acquisition strategy).

Arrangements and Findings

Historical financial performance (pre 2018/19)

The table below summarises the net revenue outturn position for each of the previous three years prior to 2018/19 at the net budget requirement level (equivalent to net expenditure on services less interest and central government funding and before any surplus or deficit on the collection fund and prior year revenue carry forward). This information is shown in Appendix A to each years' revenue outturn report presented to Cabinet.

	Original budget (£000)	Revised budget (£000)	Outturn (£000)	Variance to revised budget (£000)
2015/16	7,194	7,419	7,375	(44)
2016/17	7,329	7,425	3,377	(4,778)
2017/18	7,655	7,672	6,894	(777)

The above table shows that in each of the previous three years the Council delivered a surplus against budget.

The significant surplus in 2016/17 is due rental income from the BP Campus Site, which the Council purchased during the year. This rental income net contribution to revenue (ie gross rent received less borrowing costs associated with the acquisition, MRP and transfers of a portion of the income to a sinking reserve) was not included in the original budget for 2016/17 but was included the following year.



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MTFS 2019/20 - 2022/23 and financial outturn

The MTFS for the period 2019/20 to 2022/23 (referred to as the 'Outline Budget' in Council committee papers) was presented members at the Council meeting held on 11 December 2018. The budget gaps identified in the MTFS presented to Cabinet in December 2018 were as follows:

	2019-20	2020-21	2021-22	2022-23
	£000	£000	£000	£000
Estimated gap	1,366	4,847	6,028	4,082

While the report makes it clear that these gaps were before the implementation of any mitigating actions, the projection for each year did include forecast income from the commercial property portfolio. An analysis of this income, and how the Council intended to utilise it, was also included in the report and this is reproduced below:

	2019-20 £'000	2020-21 £'000	2021-22 £'000	2022-23 £'000
Rental Income	(50,629)	(49,122)	(50,116)	(50,366)
Loan Interest Payable	23,028	22,911	22,760	22,370
Minimum Revenue Provision	11,052	11,334	11,624	11,921
Sinking Funds	6,405	4,840	5,840	6,735
Set aside for specific revenue purposes	555	555	555	555
Net Income (used to fund Revenue budget)	(9,589)	(9,482)	(9,337)	(8,785)

In summary, the Council expected the income generated by the commercial property portfolio to contribute approximately £9 million towards its revenue budget in each year of the next four years.

For context, the Council expected to incur net expenditure (before taking into account income from commercial properties or the cost of servicing the debt raised to finance the purchase of those properties) on the delivery of services in each of the four years covered by the MTFS:

	2019-20 £000	2020-21 £000	2021-22 £000	2022-23 £000
Net expenditure	23,608	25,597	26,752	24,050

The forecast income from commercial properties presented a significant percentage of forecast net expenditure, as shown in the following table:

	2019-20 £000	2020-21 £000	2021-22 £000	2022-23 £000
Net income commercial properties	9,589	9,482	9,337	8,785
Net expenditure	23,608	25,597	26,752	24,050
Net income as % of net expenditure	40.6%	37.0%	34.9%	36.5%

Income from commercial properties was therefore expected to fund more than a third of net expenditure on the delivery of services in each of the years covered by the MTFS. This illustrates the significance of the commercial property income to the Council's ability to finance its operations.



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The timing of our work enables us to consider the extent to which the Council was able to address the forecast budget gaps reflected in the December 2018, December 2019 and January 2021 MTFS, the reasonableness of the budget assumptions and to mitigate any risks.

The table below shows the gap reported and the final outturn position for each year (positive numbers represent a deficit while negative numbers are a surplus). It is important to note that the period covered by the MTFS was impacted by economic volatility caused by the pandemic and then global events (particularly the conflict in Ukraine).

This shows the Council reported a surplus for each of the years covered by the MTFS and the two subsequent years up to the date of our work. A brief summary for the reasons for the underspends include:

- 2019/20 underspend achieved by services
- 2020/21 underspend due to a combination of underspend of Covid-19 related grants to cover additional cost pressures (£1.5 million) and non-Covid-19 expenditure (£2 million)
- 2021/22 underspend achieved by services
- 2022/23 underspend by services £3.2 million offset by a reduction of £3 million in commercial property income
- 2023/24 underspend by services £3.3 million and a favourable variance of £4.7 million for investment property income
- 2024/25 underspend by services £7.4 million offset by a net contribution to reserves of £4.8 million.

	2019-20	2020-21	2021-22	2022-23	2023-24	2024/25
	£000	£000	£000	£000	£000	£000
Estimated gap as per Dec 2018 MTFS	1,366	4,847	6,028	4,082		
Estimated gap as per Dec 2019 MTFS		(1,412)	255	71	1,810	
Estimated gap as per Jan 2021 MTFS			(658)	1,284	2,324	282
Estimated gap as per Nov 2021 MTFS				960	838	2,611
Estimated gap as per Jan 2023 MTFS					574	3,617
Final outturn	(4,939)	(3,258)	(3,742)	(479)	(10,604)*	(3,112)

* This surplus figure is taken from the addendum on page 17 in the 2023/24 Revenue Outturn Report. The final outturn figures for years prior to 2023/24 have been taken from appendix A to the outturn reports, which show the net revenue budget monitoring and agree to the covering report. This is not the case for 2023/24, where appendix A appears to show a deficit of £3.788 million. It is unclear from the report why this discrepancy exists and we have not investigated the differences further.



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Commercial property acquisitions (August 2018)

Significant risk / risk of significant weakness

Medium Term Financial Sustainability focus on income from commercial properties.

The Council purchased its final tranche of commercial properties in August 2018, comprising the following:

- The Charter Building, Uxbridge (£136 million)
- Thames Tower, Reading (£119 million)
- The Porter Building, Slough (£66 million)

The Council provided copies of the financial models prepared as part of the pre-acquisition due diligence.

The Council engaged external advisors to prepare 'base case' assumptions and cash flow information for each of the three properties. The cash flow assumptions were prepared on a base-case and worst-case scenario.

The Council used this information to prepare its own financial models, which reflect MRP and contributions to the sinking funds, to arrive at the revenue contribution expected in each of the next 50 years.

As part of the pre-acquisition process, the Council commissioned different external advisors to perform a review of the cash flow modelling. While the adviser was broadly of the view that each input into the models was reasonable and/or prudent, the following matters were identified:

- 50-year cash flows are relatively unusual with investors typically modelling over a hold period of between 5 and 10 years. Projections over the long term are inevitably

sensitive to the input assumptions and will be required to be regularly monitored

- The cash flows present two scenarios - a 'base' case and a 'worst' case and the 'base' case has been prepared on a prudent basis, with the 'worst' case a reasonable downside case
- The cash flow does not represent a full investment appraisal or assess the risk / return metrics of the investment relative to the price paid
- The cash flows also make no allowance for capital expenditure required to maintain the properties and associated rental income.

Regarding the penultimate bullet point above, the Council has previously expressed the view (in response to the PIR) that traditional metrics used to measure the rate of return *"are less relevant to a Council due to our position as a long-term investor focused principally on income return (main purpose was to generate surplus income to offset the loss of grant funding and to support service provision for residents)."*

Regarding the final bullet point, the external adviser noted that the Council was aware of the omission of capital cash flows and had made allowance for this elsewhere in its financial assessment. The 'allowance' referred to is the contribution to the Council's sinking funds.

The external adviser also noted that both the base and worst-case scenarios make the same assumptions regarding lease terms, voids, rent free periods and break options, although they considered the base case to be appropriate given the current lettings status of the properties.



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We note that the PIR described the assumptions in the financial models supporting the commercial property acquisitions in 2017/18 in relation to void periods, rent-free periods and landlord costs to be potentially optimistic. The Council disputed this in their response.

The presence of such modelling and the engagement of a third-party expert to support this process demonstrate that the Council implemented arrangements to ensure due diligence was performed.

However, the review highlighted the unusually long time period over which the Council was preparing its models, that the cash flow was not a full investment appraisal and that the cash flow models lacked any allowance for capital expenditure.

Covenant reviews

As part of the pre-acquisition process for the three commercial acquisitions in August 2018, the Council commissioned external advisers to undertake a review of the financial standing of existing / prospective tenants.

This involved rating each tenant as having no signs of financial stress (green-rated), some signs of financial stress (amber-rated) or there being insufficient information available to make an assessment (red-rated).

Of the 20 tenants in place across the three properties, 12 were rated green, seven amber and one red. The red rated tenant only contributed £40,000 to a total headline rent of £3.943 million.

The Council commissioned a further review of five specific tenants across four of its commercial properties in January 2019 with the same approach taken as that described above. The review identified one amber-rated tenant and one red-rated tenant.

Portfolio Property Reviews

The Council commissioned external advisers to undertake a review of its commercial property portfolio in March 2019. The advisers raised the following recommendations:

- Continue to undertake covenant monitoring and maintain informal dialogue with tenants to both monitor covenant and intentions regarding upcoming lease breaks or expiries
- Develop formal asset management plans and undertake annual reviews of asset performance against these plans
- The advisers note that the sinking fund approach is not common practice in the investment property market and more detailed modelling should be undertaken given both the intention to hold the properties for 50 years and the Council's sensitivity to income changes
- Consider diversification away from office properties in the Heathrow Economic Area should further investment be undertaken.

A copy of this report was presented to the Overview and Scrutiny Committee at its meeting on 19 March 2019 under a private agenda item. This was accompanied by a covering report describing the Council's acquisition process.

The minutes of the meeting note that questions were raised and answered by officers, the Leader and Portfolio Holder for Finance and that the report was noted.



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Commercial property income forecasts and actuals

We have compared the Council's forecast rental income from commercial properties, borrowing costs and sinking fund contributions with those reported in the Council's financial statements. These comparisons are shown in the following tables.

Other than voids, we would expect limited variation between forecasts and actuals given that tenancy agreements will specify rents due.

The significant variance in rental income in 2022/23 is due to the loss of a tenant in 2022 following the start of the war in Ukraine and the sanctions against Russia (the tenant was a Russian owned-business).

The table below demonstrates that the rental income forecasts in the December 2018 MTFS were reasonable.

The pandemic and circumstances leading to the loss of a tenant in 2022/23 could not reasonably have been foreseen and the impact of these is not indicative of poor forecasting.

<i>Rental income</i>	2019-20 £'000	2020-21 £'000	2021-22 £'000	2022-23 £'000
Rental Income per Dec 2018 MTFS	(50,629)	(49,122)	(50,116)	(50,366)
Rental income per Statement of Accounts	(51,079)	(49,516)	(50,609)	(44,826)
Variance	450	394	493	(5,540)

For context, it also helpful to consider the collection rates for rental income from commercial properties. The information is taken from either the corresponding Asset Annual Report prepared by the Council or the annual Statement of Accounts, where collection rates were disclosed.

- 2019/20 90% (from Annual Asset Report)
- 2020/21 98.09% (from Annual Asset Report)
- 2021/22 99% (from Annual Asset Report)
- 2022/23 98.9% (from Statement of Accounts)
- 2023/24 99.09% (from Statement of Accounts)

The low collection rate in 2019/20 is due to the onset of Covid.



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Loan interest and sinking fund contributions

We would expect limited variation in loan interest payments given the Council pursued a policy of fixing interest rates for the duration of the loans. Similarly, the Council's approach to sinking funds means that forecasts should be achievable, subject to rental income remaining consistent.

The tables below shows that loan interest forecasts were reasonable and, with the exception of 2022/23, the Council was able to maintain contributions to the sinking fund that were consistent with the December 2018 MTFS.

As noted previously, the circumstances which led to the need to withdraw from the sinking funds were outside of the Council's control.

However, this significant withdrawal to support the Council's budget has resulted in the sinking fund falling below its target level and may need to be replenished in the coming years.

It also demonstrates the sensitivity and exposure of the Council's financial position to changes in the net rental income achieved and the impact of voids on the Council's budgets.

	2019-20 £'000	2020-21 £'000	2021-22 £'000	2022-23 £'000
<i>Loan Interest</i>				
Loan interest payable per Dec 2018 MTFS	23,028	22,911	22,760	22,370
Interest payable per Narrative Statement in Statement of Accounts	23,328	23,156	23,032	22,690
Variance	-300	-245	-272	-320
	2019-20 £'000	2020-21 £'000	2021-22 £'000	2022-23 £'000
<i>Sinking fund contributions</i>				
Forecast sinking funds contributions per Dec 2018 MTFS	6,405	4,840	5,840	6,735
Actual sinking fund contribution per Narrative Statement in Statement of Accounts	6,796	5,090	6,090	3,891*
Variance	-391	-250	-250	2,844

* The Council reported a contribution to the sinking fund of £7.658 million offset by a withdrawal from the fund of £3.767 million to cover the loss of a tenant and associated rental income in the year (as described above).



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Sinking Fund methodology

The Council maintains sinking funds for each of its investment properties. The purpose of these funds is to mitigate against circumstances which may reduce revenue generated by the commercial property portfolio (such as loss of a tenant) or generate costs which will need to be met from revenue resources (such as reconfiguration of the property at the end of a lease).

The Outline Budget Report presented to members at the Council meeting held on 11 December 2018 including the following analysis of the amounts planned to be transferred to the sinking funds between 2019/20 and 2022/23. The table from the report is reproduced below:

	2019-20 £'000	2020-21 £'000	2021-22 £'000	2022-23 £'000
BP Main Site	3,190	3,690	4,190	4,290
BP SW Corner	655	805	955	1,105
Elmbrook House	223	273	323	373
12 Hammersmith Grove	2,208	3,108	4,008	4,908
Stockley Park	450	550	650	750
WBC4	0	200	400	600
Communications House	536	1,036	1,536	2,036
Thames Tower	1,121	1,961	3,011	4,061
Charter Building	1,543	4,023	5,213	7,013
Porter Building	677	1,362	1,562	1,652
Total	10,603	17,008	21,848	26,788

We have not seen any evidence of committees having the opportunity to scrutinise the methodology used by the Council to determine the amounts to be set aside in sinking funds, either in years prior to 2018/19 or during 2018/19 itself.

We understand it is derived from modelling the impact of future voids, rent free periods and refurbishments on a property by property basis.

Para 5.4 of the Public Interest Report issued by KPMG raised concerns regarding the robustness of these models and recommended that:

“The Council should develop its investment property portfolio modelling to bring these in line with the expected practice of an institutional investor. This should include robust stress testing and sensitivity analysis which incorporates scenarios that cover the highest level of risk for expenditure, revenue, tenant behaviour and external socio-economic factors. Consideration should also be given to the diversification of the portfolio and whether this should be addressed over medium to longer term”

Para 2.10 of the Council's response states:

“The Council do not accept that the models were simplistic (PIR paragraph 1.8 a), although it is true to say that they became more sophisticated post 2017/2018.”

Nonetheless, the Council accepted all of the recommendations made in the PIR, and its response to the recommendation above included the following:

“The Council is already committed to undertaking a review of its Sinking Fund Strategy covering the next 50 years bringing independent consultants to review assumptions about future income levels, rental activity and to make recommendations around levels of sinking funds contribution to reserves to ensure that we continue to have a sufficient level of reserves to cover any dips in income and to cover all financing and management costs.”



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Subsequent external reviews also commented on the adequacy of the sinking funds. Section 2.1.6 of CIPFA's Capital Assurance Review highlights that:

"While the sinking fund reserve has been established for a number of years, SBC has only recently [Feb 2023] set a policy concerning its use."

CIPFA raised the following recommendation (Recommendation 4) in response to the findings of its review in relation to the Council's sinking fund methodology:

"Agree specific terms of reference for the review and treatment of the sinking fund"

The planned sinking fund review should make use of the independent resources provided. The review must take a long-term view of potential risks and their financial consequences. The council needs to set clear rules for the sinking fund in relation to its commercial investments and the overall financial resilience of the Council."

In its response to CIPFA's recommendation, the Council stated:

"Councillors have already agreed that we undertake a review to assess the sinking funds projections over a 50-year horizon. We are looking to secure external assistance and would be open to discussions as to how best we achieve this. In undertaking this review, we will seek to provide greater transparency for councillors as to the methodology and rationale underpinning the future projected contributions and will seek to link more clearly the sinking fund contributions to anticipated future behaviour of individual properties."

Further to the above, the Best Value Inspection (BVI) report noted that:

"5.16 We have observed delays and inadequate execution in the review process. The intention to report the 50 year projections to the Corporate Policy and Resources Committee by June 2024 was only completed in January 2025. The Inspection team initially requested a copy of the 50-year model in May 2024, but it was not available. A draft was only provided on 7 November 2024, despite multiple reminders and an email to the Chief Executive in September, and assurances that the information would be shared soon."

5.17 While the Council initially considered using external consultants to develop the model, it opted instead to rely on in-house expertise."

Significant weakness

In the absence of an approved sinking fund policy (presented to Corporate Policy and Resources Committee in February 2023), scrutiny by members of the underlying methodology used by the Council to determine the adequacy of the amounts being set aside and underlying sinking fund modelling which mirrors the timeframe over which the Council intends to hold the associated properties, we are unable to conclude that the Council had proper arrangements in place to ensure that sufficient amounts are being set aside from net rental income to support future capital costs or rent losses from voids.



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Council's MRP policy

Since 2004, local authorities have been responsible for determining whether their capital expenditure is affordable, prudent, sustainable and offers value for money. This is done within a framework known as the Prudential Code for Capital Finance in Local Authorities (the 'Prudential Code'). Councils are required to comply with the Prudential Code by legislation (The Local Government Act 2003 in England and Wales).

Councils demonstrate compliance with The Prudential Code using 'prudential indicators'. These are set and approved by members as part of the annual budget setting process.

There is a further element of the Prudential Code, known as the Capital Financing Requirement (CFR). The CFR measures the extent to which a local authority's historical capital expenditure still needs to be financed (ie the authority has not yet used capital receipts, capital grants or revenue resources to finance the capital expenditure) and reflects the authority's underlying need to borrow (and repay) funds.

The Prudential Code determines how a local authority should calculate its CFR. Once calculated, the CFR is used to determine an amount known as a 'minimum revenue provision' ('MRP'). The purpose of the MRP is to ensure that a local authority is setting aside resources to maintain its underlying need to borrow at an affordable level.

The requirement to set aside MRP is set out in legislation rather than the Prudential Framework. In a local authority's annual Statement of Accounts, this is achieved by reducing the General Fund by the value of the MRP.

It is important to emphasise that the MRP represents a reduction in the revenue resources available to a local authority - once charged to the General Fund (a cash backed, usable reserve) in the accounts, it is money that is no longer available to spend on future service delivery or capital programmes.

Legislation provides a number of options which a local authority can use to calculate its annual MRP charge. A local authority must state which option(s) it has chosen to apply as part of the budget setting process. This statement is then approved by members as part of the wider budget approval. The Council set out its MRP policy choices in its Annual MRP Statement.

The Council commenced MRP charges in 2017/18 following acquisition of the investment properties and draw down the loans to finance these acquisitions. Prior to this the Council was debt-free and did not charge MRP.

The MRP policy applicable to 2018/19 was approved by Council (following recommendations from Cabinet) in February 2018 as part of the budget setting process. Cabinet considered the policy at its meeting on 21 February 2018.

The policy is reproduced below:

"Capital expenditure incurred during the financial year on asset acquisitions will not be subject to a MRP charge until the following complete financial year. For capital expenditure incurred that is funded from borrowing, MRP will be determined by charging the expenditure over the expected useful life of the relevant asset as the principal repayment on an annuity with an annual interest rate equal to the relevant PWLB rate at the point the expenditure is incurred (continued over)."



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MRP on purchases of freehold land will be charged over 50 years. MRP on expenditure not related to fixed assets but which has been capitalised by regulation or direction will be charged over 20 years.

The annuity method makes provision for an annual charge to the General Fund which takes account of the time value of money (whereby paying £100 in 10 years' time is less of a burden than paying £100 now). The schedule of charges produced by the annuity method thus results in a consistent charge over an asset's life, taking into account the real value of the annual charges when they fall due.

The annuity method also matches the repayment profile to how the benefits of the asset financed by borrowing are consumed over its useful life (i.e. the method reflects the fact that asset deterioration is slower in the early years of an asset and accelerates towards the latter years). This re-profiling of MRP therefore conforms to the DCLG "Meaning of Prudent Provision" which provide that "debt [should be] repaid over a period that is reasonably commensurate with that which the capital expenditure provides benefits.

Capital expenditure incurred during 2018/19 will not be subject to a MRP charge until 2019/20."

The statutory guidance applicable from 1 April 2019 is the Capital finance: Guidance on minimum revenue provision (4th edition). The guidance provides four options which an authority may use to calculate its MRP (and notes that an authority may use a combination of the four to reflect when debt was taken out), although it is important to note para 23 of the guidance, which states:

"However, this does not rule out or otherwise preclude a local authority from using an alternative method should it decide that is more appropriate."

Option 1 (the "Regulatory Method") and Option 2 (the "CFR Method") may only be used where capital expenditure was incurred before 1 April 2008 (per para 38 of the guidance). The Council has not used either of these methods. Option 4 (the "Depreciation method") is not appropriate for commercial properties given that depreciation is not charged on assets of this type and this is reflected in para 45 of the statutory guidance, which states:

"The duty to make MRP extends to investment properties where their acquisition has been partially or fully funded by an increase in borrowing or credit arrangements. As depreciation is not charged on investment properties, Option 4: the Depreciation method is not a suitable approach for calculating the MRP to be charged in respect of investment properties."

The Council has therefore employed Option 3: the Asset Life method in accordance with the guidance.

The Asset Life method can be applied in two ways:

- The equal instalment method, which results in an equal amount being charged as MRP in each year of the asset's useful economic life
- The annuity method, where the MRP charged reflects the principal amount to be repaid in the year so that, over the asset's useful life, the amount of capital expenditure financed by borrowing is fully funded from revenue resources.



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As per the Council's policy above, the Council has opted to apply the annuity method. In practice, this results in the nominal value of the MRP increasing on an annual basis. However, because this method takes into account the time value of money, the charge is effectively spread equally over the life of the asset. The Council's policy makes this clear.

The Council's MRP policy states that *"For capital expenditure incurred that is funded from borrowing, MRP will be determined by charging the expenditure over the expected useful life of the relevant asset"*. This approach is consistent with the guidance.

For commercial properties purchased in 2018/19, the Council included the MRP profile for each asset in the respective financial model prepared prior to acquisition. This uses Excel's PPMT function to calculate the principal repayment on the borrowing taken out to fund the asset using the 50-year annuity rate as at a given date. The profile shows the nominal value of the MRP set aside increasing between year 1 and year 50. This methodology is consistent with the acquisitions made in 2017/18.

The BVI report raises concerns regarding the amount of MRP provided for in 2023/24, highlighting that the charge is only around 1% of the CFR. For context, MRP charges in the years 2018/19 to 2022/23 are shown in the tables below (based on the CFR note in the published Statement of Accounts for those years). This shows that for the years preceding 2023/24 (including 2018/19), the MRP charge has been approximately 1% of the CFR.

As noted above, the annuity method applied by the Council will result in lower MRP charges in earlier years, increasing as a proportion of the CFR in later years. However, because this method takes into account the time value of money, the real charge borne by tax payers remains consistent in each year.

Following the issues raised by the BVI team, the Council commissioned its treasury advisors to review its MRP policy. The Council have provided us with a copy of the report, which concludes that the methodology applied by the Council is consistent with government guidance.

	2018-19 £000	2019-20 £000	2020-21 £000	2021-22 £000	2022-23 £000
Opening CFR per Capital Financing and Expenditure note in Statement of Accounts	678,998	1,051,121	1,116,100	1,128,532	1,117,687
MRP charged to general fund per Capital Financing Note in Statement of Accounts *	7,845	11,052	11,903	12,327	12,095
MRP charge as a % of CFR (%)	1.16	1.05	1.07	1.09	1.08

* This is incorrectly referred to as a repayment of debt in the Capital Expenditure and Financing Note



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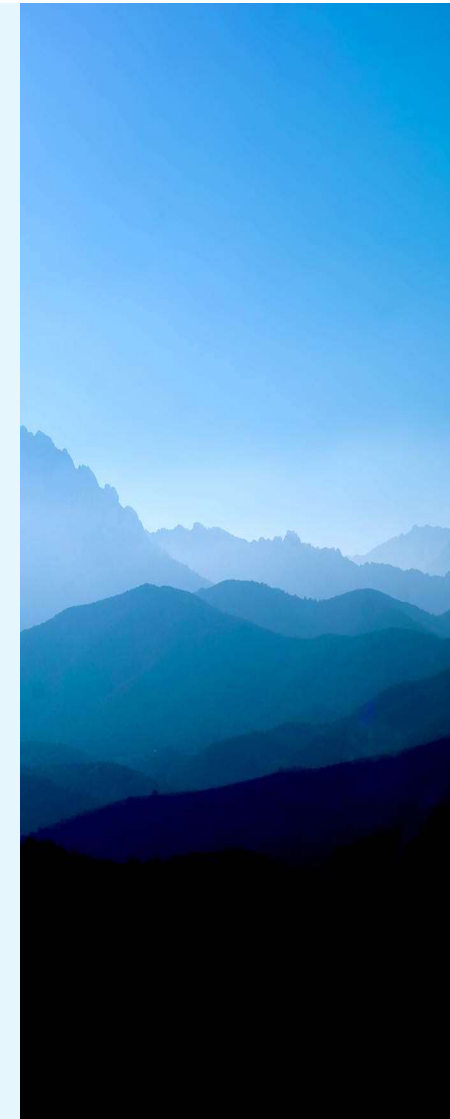
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Commercial property valuations

The Council engages an external valuer to value its commercial properties. This exercise is undertaken annually. The table below shows the purchase price and value of the Council's commercial property portfolio at each financial year end covered by this report.

This information is taken from the Council's annual commercial asset reports. For the reasons set out on pages 4 and 5 of this report, these values have not been subjected to any audit procedures.

Property (purchase date)	Purchase price (£m)	Value as at				
		31 March 2019 (£m)	31 March 2020 (£m)	31 March 2021 (£m)	31 March 2022 (£m)	31 March 2023 (£m)
BP Campus, Sunbury Business Park, Sunbury (September / December 2016)	384.90	389.08	391.73	393.10	386.80	302.35
12 Hammersmith Grove (January 2018)	170.00	170.80	165.90	162.00	162.00	140.25
Charter Building, Uxbridge (August 2018)	135.98	135.40	131.20	105.00	99.00	80.00
Thames Tower, Reading (August 2018)	119.32	127.20	126.80	113.80	109.84	103.70
The Porter Building, Slough (August 2018)	66.47	71.40	69.90	62.00	57.35	45.50
World Business Centre 4, Heathrow (Sept 2017)	47.25	47.00	45.80	46.00	45.10	36.10
3 Roundwood Avenue, Stockley Park (July 2017)	21.40	20.55	20.10	18.34	16.40	11.00
Elmbrook House, Sunbury (December 2016)	7.16	7.46	7.24	7.23	6.25	4.50
TOTAL	952.48	968.89	958.67	907.47	882.74	723.40



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The value of the Council's commercial property portfolio for the period 31 March 2019 to 31 March 2023 fell by £245 million (25%), with all properties declining in value. The year-on-year overall change is shown in the table below.

The most significant fall in the value of properties was in 2022/23 with 3 Roundwood Avenue, Stockley Park and Elmbrook House both losing almost a third of their value.

While the falls in 2022/23 were caused primarily by wider market conditions which affected office accommodation more broadly, the loss of tenants during the year had an impact on the valuation for two of the properties (The Porter Building and 3 Roundwood Avenue, Stockley Park).

The fall in the value of the commercial properties did not impact on the Council's General Fund because:

- The capital accounting and funding framework which applies to local authorities requires movements in the value of investment properties to be excluded from the General Fund
- No additional revenue provision (MRP) has been made as it expects rents over the 50-years to continue to be sufficient to cover the financing costs and principal repayments associated with the borrowing

The nature of property means that values are expected to fluctuate from year to year in cycles that mirror the wider economy. Nonetheless, significant falls such as those experienced in 2022/23, when coupled with loss of tenants (and the associated loss of income) could significantly impact the Council's ability to service and repay its borrowing because:

- A reduction in income reduces the revenue funds available to pay interest due and set aside to fund the repayment of principal
- In the event the Council was unable to set aside sufficient amounts from revenue, it may be necessary to dispose of the asset and use the resulting capital receipts to repay debt. Where property values have fallen, the capital receipts received may not be sufficient to cover these repayments.

We have commented on exit strategies on the following page.

	Value as at				
	31 March 2019 (£m)	31 March 2020 (£m)	31 March 2021 (£m)	31 March 2022 (£m)	31 March 2023 (£m)
Value of commercial property portfolio	968.89	958.67	907.47	882.74	723.40
Year-on-year change in value	-	-10.22	-51.2	-24.73	-159.34
Year-on-year change in value (%)	-	-1.05%	-5.34%	-2.73%	-18.05%



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Asset management plans and exit strategies

The portfolio review by external consultants in March 2019 highlighted that there were no formal, long-term asset management plans in place for the commercial properties. The consultants noted that such plans were particularly important for the multi-let assets and recommended that once such plans had been developed, monitoring against these should take place on an annual basis.

Cabinet approved an overarching Asset Management Plan in September 2020, although this was strategic in nature, covering the Council's entire asset basis (ie municipal, commercial and regeneration portfolios) and did not address intentions regarding individual properties in the portfolio.

At the same meeting, Cabinet received the first annual property report. This reported detailed the portfolio's performance against the KPIs set by the Council, market commentary, lettings activity and asset management activity. The report also included a profile of each asset in the portfolio, incorporating a brief description of the strategy for the asset.

Except for Elmbrook House, where the medium-term strategy was to consider a residential development, the Council's intention was to hold the commercial properties for the long term whilst maximising income through proactive management of tenancies.

Similar annual reports were prepared for 2020/21, 2021/22 and 2022/23.

The Council did not develop exit strategies for its commercial properties. The BVI report noted the following regarding exit strategies (4.22 of the BVI Report):

"When we requested to see individual exit strategies for the investment properties in May 2024, we found that these strategies were not in place. First drafts were eventually provided to us in November 2024. In our view, these strategies are not fit-for-purpose. They focus more on maintaining ownership rather than on potential exit options, and fail to adequately consider site disposals"

Significant weakness

In the absence of asset management plans and exit strategies prepared in a timely fashion after the acquisition of the commercial properties, we are unable to conclude that the Council had proper arrangements in place to manage the medium and long-term risks (both financial and non-financial) associated with the commercial property portfolio.

Conclusion

In recent years, the Council reported surpluses against its revenue budget and was able to close the budget gaps forecast in the December 2018 MTF5.

Apart from 2019/20, when the onset of the pandemic in March 2020 had a significant impact on commercial property income, the Council collected more than 98% of the commercial rent due. In 2019/20, 90% of the rent due was collected.

Net income from commercial properties (rents less interest on borrowing and MRP) has supported the Council's budgets and allowed the Council to build up its sinking fund to cover future voids or capital expenditure required to maintain these assets as Prime / Grade A commercial assets over their 50-year target lifespan.



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However, in 2022/23 the contribution to sinking funds was significantly reduced by a withdrawal from the fund (£3.767 million) to cover the loss of a tenant and associated rental income in the year.

External advisers undertook reviews of the cash flow models for each commercial property and noted that these were not full investment appraisals and that cash flows associated with future capital costs had been excluded (the Council's view is that traditional investment performance measures were not relevant and future capital costs was addressed by the sinking fund).

The portfolio review in March 2019 highlighted that there were no asset management plans in place for the commercial properties and that more detailed modelling of the sinking fund contributions was required given the time frame over which the Council intended to hold the assets.

It is unclear how the Council calculated the amounts to be transferred to sinking funds in the financial models as the calculations are not included in these models. In some years the contribution to the sinking fund exceeds the amount of available revenue after MRP and debt interest cost, indicating that in some years the general fund would potentially need to contribute to the sinking fund.

The Council also failed to set a policy for the future use of the sinking funds (this was not done until February 2023 when the Sinking Fund Policy was presented to the CPRC).

The annual MRP charge currently appears very low at only 1% of the Capital Financing Requirement. This is due to the Council applying an annuity based MRP charge where the MRP increases as the borrowing costs decrease each year and results in a consistent total charge amount each year.

Although the valuation of the commercial property portfolio has fallen (31 March 2019 £968.89 million to 31 March 2023 £723.40 million), the financial models continue to forecast that net rents will be sufficient to repay borrowing and therefore no additional amounts have been set aside as MRP for these valuation losses.

While the Council has been able to deliver budget surpluses through to 2022/23, the budget has been heavily reliant on rents from commercial properties and is significantly exposed to sensitivities around this.

We have noted significant weaknesses in respect of asset management plans, financial modelling and the adequacy of sinking funds for the commercial property portfolio.

Therefore, we are unable to conclude that the Council had proper arrangements in place to ensure that it:

- Plans finances to support the sustainable delivery of services in accordance with strategic and statutory priorities
- Identifies and manages risks to financial resilience, e.g. unplanned changes in demand, including challenge of the assumptions underlying its plans.

2015 Code reporting criteria

For 2018/19 and 2019/20 these significant weaknesses impact on:

- Planning finances effectively to support sustainable delivery of strategic priorities and maintain statutory functions
- Managing and utilising assets effectively to support the delivery of strategic priorities.



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Informed decision making and governance

The Council has been subject to a number of external reviews which have raised concerns regarding information presented to members to support decision making. These concerns cover the following areas:

- Budgeting, financial monitoring and performance monitoring
- Acquisition and financing of investment and regeneration properties
- Affordable housing programmes
- Risk management
- Adequacy of internal audit.

Our work has been informed by the findings of external reviews.

Arrangements and Findings

Budgeting, financial monitoring and performance monitoring

Significant risk / risk of significant weakness

Quality and robustness of information used for decision making.

The Council set its budgets for each of the five financial years covered by this report (2018/19 - 2022/23) in accordance with statutory requirements.

Each of the revenue budgets were balanced with limited use of reserves. The 2023/24 budget approved by Council at its meeting on 20 February 2023 was also balanced, although this was only achieved through drawing down £5.9 million from property sinking funds.

Members received quarterly revenue and capital monitoring reports throughout the year. These were presented to Cabinet prior to May 2021 and the Corporate Policy and Resources Committee (CPRC) thereafter.

During 2018/19 and 2019/20, quarterly revenue monitoring reports included a summary of the position against the net budget. Variances greater than 5% or £5,000 (whichever is the lower) against each area of spend were then reported, categorised by portfolio. A separate section for the revenue impact of the commercial asset acquisitions was also included. Each report was accompanied by appendices providing a more granular analysis of each area of expenditure.

In 2020/21, the format of revenue reports were amended to include an explanation of the existing and forecast impact of Covid 19 on the Council's finances.

In 2021/22, further changes were made to the revenue monitoring reports, increasing the threshold above which variances were reported to £20,000 (from the lower of 5% or £5,000), structuring the report around committee responsibilities and adding additional information regarding the net revenue forecast position. Appendices provide more granular analysis of income and expenditure.



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Each quarterly capital monitoring report provides a summary of the status of the programme on a portfolio basis. A detailed analysis of each scheme is included in the appendices to the quarterly report, which was amended to reflect the new committee structure from May 2021.

It is unclear to what extent the Council developed, maintained and reported on non-financial key performance indicators during the period 2018/19 to 2021/22. We have not seen any evidence that such key performance indicators, linked to the Council's strategic and operational objectives were reported to Cabinet or any other committee.

The CPRC received a Key Performance Indicator Report at its meeting on 22 April 2022. The service delivery KPIs are included in appendix 1 to the report and are described in para 1.1 as KPIs reported within the Council to monitor service delivery.

The KPIs are categorised by committee responsibility. Appendix 4 includes the investment and property KPIs although it states that these are only reported annually.

The report recommends that members agree the KPIs to be reported on a quarterly and annual basis to both the CPRC and the relevant committees. The minutes of the meeting show that this was agreed by members. However, there is no evidence of the KPIs being reported to either the CPRC or other committees for the remainder of 2022/23.

Significant weakness

It is unclear what arrangements the Council had in place to ensure formal monitoring, scrutiny and challenge of KPIs by members.

Acquisition and financing of investment properties

The Council purchased its final tranche of commercial properties in August 2018, comprising the following:

- The Charter Building, Uxbridge (£136 million)
- Thames Tower, Reading (£119 million)
- The Porter Building, Slough (£66 million)

In July 2018, Cabinet recommended to Council that a supplementary capital estimate (ie an amendment to the previously approved capital programme for 2018/19) for an additional £594.859 million be approved for property acquisitions to support housing and regeneration projects.

This was approved by members at the Council meeting held on 19 July 2018. To allow the purchases to be financed by borrowing, an increase in the formal limits on the amounts the Council could borrow of £590 million was also approved at the meeting.

Confidential papers were presented to the July 2018 Cabinet meeting regarding the acquisitions. All three properties were considered under agenda item 17 'Investment acquisition (N)'. This agenda item was accompanied by two appendices. The first summarised the three proposed acquisitions. The second appendix included pre-acquisition reports prepared by the Council's external property advisers.

As far as we are aware, these were the only reports presented to members of the Cabinet prior to the acquisitions being completed.



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While the covering paper includes a section headed 'Financial Implications' this does not include any detailed financial information from the financial models such as amounts to be set aside for sinking funds and MRP and the methodologies for calculating those amounts. Instead, there is a focus on the low borrowing rates available to finance the acquisitions.

The covering report also refers to the three properties generating £18.7 million gross rental income per annum over the period of the tenants' leases.

A pricing commentary is included each of the external property adviser's reports. This includes details of the passing rent per annum, weighted average unexpired lease term and their view of the purchase price range.

The minutes of the meeting record that the acquisitions were approved. The details of discussion (if any) of the risks and rewards associated with each of the purchases is not recorded in the minutes.

The nature of information presented to Cabinet in relation to the August 2018 commercial property acquisitions is consistent with that presented to Cabinet in respect of the acquisitions which took place in 2017/18 and which was the subject of KPMG's Public Interest Report. The acquisitions were not subject to consideration by members of any other committee.

A presentation to the Overview and Scrutiny Committee took place at its meeting on 19 March 2019. A covering report summarising the reasons for the commercial acquisitions was presented, accompanied by the property portfolio report prepared by the external advisers.

This included an analysis of the portfolio by property showing purchase cost, annual rent, yield, lease length and contribution to revenue.

The publicly available minutes note that the members raised a number of questions, which were responded to by officers, the Leader and the Portfolio Holder for Finance.

At its meeting on 12 December 2017, Cabinet was presented with a number of property investment strategic parameters. These parameters are narrative criteria rather than any numerical metrics. The criteria are categorised under 'Revenue Generation' and 'Social Investment'. The paper notes that the parameters would be revisited following the conclusion of the Government's consultation on the statutory guidance relating to local authorities investing and borrowing.

The parameters were repeated in the Capital Strategy presented to Cabinet in February 2019 unamended, indicating that the Council continued to consider them relevant. It is therefore not clear why these parameters were not explicitly considered in the papers presented to Cabinet requesting approval for the acquisition of the three commercial properties in August 2018.

Significant weakness

The information contained in the reports presented to Cabinet regarding the commercial property acquisitions made in August 2018 was insufficient. The reports did not contain sufficient information on the financial implications of the purchases and the risks associated with holding the properties and how the risks would be managed.



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Risk Management

The Council has maintained a corporate risk register during the period covered by this report. The risk register was a standing agenda item for the Audit Committee throughout.

The corporate risk register was also periodically reviewed by Cabinet prior to the introduction of the Committee system.

The Internal Audit Manager had overall responsibility for the register and prepared and presented the associated reports to the Audit Committee.

The format of the Corporate Risk Register remained the same throughout 2018/19 to 2021/22. It mapped each risk to one of the four priorities in the Council's Corporate Plan (Housing, Economic Development, Clean and safe environment and Financial Sustainability) and assigned a risk owner(s).

Risks were scored based on the likelihood of the risk occurring and the impact were it to do so. Controls were recorded against each risk and any outstanding actions in relation to those controls are recorded on the risk register, along with a target date for completing the actions.

The Council utilised a RAG system to show the extent to which mitigating actions have been addressed or remain outstanding (a red-rating means that actions to address the risk are overdue and remain outstanding, amber means they have been partially actioned and green means actions completed and / or are subject to ongoing monitoring).

In our view, the format of the corporate risk register during the period 2018/19 to 2021/22 meant it was unclear what the impact of the mitigating controls is on the likelihood and impact of the risk.

This, in turn meant that members are unable to see what the residual risk is and determine whether further action may need to be taken by officers (or, alternatively, whether to accept the risk).

The Council refreshed its Corporate Risk Management Policy in July 2020. The format of the Corporate Risk Register was also amended significantly in November 2022 following comments raised by members of the CPRC in September 2022.

While the LGA Corporate Peer Challenge noted that corporate and service risk registers were well aligned, paragraph 6.23 of the BVI Report included the following observations:

"The risk registers that we inspected, including the corporate risk register regularly reported to Audit Committee and the Corporate Policy and Resources Committee, are not fit for purpose. Members have echoed this sentiment, stating that the risk registers are poor and contain errors, affecting decision making.

We note, for example, that while the investment portfolio is included in the corporate risk register, it is reported with a lower level of risk than other areas and does not adequately reflect the current forecasted income. Corporate risks also do not include the delivery of savings to balance the MTFS, despite this being a major risk to the Council."

Other weakness

The format of the risk register presented to members and the information it contained did not support robust scrutiny of the Council's risks and the actions being taken to mitigate those risks.



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Adequacy of Internal Audit

For each of the years covered by this report, an annual Internal Audit Plan was prepared and approved by the Audit Committee. Half yearly progress reports were also presented to the Audit Committee in each of the years.

Accompanying both the half-yearly updates and annual reports were updates reflecting progress on audits in that year's plan along with the current status of the audit (a status of 'Open audit' reflecting outstanding actions and 'Closed' denoting that no further action is required).

During the period covered by our report, concerns regarding the adequacy of internal audit resource available were raised by the Head of Internal Audit on two occasions:

- Internal Audit Summary Report for 2018/19 presented to the Audit Committee on 25 July 2019 notes that the Internal Audit function operated with significant resource shortage between April and October 2019, which required *"some reprioritising of the 2018/19 Internal Audit plan"*
- The covering report for the 2022/23 Internal Audit Plan presented to the July 2022 Audit Committee notes that the plan has been amended following revised budget position which resulted in the growth bid for an audit apprentice not being approved that resulted in a number of audits being removed from the workplan due to resourcing constraints.

In each of the five years covered by this report, the Head of Internal Audit's opinion provided 'reasonable assurance' over the adequacy and effectiveness of the Council's framework of governance, risk management and internal control.

A small number of reports issued by Internal Audit in each year subject to our review received opinions of 'Major improvement needed' (changed to 'limited assurance' in 2022/23 following a change in the opinion levels used by Internal Audit).

We requested copies of several Internal Audit reports during our work, but the Council was unable to provide these due to the amount of time elapsed since the work took place and internal changes to the internal audit team (which is now outsourced).

Examples include the Commercial Asset and Investment reviews performed in 2019/20 and 2020/21 (the Council could not locate final reports for either of these audits) and 2021/22 (the Council was only able to provide a proposed final draft).

While acknowledging the unusual circumstances in which our value for money work is taking place, we would expect the Council to have document management systems in place to ensure important information is held for an appropriate period of time.



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The Head of Internal Audit has undertaken self assessments against the requirements of the Public Sector Internal Audit Standards regarding the effectiveness of the Internal Audit function periodically during the five years covered by this review.

External effectiveness reviews also took place in 2018 and late 2023 (with the latter focussing on work performed in 2022/23). The outcome of both the self-assessments and the external reviews were reported to Audit Committee, with no significant shortcomings identified.

Internal Audit performed the following reviews relating to the Council's commercial property portfolio:

2019/20 - Commercial Asset Acquisitions and Investments 'Some improvement required'

2020/21 - Assessed as 'effective' (June 2021)

2021/22 - 'Some improvement needed' (July 2022)

2022/23 - 'Reasonable assurance' (June 2023)

Given the complex nature of the Council's commercial property portfolio, it is unclear whether Internal Audit possessed the necessary expertise to undertake effective reviews in this area, particularly given the existing resource constraints within the team.

Other weakness

The Council's Internal Audit function did not have sufficient capacity and capability to robustly assess the risks associated with the Council's commercial property portfolio and whether the associated control environment was appropriate for the scale and complexity of the investments made.

Governance of Knowle Green Estates Ltd (KGE Ltd)

Significant risk / risk of significant weakness

Governance of Knowle Green Estates Ltd.

Knowle Green Estates Ltd was formed in May 2016 as a wholly owned subsidiary for the purpose of holding investments in residential property and affordable housing in the borough.

This followed approval from Cabinet to establish a local authority trading company for this purpose at its meeting on 7 April 2016.

On incorporation, the Council's two Deputy Chief Executives (Terry Collier, also the Council's s151 officer, and Lee O'Neil) were appointed as directors.

The s151 Officer remained a director until 1 January 2025. During that time, a number of other officers and elected members were appointed to the director / senior officer roles in the company.

This introduces potential conflicts of interest and governance risks where the senior positions in the company were all held by officers or councillors of the Council. During this time, the company acquired a substantial amount of property including asset acquisitions from the Council.

It was not until January 2021 that the company appointed two non-executive directors with no connection to the Council.



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In 2016/17, the Council donated Harper House to the company.

In May 2017, Cabinet was presented with a report on the relationship between the Council and the company. Given this relates to arrangements in place prior to 2018/19 we have not reviewed this report in detail but note that this appears to be the first report presented to members regarding KGE and was presented after the donation of Harper House to the company.

In September 2018, an update on KGE's business plan was presented to Cabinet as an exempt paper which stated that the company's business plan was being prepared with the assistance of qualified property accountants and tax advisors.

The business plan was not presented to Cabinet for approval until January 2020. As noted above, by this point the company was already holding property with substantial value on its balance sheet.

Prior to Cabinet's consideration of KGE's business plan, the Overview and Scrutiny Committee (O&SC) had an opportunity to review and comment on the content of the plan.

The outcome of this review is reflected in the recommendation to Cabinet, which highlights that members were unclear what the expectations of KGE were in the context of housing delivery and how arrangements relating to asset transfers from the Council to the company (including valuation of those assets) were operating.

The minutes of the Cabinet meeting show that the Leader agreed with the O&SC recommendations and asked the director of the company to provide further details.

The LGA Corporate Finance Peer Challenge (December 2020) noted that the Council should *"seek assurance they are content with the financial and governance arrangements for KGE and its future viability as it continues to scale up its operations."*

This was reflected in a recommendation raised by the peer review team:

"Clarify how the council is going to deal with viability issues for both individual housing schemes and the performance of your housing company."

The Council developed an action plan in response to the recommendations raised and this was presented to Cabinet in May 2021, with the following actions:

- KGE Business Plan being refreshed over 50-year time frame Cabinet has provided a steer on valuation basis to be used for transferring developments from Council to KGE
- New NEDs will provide additional expertise and challenge on KGE Board
- As [recommendation 23] above KGE 5 Year integrated business plan refreshed
- Align KGE with budget monitoring and financial reporting timeline for the Council.



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The action plan shows that these were to be implemented by June 2021.

A further update was presented to the Audit Committee in November 2021. This indicated that a 50-year viability model covering the P&L, balance sheet and cash flow had been produced and that the 2022/23 KGE budget was being produced alongside the Council budget.

In October 2021 and March 2022, papers were presented to CPRC regarding the provision of short-term funding assistance to the company. This was followed by a further report to CPRC in April 2022 regarding the repatriation of funds from KGE to the Council.

These reports were indicative of continuing ambiguity in the governance arrangements of KGE. The reports were prepared by the Council's Chief Accountant in his capacity as an officer of the Council, but who at the time continued to act as KGE's Head of Finance.

While the report legitimately deals with the Council's interest in realising a return from its subsidiary, there are some elements which we would reasonably expect the company to manage as part of its strategic and financial planning Council (such as determining how to fund the company's responsibilities for lifecycle replacement programmes), with resulting financial plans presented to the Council for further consideration.

We also observe that the financial information presented in the appendices to the reports does not reflect the options discussed.

Although this is made clear in para 3.1 and the report is presented in the context of some developments being subject to finalisation and approval, these discrepancies means the annual impact of the proposals on the company's financial performance is not clear from the information presented.

Subsequent external reviews have commented on the governance of KGE. The CIPFA Capital Assurance Review observed that potential conflicts could arise given that:

- The S151 officer advises the Council on the affordable housing schemes while also being involved in decision making around project viability at KGE
- The Council's Chief Accountant acts as KGE's Finance Director
- the Vice Chair of the Development Sub-Committee plays a role in the gateway process for key Council projects, including affordable housing projects that will potentially impact KGE over the long term.

CIPFA express the view that the arrangements described above are "*potentially problematic*" because:

"The S151 has a statutory duty to administer council affairs and advise members of the prudence and legality of financial decisions. It is worth considering how effectively these powers can be deployed on decisions about KGE given that the S151 chairs the KGE board."

CIPFA also note that the capacity of the finance team is impacted by these dual roles, with a subsequent impact on the timeliness and quality of financial report to members.



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While noting that KGE was subject to regular review by the Cabinet, Audit Committee and Overview and Scrutiny Committee, the BVI report made similar observations to CIPFA regarding governance:

“We believe [the S151 officer’s] dual role reflected poor governance practices by the Council. This was noted by CIPFA in their July 2023 report, which stated it was ‘imperative that the KGE governance arrangements – and their practice – are as good as they can be.’ The failure to address this issue in a timely manner is a concern.”

We also note that a business plan was still being prepared in September 2018 (as reported to Cabinet that month), more than two years after the company was initially set up. By 31 March 2019, KGE held nearly £7 million of assets on its balance sheet. A business plan was not presented to members until January 2020.

Significant weakness

It is not unusual for local authority trading companies to initially appoint senior Council officers and members as directors on incorporation. However, it is important to develop a succession plan which allows senior officers and members to step away from company director roles as soon as possible, thereby mitigating any perceived or actual conflicts of interest.

While acknowledging senior officers’ desire to ensure they were fully aware of KGE’s operations and financial position, appropriate governance structures should have been planned and put in place to enable the Council to have the appropriate degree of oversight of its wholly owned subsidiary as soon as was practicable while avoiding potential conflicts of interest.

We have not seen any evidence that this was the case. This view is further reinforced by the external reviews which took place in later years (particularly the CIPFA Capital Assurance Review in 2023 and Best Value Inspection in late 2024/early 2025).

We also note that a business plan was still being prepared in September 2018 (as reported to Cabinet that month), more than two years after the company was initially set up. By 31 March 2019, KGE held nearly £7 million of assets on its balance sheet. A business plan was not presented to members until January 2020.

For the above reasons, we are unable to conclude that the Council put in place appropriate arrangements for the governance of KGE.



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Change to a committee system

Risk of significant weakness

Introduction of the committee system.

The Council moved from a cabinet and strong leader governance model to a committee model in May 2021.

Internal Audit completed a review of the arrangements and issued an assurance opinion of 'Major Improvement Required' and raised a number of recommendations.

The Council acknowledged this as a significant governance issue in the 2021/22 Governance Statement. This matter was also identified as an area of concern in the LGA Peer Review and BVI report.

The Council has been unable to locate a final copy of Internal Audit's report on the new committee system and we were provided with a copy headed as 'Proposed final report' which includes drafting comments from the s151 officer and Head of Corporate Governance.

A summary version of Internal Audit's report, along with the eight high priority, 'red-rated' recommendations raised, was presented to the 20 April 2022 meeting of the CPRC.

The recommendations paper included officer responses showing that the recommendations were accepted with a target implementation date of Autumn 2022.

Internal Audit's Annual Report for 2021/22 was presented to the Audit Committee in July 2022 and (Appendix A) noted the current status of the audit was 'Open Audit' and that the recommendations were to be "addressed further by the new Group Head of Corporate Governance when she starts post in September 2022".

Recommendation 1 acknowledged the upcoming LGA Corporate Peer Review. This review took place in November 2022 and reported to the Council in February 2023.

The Peer Review covered five themes:

- Local priorities and outcomes
- Organisational place and leadership
- Governance and culture
- Financial planning and management
- Capacity for improvement.

Under Governance and culture, the Peer Review team reported the following observations:

"The committee system that was introduced quickly last year at the behest of Councillors is not yet working well enough to create consensus to take forward important plans for the Council.

Whilst officers are satisfied that they delivered the committee system within the tight timeline prescribed by the Members, the impact of such a significant shift in the way decisions are made and scrutinised, seems to have been underestimated on both sides.

There appears to be little evidence that this transformative shift was resourced effectively and as a result Members at least have still not adapted to this new way of making democratic decisions.



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Some of the provisions within the committee system and its supporting constitution make decision making more complex, which can add to both the political tension within the committee system itself and undermine the confidence of partners in its observations of the functioning of the democratic system."

The Peer Review team's observations indicate that the Council had made limited progress against Internal Audit's recommendations by the Autumn of 2022 as originally envisaged.

The Peer Review team made the following recommendation in relation to these observations:

"Recommendation 9

Review the working of the committee system by looking at best practice elsewhere to consider how to create a system that is fit for purpose."

The Council developed an action plan to address the Peer Review's recommendations, although due to the timing of the review, this took place after 31 March 2023 (the outline action plan was presented to the CPRC at its meeting on 17 April 2023).

The BVI report acknowledged that the Council had made some progress in increasing the effectiveness of the committee system since the LGA Peer Review in 2022. However, the inspection team were unclear how much scrutiny and challenge is taking place in the committees.

Other weakness

The Committee system did not facilitate effective governance and decision making following its implementation in May 2021. Weaknesses in the system were identified by Internal Audit in early 2022 but the Council did not address these in a timely manner.

Housing and regeneration acquisitions and viability of the Council's housing developments (strategy)

Risk of significant weakness

Viability of the Council's housing delivery programme.

The Council's Corporate Plan 2016 - 2019 (adopted by the Council in July 2016) included housing and economic development as key strategic priorities.

Under the housing priority, the Corporate Plan stated that the Council planned to:

- invest in existing properties and convert them, where necessary, to provide much needed homes for our residents
- develop some of our existing sites as well as acquire new sites.

Under economic development the Council planned to "look for opportunities where we can use our assets to stimulate the local economy".



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The Council purchased the following properties in 2018/19 for the purposes of affordable housing and regeneration:

- Thameside House in April 2018 (£8.5 million)
- Communications House in July 2018 (£11.7 million)
- Victory Place Ashford in March 2019 (£5 million)

The purchase of Thameside House was approved by Cabinet in April 2018. The Council's initial intention was to hold the asset for investment purposes (through conversion to grade A office space), but it was subsequently decided to use it for regeneration purposes.

Cabinet received a covering report accompanied by the external property advisers' Market and Pricing Report. The latter included an analysis of redeveloping the site for both office and residential purposes.

In both cases, the adviser indicated that the analyses were based on optimistic assumptions. The covering report does not draw attention to these optimistic assumptions.

Communications House is an office building in Staines-upon-Thames and was purchased to initially generate an income stream and then regeneration. The purchase was approved by Cabinet in April 2018.

Victory Place Ashford was a car park site adjacent to Ashford Hospital which was designated by the NHS Trust as surplus to requirements and therefore put up for sale. The Council intended to purchase the land for the purposes of residential development. The purchase was approved by Cabinet in December 2018.

The substance of the reports presented to Cabinet was consistent with those for Thameside House (although Victory Place Ashford was not accompanied by a market and pricing report from the external property advisers).

Further properties were purchased in 2019/20 to support housing development and regeneration:

- Summit Centre in September 2019 (£13.785 million)
- Oast House in October 2019 (£20.097 million)
- Elmsleigh Centre in February 2020 (£39.325 million)

The reports presented to Cabinet in relation to the 2019/20 acquisitions were as described for those purchases made in 2018/19.

As with the acquisition of the commercial properties, the reports referred to in the previous paragraphs appear to be the only information presented to members of the Cabinet prior to the acquisitions being completed.

While the covering papers include a section headed 'Financial Implications' this does not include any detailed financial information, such as amounts to be set aside for sinking funds and MRP and the methodologies for calculating those amounts. Instead, there is a focus on the low borrowing rates available to finance the acquisitions.

We note that the external reviews refer to the absence of a strategic approach to both the affordable housing and regeneration programmes.



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The LGA Corporate Finance Peer Challenge (December 2020) noted that it was unclear to them how some of the Council's small-scale developments fit into the wider vision for delivery of affordable housing and included a recommendation to clarify how the Council is going to deal with viability issues for both individual housing schemes and the performance of the housing company.

The BVI report states the following:

"4.33 The Inspection team could not find a report, approved by members, that supports the development of a housing delivery programme with clear details on proposed sites, budgets, staffing resources, timescales, and associated risks. When asked, the Council pointed to two documents. First, the Corporate Plan 2016-19 which mentions the Council's aspirations to 'develop some of our existing sites for housing as well as acquire new sites'.

Second, an exempt Cabinet report from January 2020 on the Review of Knowle Green Estates, by which time all sites had already been purchased by the Council.

4.34 We believe the Council lacked a well-defined decision to embark on a programme of acquisitions for housing delivery. Members were not provided with sufficient information on the programme's scale, required budget, staffing resources, or risks, including those relating to planning and market conditions. The Council subsequently approved individual property purchases through exempt reports without the context of the programme being fully explained."

Significant weakness

Prior to embarking on acquisitions for regeneration purposes, the Council did not develop a strategy setting out how the acquisitions and their subsequent development would support achievement of the Council's corporate priorities regarding housing and regeneration.

Reports presented to members about the acquisitions did not contain sufficient information on the financial implications of the purchases and the risks associated with holding the properties and how the risks would be managed.

Housing and regeneration acquisitions and viability of the Council's housing developments (financial viability)

The viability of the Council's housing developments has become increasingly uncertain due to both the self-imposed moratorium on developments in Staines and wider macroeconomic factors which have had an adverse impact on forecast construction costs.

There is a risk that the Council is unable to fund those developments already underway to completion or is unable to divest from these developments without incurring significant revenue costs not previously budgeted for.

The key development sites for affordable housing were in Staines-upon-Thames, including Thameside House and Oast House, where initial plans were to provide 621 housing units, of which 426 would be affordable.



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At its meeting on 10 December 2020, full Council passed a motion requiring Cabinet to consider whether significant developments in Staines Town Centre, by the Council or private developers, should be kept on hold / deferred until the Staines Development Framework had been consulted on and adopted.

The matter was considered by Cabinet at its meeting on 25 January 2021, where officers presented report setting out the implications of placing developments on hold in Staines. This included the adverse impact on the Council's revenue budget, both in terms of lost income and the costs associated with holding sites and / or writing off previously capitalised costs to revenue.

Cabinet agreed to the moratorium, subject to three conditions being met:

- The Strategic Planning team undertake an Issues and Options consultation exercise for the Staines Development Framework
- A sub-committee, which was agreed at Extraordinary Council on 21 January 2021, is included in the recommendations of the Committee System Working Group to be reported to Extraordinary Council, currently scheduled for 25 March 2021
- The viability of all the developments are reviewed by the assets team.

Despite the significant financial impacts of the moratorium, these were not reflected in the MTFS for the period 2021/22 to 2024/25 or the detailed revenue budget for 2021/22.

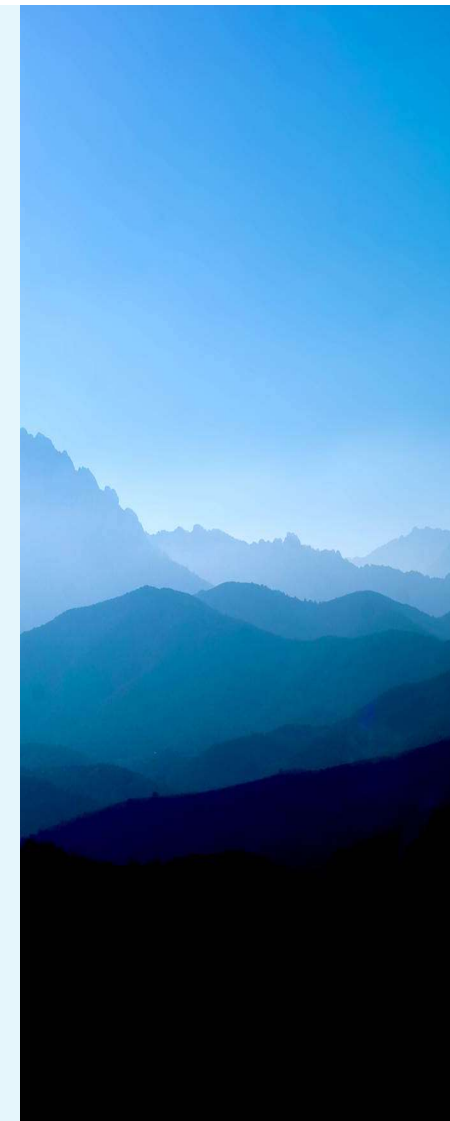
Given the Council passed the motion on 10 December, and officers were able to prepare a paper setting out the financial implications ahead of the Cabinet meeting on 25 January, it is unclear why the potential impacts were not incorporated into the MTFS presented to Cabinet on 27 January 2021 and detailed 2021/22 budget presented to Council on 25 February 2021 (either when preparing the original papers or through an item added to the agenda).

The moratorium remained in place until early January 2022, when the Council determined that each of the three conditions imposed by Cabinet had been met. At its meeting on 19 January 2022, the CPRC decided not to impose a further moratorium.

Sections 3 and 4 of the report presented to the CPRC on 19 January 2022 are headed 'Options analysis and proposal' and 'Financial implications'. Both sections are very high level, with the 'Financial Implications' section referring to Appendix A of the report, which itself is one page setting out the monthly and cumulative revenue and capital costs of the affected schemes (Thameside House and Oast House).

It is notable that the report does not appear to offer any alternative other than proceeding with development of the sites for the purposes of housing provision and the costs that would be incurred were a further moratorium to be imposed.

For example, the financial implications of disposing of the affected site is not considered. It is therefore unclear whether members had all the necessary information to make an informed decision regarding the matter.



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A report was presented to an Extraordinary Council Meeting in February 2023 regarding the long-term viability of the Council's housing programme.

As the original intention was for KGE Ltd to take on responsibility for managing the developments once complete (assuming they were financially viable), the company's future was closely tied to the housing programme.

The report highlights the financial risks and challenges presented by the housing programme, which can be summarised as follows:

- Reductions in the number of affordable housing units (due to height restrictions placed on key developments by councillors) and the resulting reduction in rental income of £92 million
- Inflationary increases in construction costs and the associated impact on the housing schemes, exacerbated by the Council's self-imposed delays, adding £34 million to capital costs
- Increases in financing costs due to the additional borrowing needed to finance the increased capital costs.

The above increases were offset by reductions in lifecycle costs due to fewer housing units, meaning fewer bathroom and kitchen replacement works etc. Nonetheless, the paper still projected a fall of £196 million in KGE's cash balances by 31 March 2072 (ie in 50 years time).

This section of the report makes reference to Appendix A of the report which shows that this would result in KGE having a negative cash balance of £55 million by 2072.

The report also makes it clear that if it is not possible to make the schemes viable (whether that involves transferring to KGE or retention of the schemes by the Council) then the Council would face abortive costs of approximately £9 million, reflecting the capital costs incurred to date which would now need to be covered by the Council's revenue budget.

The paper then sets out a number of scenarios being considered to return the housing programme to viability:

- Scenario 1 - An application for grant funding to Homes England to fund 25% of the development project costs, noting that this would require KGE Ltd to become a registered provider of housing
- Scenario 2 - Bringing forward plans to develop the Tothill Car Park site *"to cover the shortfall in KGE and make it financially viable"*
- Scenario 3 - Council injecting £55 million of capital into KGE Ltd through purchase of equity in the company.

The report considers the above three scenarios in combination are required to ensure viability.



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The report also presents the following scenarios but concludes that none are realistic:

- Scenario 4 - Increasing the number of apartments at Thameside House and Oast House (not feasible due to additional capital and financing costs incurred)
- Scenario 5 - Take out short term loans to finance additional construction costs to avoid locking in higher interest rates (not viable as interest rates not expected to fall in medium term)
- Scenario 6 - Sell some units in each development to cover amounts borrowed while retaining freehold (not viable because rental reductions would not be offset by loan and interest savings)
- Scenario 7 - Sell sites to other developers while acknowledging that capitalised costs relating to those sites may have to be written off to revenue (not recommended as officers considered the current market to be depressed and expect a net loss on the purchase price for Thameside House, Oast House and Victory Place)
- Scenario 8 - become a commercial landlord (not viable because KGE would still be unable to maintain a healthy cash balance).

The report provides further information regarding the first three scenarios, although the financial impact of the actions required by each scenario, particularly on the Council, are difficult to follow and / or are unclear.

For example:

- Paras 2.15 - 2.18 refer to scenario 2 and bringing forward the Tothill Car Park investment. However, there are no details regarding the financial impact of doing so, with para 2.18 simply stating *"The aim of the new development would be to build the maximum number of apartments to ensure that KGE becomes fully financially viable"*
- Paras 2.30 - 2.32 imply that, even with Homes England funding (scenario 1), bringing forward the Tothill Car Park development (scenario 2, which as noted above, does not include any financial information) and an equity investment by the Council of £55 million (scenario 3), KGE would not be able to meet interest payments so would need the Council to provide £1 million to £2 million of additional cash support a year.

Para 2.33 states *"Officers are recommending this Scenario, in conjunction with Scenario one and two above is agreed"*.

This is consistent with the recommendations at the start of the report, although is contradicted by 3.4 which states *"Officers are recommending that these the Council agree to Scenario 1, 2, 3 and 4 to secure the financial viability of KGE, noting that under these options, KGE will be able to contribute to the Council's cashflow from March 2029"*

Para 2.40 explicitly rules out scenario 4 as an option. This is also the first reference to March 2029 being the point at which KGE can contribute to the Council's cash flow.



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The minutes of the meeting show that Council approved the report.

Both the LGA Corporate Finance Peer Challenge (December 2020) and the BVI report identified the absence of a strategic approach to the Council's housing programme.

The LGA Corporate Peer Challenge (February 2023) report notes that there has been good collaborative working between officers and members on the new Local Plan but that members need to accept the trade off between urban density and protecting green belt land if the Council is to deliver its affordable housing programme.

The DLUHC CIPFA Capital Assurance Review (May 2024) draws attention to the fact that, at the date CIPFA was undertaking its review (early 2023), the impact of the review of the viability of the Council's housing programme in February 2023 had not been incorporated into the Council's medium term financial planning.

CIPFA raised concerns that reports taken to the Extraordinary Council Meeting on 2 February 2023 lack detailed sensitivity analysis taking into account construction cost inflation and interest rate movements. CIPFA also indicate that there are other risks not properly assessed, including:

- Tenants right to acquire properties and the impact of any such disposals during the 50-year period
- Planning conditions which may be imposed on the developments
- Eligibility for Homes England grant

- Timing of schemes, including one scheme only recently added to the programme (and therefore the least developed) but on whose completion progress on other projects will depend.

CIPFA also observe that the February 2023 Extraordinary Council Meeting at which the affordable housing programme was considered did not receive a detailed risk assessment of the impact of cancelling the programme versus its continuance and that officers offered an option at the meeting which was not covered in the papers (resulting in changes to the report recommendations).

CIPFA summarise the position relating to the affordable housing as follows:

"Mutual dependency between schemes, along with disparate timescales, the problem of timing, transfer viability assessment and funding eligibility are serious matters. Officers have stated that they are open to considering a wide range of further options if the deliverability of schemes becomes compromised."

These options appear to involve converting affordable housing to either private rented or private sales. This could compromise Homes England funding and create further losses. Moreover, the risks associated with progressing the schemes cannot be divorced from SBC's wider debt position, especially given the criteria that have triggered this DLUHC review."



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To date, the Council has been so focused on avoiding losses through sales that it might have underplayed the potentially greater risks associated with continuing the programme. It is accordingly essential that there is a clear and realistic assessment of the alternative options. This assessment may also need to revisit the valuations for individual properties in particular the Oast House to consider the site's potential value if developed to its maximum potential."

Significant weakness

Information presented to members regarding the financial implications of the housing development programme was inadequate. Key reports about the future direction of the programme were difficult to follow. It is unclear from the minutes of the meetings whether and to what extent members challenged the information presented.

Conclusion

While the Council sets and monitors its financial budgets it is unclear to what extent it has developed, maintained and reported on non-financial key performance indicators. We have not seen any evidence that such indicators were reported to Cabinet or any other committee.

The Council purchased its final tranche of commercial properties in August 2018. Confidential papers were presented to the July 2018 Cabinet meeting regarding the acquisitions and Members were presented with high level information. However, Members were not presented with any details of the Council's financial models, such as amounts to be set aside for sinking funds and MRP and the methodologies for calculating those amounts.

The Council developed a significant affordable housing programme and acquired a number of properties and sites for development. However, this does not appear to be supported by strategic plan and the Council has encountered a number of financial and operational issues in developing these sites.

Although improvements were made to the corporate risk register in 2022, there remain concerns over the effectiveness of how risks are assessed and reported.

The Internal Audit function has experienced capacity challenges during the period covered by this report and, in our view, did not fully consider the full extent of the operational and strategic risks of the commercial property portfolio.

We noted concerns around governance and potential conflicts of interest for KGE Ltd where officers and members of the Council were also the directors of the company.

While some progress has been made in implementing the committee system of governance some issues remain and it is not clear how much scrutiny and challenge is taking place in the committees.

We have noted a number of significant and other weaknesses in respect of the performance management arrangements, information presented to Members to support the acquisition of the commercial property portfolio, the strategic development for the affordable housing programme, risk management, capacity of the internal audit function, governance over KGE and the implementation of the committee structure.



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Therefore, we are unable to conclude that the Council had proper arrangements in place to ensure that it:

- Monitors and assesses risk and how the body gains assurance over the effective operation of internal controls
- Ensures effective processes and systems are in place to ensure budgetary control, to communicate relevant, accurate and timely management information (including non-financial information where appropriate) and ensure corrective action is taken where needed
- Ensures it makes properly informed decisions, supported by appropriate evidence and allowing for challenge and transparency.

2015 Code reporting criteria

For 2018/19 and 2019/20 these significant weaknesses impact on:

- Understanding and using appropriate and reliable financial and performance information to support informed decision making and performance management
- Managing risks effectively and maintaining a sound system of internal control
- Acting in the public interest, through demonstrating and applying the principles and values of sound governance.

We have summarised our findings in the tables on the following pages and have raised a recommendation regarding the matters identified on page 51.



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For audits relating to 2018/19 and 2019/20 (which have been conducted in accordance with the requirements of the 2015 Code of Audit Practice), we have identified the following significant weaknesses in arrangements which gave rise to qualification of our conclusions.

	Area	Year(s) affected	Finding	Overall conclusion
1	Sustainable resource deployment: Medium term financial sustainability	2018/19 2019/20	While the Council has been able to deliver surpluses, weaknesses in the Council's financial modelling related to commercial property acquisitions (as identified by the Council's external advisers) mean it is unclear whether amounts set aside into sinking funds are sustainable in the medium term.	Adverse
2	Managing and utilising assets effectively	2018/19 2019/20	The portfolio review in March 2019 highlighted that there were no asset management plans in place for the commercial properties.	Adverse

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	Area	Year(s) affected	Finding	Overall conclusion
3	Informed decision making: quality and robustness of information used for decision making	2018/19 2019/20	<p>It is unclear to what extent the Council developed, maintained and reported on non-financial key performance indicators during the year.</p> <p>Acquisitions of both commercial and regeneration properties were subject to approval by Cabinet. Members were presented with high level information focussing on borrowing rates (in the covering report) and reports by the Council's property advisors on expected price ranges given the nature of the properties and national and local market conditions. Members were not presented with any details of the Council's financial models, such as amounts to be set aside for sinking funds and MRP and the methodologies for calculating those amounts. There was also no reference to the narrative 'Property Investment Strategic Parameters' presented to Cabinet in 2017 in any of the reports presented to Cabinet.</p> <p>Information presented to members regarding the financial implications of the housing development programme was inadequate. Key reports about the future direction of the programme were difficult to follow. It is unclear from the minutes of the meetings whether and to what extent members challenged the information presented.</p>	Adverse

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	Area	Year(s) affected	Finding	Overall conclusion
4	Working with partners and other third parties: Governance of Knowle Green Estates Ltd (KGE Ltd)	2018/19 2019/20	<p>While acknowledging senior officers' desire to ensure they were fully aware of KGE's operations and financial position, appropriate governance structures should have been planned and put in place to enable the Council to have the appropriate degree of oversight of its wholly owned subsidiary as soon as was practicable while avoiding conflicts of interest. We have not seen any evidence that this was the case. This view is further reinforced by the external reviews which took place in later years (particularly the CIPFA Capital Assurance Review in 2023 and Best Value Inspection in late 2024 and early 2025).</p> <p>We also note that a business plan was still being prepared in September 2018 (as reported to Cabinet that month), more than two years after the company was initially set up. By 31 March 2019, KGE held nearly £7 million of assets on its balance sheet. A business plan was not presented to members until January 2020.</p>	Adverse

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For audits relating to 2020/21, 2021/22 and 2022/23 (which have been conducted in accordance with the requirements of the 2024 Code of Audit Practice), we have identified the following significant and other weaknesses in arrangements.

	Risk of significant weakness	Findings	Weakness identified?	Is weakness significant?	Recommendation raised?
1	Sustainable resource deployment: Medium term financial sustainability	While the Council has been able to deliver surpluses, weaknesses in the Council's financial modelling related to commercial property acquisitions (as identified by the Council's external advisers) mean it is unclear whether amounts set aside into sinking funds are sustainable in the medium term.	Yes	Yes	Yes
2	Managing and utilising assets effectively	The portfolio review in March 2019 highlighted that there were no asset management plans in place for the commercial properties.	Yes	Yes	Yes
3	Informed decision making: quality and robustness of information used for decision making	<p>It is unclear to what extent the Council developed, maintained and reported on non-financial key performance indicators during the year.</p> <p>Acquisitions of both commercial and regeneration properties were subject to approval by Cabinet. Members were presented with high level information focussing on borrowing rates (in the covering report) and reports by the Council's property advisors on expected price ranges given the nature of the properties and national and local market conditions. Members were not presented with any details of the Council's financial models, such as amounts to be set aside for sinking funds and MRP and the methodologies for calculating those amounts. There was also no reference to the narrative 'Property Investment Strategic Parameters' presented to Cabinet in 2017 in any of the reports presented to Cabinet.</p> <p>Information presented to members regarding the financial implications of the housing development programme was inadequate. Key reports about the future direction of the programme were difficult to follow. It is unclear from the minutes of the meetings whether and to what extent members challenged the information presented.</p>	Yes	Yes	Yes

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	Risk of significant weakness	Findings	Weakness identified?	Is weakness significant?	Recommendation raised?
4	Informed decision making: quality and robustness of information used for decision making	The format of the risk register presented to members and the information it contained did not support robust scrutiny of the Council's risks and the actions being taken to mitigate those risks.	Yes	No	Yes
5	Informed decision making: quality and robustness of information used for decision making	The Council's Internal Audit function did not have sufficient capacity and capability to robustly assess the risks associated with the Council's commercial property portfolio and whether the associated control environment was appropriate for the scale and complexity of the investments made.	Yes	No	Yes
6	Governance of Knowle Green Estates Ltd.	<p>While acknowledging senior officers' desire to ensure they were fully aware of KGE's operations and financial position, appropriate governance structures should have been planned and put in place to enable the Council to have the appropriate degree of oversight of its wholly owned subsidiary as soon as was practicable while avoiding conflicts of interest. We have not seen any evidence that this was the case. This view is further reinforced by the external reviews which took place in later years (particularly the CIPFA Capital Assurance Review in 2023 and Best Value Inspection in late 2024 and early 2025).</p> <p>We also note that a business plan was still being prepared in September 2018 (as reported to Cabinet that month), more than two years after the company was initially set up. By 31 March 2019, KGE held nearly £7 million of assets on its balance sheet. A business plan was not presented to members until January 2020.</p>	Yes	Yes	Yes

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	Risk of significant weakness	Findings	Weakness identified?	Is weakness significant?	Recommendation raised?
7	Introduction of committee system	The Committee system did not facilitate effective governance and decision making following its implementation in May 2021. Weaknesses in the system were identified by Internal Audit in early 2022 but the Council did not address these in a timely manner.	Yes	No	Yes
8	Viability of the Council's housing delivery programme	<p>Prior to embarking on acquisitions for regeneration purposes, the Council did not develop a strategy setting out how the acquisitions and their subsequent development would support achievement of the Council's corporate priorities regarding housing and regeneration.</p> <p>Reports presented to members about the acquisitions did not contain sufficient information on the financial implications of the purchases and the risks associated with holding the properties and how the risks would be managed.</p>	Yes	Yes	Yes
9	Viability of the Council's housing delivery programme	Information presented to members regarding the financial implications of the housing development programme was inadequate. Key reports about the future direction of the programme were difficult to follow. It is unclear from the minutes of the meetings whether and to what extent members challenged the information presented.	Yes	Yes	Yes

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Our work has identified significant weaknesses in the Council’s arrangements to secure economy, efficiency and effectiveness in the use of resources (value for money). These weaknesses relate to financial sustainability and governance and affect all years. Our findings are consistent with those matters raised in the various external reviews of the Council which have taken place over the past five years.

Given the timing of our work, the outcome of the various external reviews and inspections which have taken place since 2020, including the recommendations raised by each of those reviews, and the Council’s ongoing work to address the recommendations, we do not consider it appropriate to re-raise these matters.

We understand that the Council has compiled an Improvement and Recovery Plan to address the recommendations previously raised by external reviews and inspections. As this was prepared after 31 March 2023 and does not relate directly to arrangements in place during the years we are required to report on, we have not undertaken any procedures to verify the completeness of the action plan or the effectiveness of the actions being taken by the Council. However, we acknowledge the importance of the Improvement and Recovery Plan in addressing the weaknesses we have described in this report and the recommendation below reflects this.

	Area	Year(s) affected	Significant weakness noted?	Recommendation	Management response
1	Financial Sustainability Governance	2018/19 2019/20 2020/21 2021/22 2022/23	Yes	Continue to maintain and utilise the Improvement and Recovery Plan to capture and address the recommendations made by external reviews and investigations. Ensure member oversight of progress against the action plan is transparent and provides opportunity for constructive challenge and scrutiny.	

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Independence

We confirm that the firm, and the engagement team including other BDO network firms conducting the audit comply with relevant ethical requirements including the FRC's Ethical Standard and the IESBA Code of Ethics and are independent of Spelthorne Borough Council.

Details of services, other than audit, provided by us to the Group or Spelthorne Borough Council during the period and up to the date of this report are set out in the table below. We have not identified any threats to our independence arising from the provision of these services.

Commercial relationships

The Council acquired the freehold interest in a property in Reading in which we currently hold a lease under the terms arranged with the previous owner. We are satisfied that this does not present a threat to our independence and objectivity as your auditor as this commercial relationship is at arms length, the audit team are not party to the lease negotiations and the amounts are not material to either party.

This matter was considered by the Audit Committee on 1 November 2018, where members noted the relationship and agreed that it did not compromise our independence.

We have not identified any other relationships or threats that may reasonably be thought to bear on our objectivity and independence.

Fee summary

Proposed audit fees for work performed in relation to the backstop arrangements and value for money are shown in the table below. These fees are subject to discussion with officers and approval by Public Sector Audit Appointments Ltd.

Our work relating to Housing Benefit Assurance Procedures is complete and the amounts shown in the table are the actual fees billed to the Council.

Area	Year ended	31 March 2019	31 March 2020	31 March 2021	31 March 2022	31 March 2023	Independence safeguards	Impact on independence
Audit Services:								
Backstop arrangements relating to the Statement of Accounts (proposed)		55,000*	10,500	10,500	10,500	10,500	None required	N/A
Value for Money (proposed)		20,000	15,000	15,000	15,000	15,000		
Non-audit services:								
Housing Benefit Assurance Procedures (actual)		7,102	13,102	22,260	16,800	21,084	None required	N/A
Total proposed fees		82,102	38,602	47,760	42,300	46,584		

* The increased proposed fee for the year ended 31 March 2019 reflects preliminary planning and risk assessment procedures performed by the audit team in 2019 and 2020. This work was performed on the assumption the audit would commence as normal once the predecessor auditor had completed their work relating to the prior year.

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Those Charged with Governance (TCWG)

References in this report to Those Charged With Governance are to Spelthorne Borough Council as a whole. For the purposes of our communication with those charged with governance you have agreed we will communicate primarily with the Audit Committee.

Communication

The National Audit Office has issued Local Audit Reset and Recovery Implementation Guidance (LARRIGs) to support the reset and recovery of local audit in England. LARRIG 02 states that the frequency with which matters are communicated to Those Charged With Governance may be less in the circumstances created by backstop arrangements and that it may therefore be appropriate to include all communications relevant to an audit within a single document. In line with this guidance, we issued a combined Audit Planning Report and Audit Completion Report in respect of the audit of the financial statements.

This Auditor’s Annual Report includes our findings and conclusion for the review of the Council’s arrangement for value for money.

Communication required	Date (to be) communicated	To whom	Communication method
Audit Planning Report	4 December 2024	Audit Committee	Combined Audit Planning Report and Audit Completion Report
Audit Completion Report	4 December 2024	Audit Committee	Combined Audit Planning Report and Audit Completion Report
Combined Annual Audit Letters 2018/19 and 2019/20 and Auditor’s Annual Reports 2020/21, 2021/22 and 2022/23	25 September 2025	Audit Committee	Combined Annual Audit Letters and Auditor’s Annual Reports

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Financial reporting

Spelthorne Borough Council is expected to have effective governance arrangements to deliver its objectives. To this end, the publication of the financial statements is an essential means by which Spelthorne Borough Council accounts for its stewardship and use of the public money at its disposal.

The form and content of Spelthorne Borough Council's financial statements, and any additional schedules or returns for consolidation purposes, should reflect the requirements of the relevant accounting and reporting framework in place and any applicable accounting standards or other direction under the circumstances.

The Section 151 Officer is responsible for preparing and filing a Statement of Accounts and financial statements which show a true and fair view in accordance with CIPFA Code of Practice on Local Authority Accounting for the relevant year, applicable accounting standards or other direction under the circumstances.

Our audit of the financial statements does not relieve management nor those charged with governance of their responsibilities for the preparation of materially accurate financial statements.

Use of resources

Local authorities are required to maintain an effective system of internal control that supports the achievement of their policies, aims and objectives while safeguarding and securing value for money from the public funds and other resources at their disposal.

As part of the material published with its financial statements, Spelthorne Borough Council is required to bring together commentary on its governance framework and how this has operated during the period in a Governance Statement.

In preparing its Governance Statement, Spelthorne Borough Council will tailor the content to reflect its own individual circumstances, consistent with the requirements of the relevant accounting and reporting framework and having regard to any guidance issued in support of that framework. This includes a requirement to provide commentary on their arrangements for securing value for money from their use of resources.



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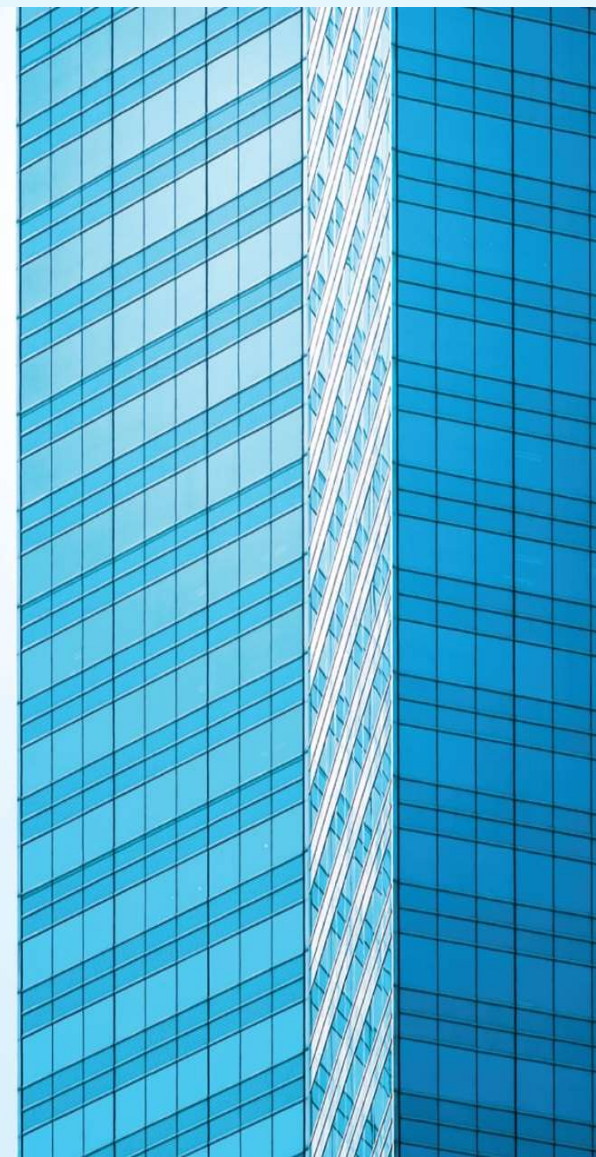
Our responsibilities and reporting

We are responsible for performing our audit under International Standards on Auditing (UK) to form and express an opinion on your financial statements. We report our opinion on the financial statements to the members of Spelthorne Borough Council.

We are required to satisfy ourselves that Spelthorne Borough Council has made proper arrangements for securing economy, efficiency and effectiveness in its use of resources. This means that we have regard to relevant guidance issued by the National Audit Office and undertake sufficient work to be able to satisfy ourselves as to whether Spelthorne Borough Council has put arrangements in place that support the achievement of value for money.

What we don't report

Our audit is not designed to identify all matters that may be relevant to Spelthorne Borough Council and cannot be expected to identify all matters that may be of interest to you and, as a result, the matters reported may not be the only ones which exist



For more information:

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The matters raised in our report prepared in connection with the audit are those we believe should be brought to your attention. They do not purport to be a complete record of all matters arising. This report is prepared solely for the use of Spelthorne Borough Council and may not be quoted nor copied without our prior written consent. No responsibility to any third party is accepted.

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