

Kettering Borough Council – 2018-2019 External Audit

Executive Summary to the 25th July 2019 Monitoring and Audit Committee on the findings from review of the Council’s arrangements for commercial ventures and decisions during the 2018-2019 financial year.

Background

The Council has expanded its commercial activities both inside and outside of their area. It has an ambitious capital and property strategy aimed at becoming more self-sufficient.

The Council holds investment properties in order to earn rental income. This includes two properties which the Authority purchased in 2017/18, at a total cost of £33.638million. This is made up of:

- Linear House in Derby: £14.861million cost
- Staples Distribution Centre (shared with Corby Borough Council at 50%): £18.777million cost for the Authority’s share

The Authority also acquired two properties during 2018/19:

- Haylock House in Kettering: £4.575million cost
- Kingfisher House in Wakefield: £5.523million cost

The aim of these investments is to assist the Council to generate income and reduce reliance on funding from central government, and secure its future financial sustainability.

Audit approach

In response to our significant audit risk in the 2018-2019 External Audit plan, we reviewed the adequacy of the Council’s arrangements for commercial ventures and decision making. We considered the alignment of the Council’s plans to its strategic and corporate objectives, the adequacy of the governance arrangements and due diligence put in place for each of the individual acquisitions above. We have also considered the robustness of the assumptions the Council is making for future income and receipts associated with its commercial ventures as part of its budget setting and medium term financial planning.

We have reviewed a significant amount of written documentation, either available from the Council’s website or provided to us by Council officers.

Findings

The Council’s key strategic documents are well aligned. The overall aims of the Council are consistent, creating a balanced depiction of the Authority’s strategic goals and plans to achieve them.

The Council has complied with the updated Prudential Framework to produce a Capital Strategy. This Capital Strategy largely observes the Framework’s guidelines for content although to strengthen this further it would benefit from a more explicit mention of prudence to be consistent with its Treasury Management Strategy.

In order for each investment opportunity to gain approval, members of the Asset Management Board ('AMB') were introduced to the opportunities in a presentation detailing notable elements of the property, which helped members of the AMB to make more informed decisions. Whilst we found that the minutes of the AMB meetings taken in isolation are not sufficiently detailed to properly evaluate the level of debate or enquiry that occurred in relation to these investment opportunities, these minutes should be read alongside the detailed presentations provided by the officers.

The Council has a risk policy outlining its strategy and approach to risk management. In addition to this it has a risk register for cataloguing risks and their severity, both their "*gross risk*" and "*residual risk*". This shows the Council has a proactive approach to risk management, and that there are specific actions in place to mitigate the risks associated with Commercial Investments.

We found that the Council has sought thorough advice from a range of legal, valuation and technical experts for the acquisition of all of its investment properties. The Council are providing some final documentation to us to conclude our audit review of the acquisition of Linear House but notwithstanding this we did not have any significant concerns with the due diligence applied to the decision. Acquisition of investment properties are supported by valuation report carried out by property consultants. For example, this was performed by Lambert Smith Hampton ('LSH') for the Staples Distribution Centre and Kingfisher House, Berry's for Haylock House and JLL for Linear House. These valuations give the Council detailed information about the property, the local environment and a simplistic expected return figure. Additional checks have also been carried out for some of the investment properties. For example, financial due diligence was carried out prior to the investment in the Staples Distribution Centre and a Title Report was commissioned for Kingfisher House. This provides robust management information to help the Council to ensure that it is making informed decisions.

Whilst we find that some Council's obtain external advice to support their financial forecasts for commercial schemes, the Council have decided to do this internally and have an approach that consolidates all the due diligence and advice they have received on the acquisition and how this modelled in to the budget and financial plans. We have no significant concerns on the Council's arrangements to prepare accurate and reliable financial forecasts of its commercial ventures. We found that the assumptions relating to commercial investments within the Medium Term Financial Forecast appear to be reasonable. The changes to the net income figure are in line with the changes to the Council's property portfolio over the past year. Large increases were seen in rental income, premises costs, supplies and services, although the increases appear reasonable.

Conclusion

We have obtained sufficient and appropriate evidence to conclude that overall, the Council has sound arrangements in place to make significant commercial decisions. These arrangements should also be looked at alongside the Council having good arrangements in place to achieve its financial sustainability, and resilience. In particular, the Council has achieved £12.8million of efficiencies to date. Whilst we did not identify a significant risk at the planning stage, the work we have undertaken as a minimum as part of our audit procedures to look qualitatively and quantitatively on the Council's financial resilience (which applies sensitivity tests to the Council's level of available reserves, reliance on uncertain income streams, medium term saving requirement, track record on savings and efficiencies) has shown that the Council has good arrangements in place to meet its budget, medium term financial targets and sufficient headroom to address any financial shocks. When we report our final VFM conclusion to the next Monitoring and Audit Committee, we will present a bridge graph to illustrate our assessment of the Council's financial sustainability.