

ABERDEEN CITY COUNCIL

COMMITTEE	Audit, Risk and Scrutiny Committee
DATE	22 February 2018
REPORT TITLE	Internal Audit Report AC1824 – Bond Governance
REPORT NUMBER	IA/AC1824
LEAD OFFICER	David Hughes
AUTHOR	David Hughes

1. PURPOSE OF REPORT

- 1.1 The purpose of this report is to present the planned Internal Audit report on Bond Governance.

2. RECOMMENDATION

- 2.1 It is recommended that the Committee review, discuss and comment on the issues raised within this report and the attached appendix.

3. BACKGROUND / MAIN ISSUES

- 3.1 Internal Audit has completed the attached report which relates to an audit of Bond Governance.

4. FINANCIAL IMPLICATIONS

- 4.1 There are no direct financial implications arising from the recommendations of this report.

5. LEGAL IMPLICATIONS

- 5.1 There are no direct legal implications arising from the recommendations of this report.

6. MANAGEMENT OF RISK

- 6.1 The Internal Audit process considers risks involved in the areas subject to review. Any risk implications identified through the Internal Audit process are as detailed in the attached appendix.

7. IMPACT SECTION

7.1 **Economy** – The proposals in this report have no direct impact on the local economy.

7.2 **People** – There will be no differential impact, as a result of the proposals in this report, on people with protected characteristics. An equality impact assessment is not required because the reason for this report is for Committee to review, discuss and comment on the outcome of an internal audit. The proposals in this report will have no impact on improving the staff experience.

7.3 **Place** – The proposals in this report have no direct impact on the environment or how people friendly the place is.

7.4 **Technology** – The proposals in this report do not further advance technology for the improvement of public services and / or the City as a whole.

8. APPENDICES

8.1 Internal Audit report AC1824 – Bond Governance.

9. REPORT AUTHOR DETAILS

David Hughes, Chief Internal Auditor
David.Hughes@aberdeenshire.gov.uk
(01467) 537861



ABERDEEN

CITY COUNCIL

Internal Audit Report

Corporate Governance

Bond Governance

Issued to:

Steven Whyte, Director of Resources
Fraser Bell, Head of Legal and Democratic Services
Deirdre Nicolson, Solicitor
Sandra Buthlay, Senior Accountant
External Audit

EXECUTIVE SUMMARY

After obtaining a credit rating in 7 October 2016 the Council issued £370m of bonds on 1 November 2016, on the London Stock Exchange, to finance the Council's capital programmes. A suitable credit rating will be required to be maintained during the term of the bonds, until 2054, when the outstanding principal will be repaid by the Council. The Council's appointed credit rating agency will be required to conduct credit rating reviews, at least once every twelve months, for this purpose.

The Council will also have to comply with the Market Abuse Regulation (MAR), the Disclosure and Transparency Rules (DTR), the Financial Conduct Authority's Listing Rules and the requirements of the London Stock Exchange (LSE) Admission and Disclosure Standards (ADS). This means the Council must manage inside information, that is likely to have a significant effect on the price of issued bonds or on related derivative financial instruments, correctly in order to avoid insider dealing and misleading investors.

The objective of this audit was to consider whether arrangements have been put in place to ensure compliance with the London Stock Exchange requirements and to safeguard the Council's credit rating.

In general this was found to be the case, with a Bond Governance Project Board meeting regularly to address the requirements and expectations of holding and maintaining a suitable credit rating and the Council being an issuer of Bonds; written policy on bond governance was in place; an Economic Policy Panel has been appointed and met to inform the annual credit rating review; an Insider List of persons with access to Inside Information is in place as required by MAR; and a programme of training staff and Elected Members has begun.

A number of recommendations have been made to further enhance governance arrangements which have been agreed with management as detailed in the report, and were either implemented as the audit progressed or will be completed by June 2018.

1. INTRODUCTION

- 1.1 The Council obtained a credit rating of Aa2, with a negative outlook, from its appointed credit rating agency on 7 October 2016, prior to issuing £370m of bonds on 1 November 2016, on the London Stock Exchange, to finance the Council's capital programmes. The rating was one notch below the UK sovereign rating with a negative outlook mirroring that of the UK sovereign rating, following the vote to leave the European Union. On 7 November 2016, the Council's appointed credit rating agency assigned the rating of Aa2 to the £370m of bonds.
- 1.2 A suitable credit rating will be required to be maintained during the term of the bonds, until 2054, when the outstanding principal will be repaid by the Council. The Council's appointed credit rating agency will be required to conduct credit rating reviews, at least once every twelve months, for this purpose.
- 1.3 The Council will also have to comply with the Market Abuse Regulation (MAR), the Disclosure and Transparency Rules (DTR), the Financial Conduct Authority's Listing Rules and the requirements of the London Stock Exchange (LSE) Admission and Disclosure Standards (ADS). This means the Council must manage inside information, that is likely to have a significant effect on the price of issued bonds or on related derivative financial instruments, correctly in order to avoid insider dealing and misleading investors.
- 1.4 Sanctions imposed by the Financial Conduct Authority (FCA) for failing to comply with relevant legislation and regulations include: suspension of trading of the Bonds on the London Stock Exchange; a maximum fine of at least €15,000,000 or 15% of gross annual turnover for insider dealing, failing to disclose inside information and market manipulation; a statement published censuring the individuals concerned; and/or imprisonment.
- 1.5 The objective of this audit was to consider whether arrangements have been put in place to ensure compliance with the London Stock Exchange requirements and to safeguard the Council's credit rating.
- 1.6 The factual accuracy of this report and action to be taken with regard to the recommendations made have been agreed with Fraser Bell, Head of Legal and Democratic Services, and Steven Whyte, Director of Resources.

2. FINDINGS AND RECOMMENDATIONS

2.1 Written Policies and Procedures

- 2.1.1 The Bond Governance Insider Protocol (the Protocol) was approved by Corporate Management Team (CMT) on 23 November 2017 and will be referred to the February 2018 Audit, Risk and Scrutiny Committee (AR&SC) for consideration. The Protocol is comprehensive and clear and covers the Council's requirements to comply with the legislative and regulatory requirements resulting from obtaining a credit rating and issuing Bonds. This is primarily in relation to the Market Abuse Regulation.
- 2.1.2 Specific areas covered by the Protocol include: roles and responsibilities; the definition of Inside Information; the requirement to maintain an 'Insider List' of individuals with access to Inside Information; the requirement of those on the Insider List to acknowledge responsibilities in relation to Inside Information; risks associated with the credit rating and bond issue; appropriate and inappropriate disclosure of inside information; training; committee reports and the need to highlight Inside Information for monitoring purposes; obligations in relation to persons discharging managerial responsibilities and persons closely associated; freedom of information requests and data protection; registers of interests, in relation to investments in Council Bonds; and the North East Pension Fund, in relation to the pension trustee being prohibited from investing in Bonds.
- 2.1.3 The Council's Investment Strategy for 2017/18 to 2019/20 and Counterparty list was approved on 9 March 2017 by the Finance, Policy and Resources Committee (FP&R). The Investment Strategy states that the Council's investment priorities are the security of capital and the liquidity of its investments. The Investment Strategy and Counterparty list were largely unchanged from 17 August 2016, when revisions to the Investment Strategy and Counterparty list were approved by Council to accommodate the Council's intention to borrow £573 million to support the Capital Programmes of £850 million, partly through the issue of Bonds.
- 2.1.4 The Borrowing Strategy for 2017/18 to 2019/20 was also approved by FP&R on 9 March 2017. It was noted that the Borrowing Strategy sets an upper limit on variable interest rate exposures for 2017/18, 2018/19 and 2019/20 of 30% of the Council's net outstanding principal sums. The Bond debt has been treated as fixed rate debt by the Council.
- 2.1.5 According to the Bond Trust Deed between the Council and the Bond Trustee, Schedule 2 Part 2 section 5.1, each bond bears interest on its outstanding principal amount from the issue date at the fixed rate of 0.1%. However, section 5.1 goes on to state that payments of interest and principal in respect of the Bonds shall be subject to adjustment for indexation. These adjustments are applied to the principal borrowed, which the interest is calculated on, from February 2018, and are based on the movement in the Retail Price Index (RPI), which is variable in nature.
- 2.1.6 The £370m of Bond debt represented 40% of short term and long term borrowing, as per the financial statement for the quarter 1 July 2017 to 30 September 2017, noted by FP&R on 1 December 2017.
- 2.1.7 Finance advised that the current Treasury Borrowing Strategy has an upper limit of 30% for variable interest rate exposure and that this is to protect the Council against any significant loss, should there be a sudden movement in bank base rates / market rates, which would then impact upon loans held at variable interest rates. The Treasury section has to manage the debt portfolio, to ensure the element of external debt which is subject to these interest rate fluctuations, sits within the limits of 0% to 30%. Although Bond debt has a variable element to it, this is in the notional principal sum, rather than the agreed, fixed interest rate of 0.1%. Finance went on to advise that Bond debt cannot be 'managed'

as such, since the principal repayment mechanism / schedule is fixed.

2.1.8 Bondholders have the option of early redemption should a Change of Status occur, which is confirmed by the rating agency as being wholly or partly the cause of the credit rating assigned to the Bonds being withdrawn or downgraded to a rating 3 notches or more lower than the long term credit rating for sovereign bonds of the UK. A Change in Status for the Council would result from the Council no longer being able to raise funds from any of the following sources: Council Tax, Non-Domestic Rates; the Scottish Government; and the Public Works Loan Board (or equivalent body). Bondholders also have the option to redeem their Bonds early should an Independence Event occur, meaning Scotland ceases to be a part of the UK and/or revokes The Union with England Act 1707 and/or enacts any law to become independent from the rest of the UK.

2.1.9 Finance has stated that in the event of early redemption of Bonds, the funds would be obtained from the Public Works Loans Board (PWLB). Whilst this is the intended source of alternative funds, the Treasury Manual has yet to be updated to reflect the process to be followed should Bonds be redeemed.

<u>Recommendation</u> The Treasury Manual should be updated to cover the procedure for early redemption of the Bonds.		
<u>Service Response / Action</u> Agreed.		
<u>Implementation Date</u> June 2018	<u>Responsible Officer</u> Treasury Officer	<u>Grading</u> Significant within audited area

2.1.10 Paragraph 1.6 of The London Stock Exchange Admission and Disclosure Standards require the Council to identify a contact responsible for communication between the LSE and the Council and a designated representative from another organisation (usually the issuer's corporate broker), at the time of admission. Any changes to the contact need to be notified in writing to the LSE. The Council's contact needs to be able to respond to requests and day-to-day enquiries from the LSE. In particular, the contact must be available before the markets open each morning to resolve any issues which could impact on the market's orderly operation. The Protocol does not identify the Council's contact and designated representative. This increases the risk that changes to the contact and representative will not be notified to the LSE.

<u>Recommendation</u> The Council's LSE contact and designated representative should be identified in the Protocol.		
<u>Service Response / Action</u> Agreed.		
<u>Implementation Date</u> Implemented	<u>Responsible Officer</u> Solicitor	<u>Grading</u> Important within audited area

2.2 Credit Rating

- 2.2.1 To maintain the credit rating the Council's appointed credit rating agency must conduct a review at least once every 12 months.
- 2.2.2 On 22 September 2017 the Council's credit rating agency downgraded the UK sovereign rating from Aa1 to Aa2, whilst moving from a negative to a stable outlook, as a result of the UK government's decision to leave the EU Single Market and customs union as of 29 March 2019, based on the belief this will harm the UK's medium term economic growth prospects. A one notch downgrade in the Council's credit rating followed from Aa2 to Aa3, reflecting the close institutional links between the Council and the UK government, due to the Council's high dependence on government grant funding. A stable outlook was given due to the Council's ability to absorb funding cuts by central government to date. This was reported to Finance, Policy and Resources Committee (FP&R) on 1 December 2017.
- 2.2.3 The first annual review was undertaken by the Council's credit rating agency in October 2017, the details of which were also reported to FP&R on 1 December 2017. The report to FP&R noted that the annual review included a presentation by the Chief Executive, Head of Finance, Head of Legal and Democratic Services, and Head of Economic Development, to Analysts from the credit rating agency, which covered: the 2016/17 reported financial position; current estimated 2017/18 financial position; projected medium term financial position; treasury and debt management position; and the local economy. Finance also reported that the credit rating agency Analysts, responsible for assessing the Council's credit rating, visited the AECC development and met with a representative from the AECC operator to gain an understanding of how the large and complex project was progressing; the robustness of future revenue assumptions; and the overall risk to the Council arising from the project. In addition, it was reported that in order to support the assessment of the economy, the Analysts visited the Oil and Gas Technology Centre (OGTC), where they met the CEO of OGTC and the Head of Communications and External Affairs of Oil & Gas UK
- 2.2.4 On 20 November 2017, the credit rating agency issued their credit opinion, Aa3 with a stable outlook, no change from that issued in September 2017. Credit strengths and challenges were detailed: strengths including a strong institutional framework and wealthy local economy albeit with exposure to oil and gas industries and their supply chains; while challenges included debt increasing in size and complexity due to the issue of the Bonds and the implementation of an ambitious savings programme.
- 2.2.5 The annual review by the Council's appointed credit rating agency, highlighted benefits of the Bond issue, including diversification of financing sources, reduction in the dominance of Public Works Loan Board debt and reduction of reliance on short term funding. Drawbacks reported related to the issue of Bonds increasing the complexity of the Council's debt structure as well as increasing the overall debt levels. It was noted that whilst the interest rate on the Bonds is relatively low, there is also indexation (linked to inflation) on the principal borrowed and since currently limited revenues are linked to inflation, this raises a possible mismatch between revenues and the indexation of capital, should anticipated revenues from the AECC development, which are projected to cover Bond financing costs, not be realised as planned.
- 2.2.6 The report also highlighted factors that could lead to a future rating downgrade. These included: failure to deliver the AECC capital project as planned; failure to realise projected revenues; failure to achieve savings; a material increase in size and nature of debt beyond that anticipated; a downgrade of the sovereign rating; a change in the relationship between Scotland and the UK or a dilution of the regulatory framework for Scottish local authorities.

2.3 Economic Policy Panel

- 2.3.1 On 14 December 2016, the Council resolved to instruct the Depute Chief Executive (Director of Corporate Governance) to develop proposals for a Fiscal Policy Panel, in order to support the Annual Credit Rating re-assessment. The Panel proposed was based on the Jersey Fiscal Policy Panel, in terms of purpose and Panel membership. Council agreed to pilot a Panel for a period of 3 annual credit rating reviews on 15 March 2017. Members further instructed the Chief Executive to undertake a national advertisement with a view to recruiting appropriately qualified members to the Panel.
- 2.3.2 Council agreed draft Terms of Reference for an Economic Policy Panel on 15 March 2017 and delegated authority to the Head of Legal and Democratic Services to finalise the Terms of Reference. The draft scope for the Panel's work is to produce an annual economic report on the Aberdeen and regional economic performance, to be presented to FP&R; to meet with businesses in key sectors twice a year to consult on issues, challenges and opportunities in Aberdeen and the wider north east region to inform that report; and to provide constructive challenge on any wider interventions that could inform the Council's annual credit rating assessment.
- 2.3.3 The requirement for the 3 person Panel was advertised in the Times and Economist in June 2017, with a time commitment of 12 days per annum per Panel member, and payment of £15,000 to £17,000 per annum per Panel member, for a period of 3 years. The Council approved the appointment of the 3 preferred candidates on 23 August 2017. The successful candidates all held senior positions as economists in established public and private sector organisations, with one candidate having developed Jersey's Fiscal Policy Panel, which is very similar to the Council's Economic Policy Panel.
- 2.3.4 It was reported to Council on 23 August 2017 that short term priorities for the Panel include finalising the Panel's terms of reference, including agreeing on a Chair and procedural issues relating to meetings and secretariat requirements. In addition, the Panel is to set out an annual work plan, which will revolve around the publication each year of its annual economic report in September / October.
- 2.3.5 The Panel has met twice to date. The first meeting in August 2017 involved a presentation to the Panel by the Council's Economic Advisor on the North East Economy. The second meeting in October 2017 involved a discussion on what the Panel required to produce the annual report. Economic data was requested including data on growth; business confidence; patent applications by sector; inward investment; specific sectors including life sciences and the energy sector; the Regional Economic Strategy and City Region Deal; Housing strategy; evidence of health of existing businesses / non-payment of NDR; school roll data; and retail spend. A number of documents have been shared with the Panel with a few items outstanding, including the requested evidence on the energy sector; City Centre Living Study; school roll data; evidence of retail spend; census information; and Local Development Plan maps. Recommendations are included for tracking purposes.

Recommendation

- (a) The Economic Policy Panel terms of reference should be finalised and approved.
- (b) The Economic Policy Panel should prepare / finalise an annual work plan.
- (c) The outstanding requested information from the October 2017 meeting should be shared with the Panel.

Service Response / Action

- (a) This has been finalised and approved.

(b) Agreed. A draft has been produced and the Service is working with the Economic Policy Panel to finalise it.		
(c) The requested information has been shared with the Panel.		
<u>Implementation Date</u>	<u>Responsible Officer</u>	<u>Grading</u>
a) March 2018	(a) Head of Legal and Democratic Services	Important within audited area
(b) March 2018	(b) Economic Advisor	
(c) Implemented	(c) Economic Advisor	

2.4 Disclosure of Inside Information

- 2.4.1 Article 7 of the Market Abuse Regulation defines Inside Information as ‘information of a precise nature, which has not been made public, relating, directly or indirectly, to one or more issuers (the Council) or to one or more financial instruments (the Bonds), and which if it were made public, would be likely to have a significant effect on the prices of those financial instruments or on the price of related derivative financial instruments’.
- 2.4.2 Article 17 of MAR and the FCA Disclosure and Transparency Rule DTR 2.1.3 require prompt and fair disclosure of relevant information to the market by issuers such as the Council. DTR 2.2.6 states that when determining whether information would be relevant to a reasonable investor’s decision, the following should be considered: the assets and liabilities of the issuer; the performance, or the expectation of the performance, of the issuer’s business; the financial condition of the issuer; the course of the issuer’s business; major new developments in the business of the issuer; or information previously disclosed to the market.
- 2.4.3 According to Article 8 of MAR, Insider Dealing arises where a person possesses Inside Information and uses that information for acquiring or disposing of financial instruments to which that information relates. Article 14 of MAR prohibits Insider Dealing. In addition, Article 10 of MAR states unlawful disclosure of Inside Information arises where a person possesses Inside Information and discloses that information to any person, except where the disclosure is made in the normal exercise of an employment, a profession or duties. The Protocol covers Unauthorised Disclosure of Inside Information; detailing the sanctions that will potentially result, including dismissal for employees; termination of contracts for contractors and agency staff; and censuring, suspension, disqualification and referral to the Commissioner for Ethical Standards for Councillors. The matter may also be referred to the Police. The Protocol also notes the requirement to notify the LSE and FCA of the matter.
- 2.4.4 The Protocol requires Inside Information to be announced at the point in time the Council or one of its Committees has made a decision relating to the information. Examples of information required to be announced are: approval of quarterly and annual accounts; award of a major capital project to a specific contractor or consortium; results of Council Elections; change in Administration; change in Chief Executive, Directors, Monitoring Officer or Section 95 Officer. A decision tree is included in the Protocol for the purposes of determining whether information is Inside Information.
- 2.4.5 Finance, Policy and Resources Committee approved a revised Communications Policy on 20 September 2017. The revised policy states the Internal and External Communications Manager is responsible for identifying communications which require to be announced to

the LSE. The decision to make an announcement will be taken by the Head of Finance following consultation with the Head of Legal and Democratic Services.

- 2.4.6 The External and Internal Communications Manager is responsible for making the announcement following the Head of Finance’s authorisation, using the ‘RNS Submit’ regulatory information service. This meets the requirements of Article 17 of MAR for the Council to ensure Inside Information is made available to the public in a manner which enables fast access and complete, correct and timely assessment of the information by the public. The use of RNS Submit also meets with the requirements of DTR 6.3.3, including the requirement to entrust a Regulated Information Service that meet minimum prescribed standards for disseminating regulated information. RNS Submit is the Regulatory Information Service offered by the London Stock Exchange and distributes announcements to over 2 million market professional terminals, databases, and financial websites across the world, including key vendor services. The RNS Submit service is username and password protected to avoid unauthorised announcements.
- 2.4.7 As at 21 December 2017, 14 public announcements had been made since the Bonds were issued. These include relevant timely announcements in relation to Committee agenda items, including: the preferred bidder for the existing and new Aberdeen Exhibition and Conference Centre; 2017/18 budget options and confirmation that the 2017/18 budget had been set; Scottish Council Election results; make up of Council administration; publication of unaudited accounts; quarter 1 financial performance; publication of Audited Annual Accounts; outcome of the annual credit rating review and quarter 2 financial performance.
- 2.4.8 The Head of Finance’s approval, given by way of email, was available for 2 requests and for one approved by the Senior Accountant. The External and Internal Communications Manager explained approvals are, in general, made by email by the Head of Finance or a delegate and otherwise by phone or face-to-face. However, the Protocol does not specify who authority is delegated to by the Head of Finance, increasing the risk of unauthorised announcements, particularly when written authorisation is not required.
- 2.4.9 Article 17 of MAR also requires the Council to post and maintain on its website for a period of at least 5 years, all inside information it is required to disclose publicly. The announcements are not currently displayed on the Council’s website.

Recommendation

- (a) Authorisation of announcements should be by written / electronic means and retained for 5 years.
- (b) Delegated authority to make announcements should be formalised.
- (c) The announcements to date should be posted on the Council’s website.

Service Response / Action

- (a) Agreed
- (b) Agreed. Specific delegations will be included in the Scheme of Governance which is to be considered by full Council on 5 March 2018.
- (c) Agreed.

Implementation Date

(a) Implemented

Responsible Officer

(c) Internal & External Communications Manager

Grading

Significant within audited area

(b) March 2018	(d) Head of Legal and Democratic Services
(c) Implemented	(c) Solicitor

2.5 Committee Reports

- 2.5.1 DTR 2.2.8 requires the directors of the issuer to carefully and continuously monitor whether changes in the circumstances of the issuer are such that an announcement obligation has arisen under Article 17 of the Market Abuse Regulation.
- 2.5.2 The Protocol has a section covering Committee Reports, which highlights the requirement to indicate under the Financial and Legal Implications whether the report has any Inside Information which would need to be reported to the LSE. The Protocol provides examples of reports where this would likely be relevant including reports approving major capital investments, reports advising of significant delays of major capital projects, especially where this will affect future revenue streams.
- 2.5.3 The template Committee reports include a section covering Legal Implications of the report. The Corporate Governance Reporting to Committee Home Page on the Zone includes Report Author Guidance April 2017. This highlights the requirement not to disclose Inside Information in Committee reports and defines Inside Information for authors. The report author guidance requires clarification as there is not an outright prohibition against disclosing Inside Information. Report authors require to be made aware of the additional requirements to report the decision to the London Stock Exchange at the same time the outcome of the meeting is made available to the public. Legal and Democratic Services are addressing this accordingly. In addition, the template Committee report available on the Zone includes the requirement to identify any legal implications associated with the Council's credit rating and bond issue, under the Legal Implications section of the template report.

2.6 Insider List

- 2.6.1 Article 18 of MAR requires issuers to draw up a list of all persons who have access to Inside Information and who are working for them under a contract of employment, or otherwise performing tasks through which they have access to Inside Information, such as advisers, accountants, or credit rating agencies (an Insider List). It also prescribes the content of insider Lists, which includes: the identity of any person having access to Inside Information; the reason for including that person in the Insider List; the date and time at which that person obtained access to Inside Information; and the date on which the Insider List was drawn up / updated. Article 18 of MAR also requires the list to be promptly updated for any changes, retained for at least 5 years from the date it was drawn up or updated and readily available should it be requested by the FCA.
- 2.6.2 Commission Implementing Regulation (CIR) 2016/347 prescribes the format of Insider Lists. This includes a permanent Insider List of persons, who due to the nature of their function or positions, have access at all times to all Inside Information within the issuer (Council). Separate 'deal specific / event specific' Insider Lists should also be maintained for persons with access to Inside Information relating to a particular deal / event only. Pro-forma permanent and deal specific / event specific lists are included in CIR 2016/347 which include the information required by Article 18 of MAR. The Protocol includes these as appendices to the Insider List section.
- 2.6.3 According to the Protocol, the permanent Insider List will include: all Councillors; all Directors; all Heads of Service; all PAs to Directors and Heads of Service; the

Communication Team; and additional employees identified by Heads of Service. The permanent Insider List is updated by Legal Services using an Excel based report exported from the PSE payroll system, detailing the current post holders for the permanent list. The report does not capture agency staff or contractors required to be included on the Insider List. As a consequence of the Target Operating Model the posts identified as appropriate for being on the Insider List may no longer be valid.

Recommendation

The payroll report should be revised to account for changes to permanent Insider List posts as a result of the Target Operating Model.

Service Response / Action

Agreed. The Insider List will be reviewed in line with TOM implementation and the finalisation of roles and responsibilities.

Implementation Date

June 2018

Responsible Officer

Head of Legal and Democratic Services

Grading

Important within audited area

2.6.4

There is an intention that the reporting process be automated using the Human Capital Management (HCM) system once it goes live. Legal Services have made a request to a HCM Project Board member to include certain reports in the system specification. This includes the ability for the HCM system to report on a scheduled basis on movement of staff on the Insider List. The list should be updated as soon as staff have left the Council (rather than when the next scheduled payroll report becomes available) and the HCM system should flag any new posts created relevant for inclusion on the Insider List. The requirements in relation to the Insider List have yet to be considered by the HCM Project Board.

Recommendation

The Insider List reporting requirements for the new HCM system should be reported to the next HCM Project Board.

Service Response / Action

Agreed.

Implementation Date

March 2018

Responsible Officer

Head of Legal and Democratic Services

Grading

Important within audited area

2.6.5

CIR 2016/347 requires the Insider List to be electronic and kept confidential, by restricting access to the Insider Lists to clearly identified persons from within the Issuer (the Council) or any person acting on their behalf or on their account due to the nature of their function or position. The Protocol states that the Head of Legal and Democratic Services is responsible for the creation and maintenance of the list. The Insider Lists are currently maintained in Word documents on an 'O drive' which 4 officers have access to. Therefore the Protocol does not clearly identify all officers with access to the Insider Lists.

Recommendation

All officers with access to the Insider Lists should be clearly identified as required by CIR 2016/347.

Service Response / Action

Agreed.

<u>Implementation Date</u>	<u>Responsible Officer</u>	<u>Grading</u>
Implemented	Solicitor	Significant within audited area

- 2.6.6 Article 18 of MAR requires the Council to take all reasonable steps to ensure that any person on the Insider List acknowledges in writing the legal and regulatory duties entailed and is aware of the sanctions applicable to insider dealing and unlawful disclosure of Inside Information. The Protocol states that the Head of Legal and Democratic Services is responsible for issuing letters detailing these duties and sanctions to all persons on the Insider Lists. A copy of the letter is included in the Protocol, which covers the legal and regulatory duties and sanctions i.e. fines and imprisonment. The need to ensure Inside Information is kept confidential and the means of ensuring this is also covered including: avoiding reading / discussing Inside Information in public areas; hard copy documents should be kept in locked cabinets; electronic documents should be password protected and restricted to a limited number of individuals; code names should be used where possible in all documents, correspondence and discussions; and computer access and other electronic devices with Inside Information should be password protected.
- 2.6.7 The recipients of the letter are required to return an acknowledgement slip to the Head of Legal and Democratic Services, confirming they have read the letter, are aware of the legal and regulatory duties entailed in having access to Inside Information; and are aware of the sanctions for unlawful disclosure of Inside Information and Insider Dealing. A copy of the letter to, and acknowledgement by, employees will be maintained on the individuals HR files and retained for a period of 7 years once the employee has left the Council. The Head of Legal and Democratic Services will keep all letters and acknowledgements for a minimum of 5 years not otherwise retained by HR after the individual's last entry on the Insider List.
- 2.6.8 An update on the creation and maintenance of Insider Lists was provided to the Bond Governance Project Board on 5 December 2017. This included an update on receipt of acknowledgement slips from persons on the permanent Insider List as well as the number of staff removed due to leaving the Council. It was reported that acknowledgements had been received from all employees sent letters and these had been passed to HR for storage; 2 letters to consultants had yet to be acknowledged despite reminders and follow up by their agency and 5 Councillors had yet to return acknowledgements despite reminders being issued. All consultants have now returned acknowledgements whilst some from Councillors are outstanding.

<u>Recommendation</u>		
The Service should remind Councillors of the requirement to return the acknowledgement slips to ensure the Council complies with Article 18 of the Market Abuse Regulation.		
<u>Service Response / Action</u>		
Agreed. A reminder will be given to Councillors at the Audit, Risk and Scrutiny Committee in February 2018.		
<u>Implementation Date</u>	<u>Responsible Officer</u>	<u>Grading</u>
February 2018	Solicitor	Important within audited area

- 2.6.9 A sample of 15 staff expected to be included on the permanent Insider List based on the requirements of the Protocol were selected and acknowledgement slips were requested from the Head of Legal and Democratic Services. The letters had been issued in all cases and all 15 acknowledgement slips were returned. The permanent Insider List was

reviewed to ensure the same 15 staff were included in line with the Protocol. 13 were present and 2 were absent since they had left the Council. No exceptions were noted.

2.6.10 It was reported to the Bond Governance Project Board on 5 December 2017 that no deal specific or event specific lists have been created. It is the responsibility of all Heads of Service, having been discussed at the Strategic Asset and Capital Board, to recommend to the Head of Legal and Democratic Services that a deal specific or event specific Insider List be created. In making the recommendation, Heads of Service should bear in mind the likelihood that a reasonable investor would have used the information in question to make his or her decision to invest in the Council's Bonds taking into consideration: whether or not the project is listed in the Council's Strategic Business Plan; the total amount of capital to be spent on the project; capital grants to ALEOs; projected revenue arising from the project and/or major reputational impact.

2.6.11 It was noted that the Protocol did not specify values or percentages, for determining if capital spend; capital grants to ALEOs or projected revenue from a project would be relevant for the purposes of determining if a deal specific / event specific list should be created. This increases the risk that inappropriate, or no, referrals will be made to the Head of Legal and Democratic Services for consideration.

Recommendation

Thresholds should be quantified for capital spend, capital grants to ALEOs and projected revenue from a project, when determining if a deal specific / event specific Insider List is required.

Service Response / Action

Agreed. Initial work on identifying appropriate thresholds has commenced and will be finalised following consultation with the Strategic Capital Projects Board.

Implementation Date

June 2018

Responsible Officer

Solicitor

Grading

Important within audited area

2.6.12 Paragraph 3.8 of the Insider Protocol indicates that the deal specific or event driven Insider List may require to be updated to include individuals involved in contract negotiations for a specific capital project. Commercial and Procurement Services has confirmed that they are to be involved with this.

2.7 Training

2.7.1 Training was delivered to Finance, Legal and Internal Audit employees on 28 November 2016. This covered an explanation of Bonds and debt capital markets; Bond documentation such as the Trust Deed; the significance of the Council obtaining a credit rating; and the ongoing requirements to comply with the requirements of the Market Abuse Regulation.

2.7.2 Eight in-house training sessions entitled 'The Bonds – a license to grow' have been delivered by Finance and Legal Services in July, August, September and November 2017 to employees and four sessions have been delivered to Councillors in May, August and September 2017. This training is mandatory for persons included on the Insider Lists and covers: what bonds are; why the Council issued them; what a credit rating is; the implications on how the Council operates; Insider Lists and the implications of being on an Insider List; Persons Discharging Managerial Responsibility; and where to obtain further help and guidance.

2.7.3 32 Councillors have attended ‘The Bonds – a licence to grow’ training to date. A further session for Councillors will be delivered by March 2018 for the 13 Councillors yet to attend. 153 employees have attended the training to date. It was noted that officers required to be included on the permanent Insider List had not attended this specific training though some will have been at the Extended Corporate Management Team (ECMT) and CMT meetings when this topic was under consideration. Of the employees required to be included on the permanent Insider List, 1 Director, 1 Head of Service, 1 member of the Communication Team and 3 PAs were recorded as having attended the training. A further two Heads of Service have delivered the training. Whilst persons on the Insider Lists receive a letter explaining their legal and regulatory duties arising as a result of being on the Insider List and are required to return signed acknowledgement slips stating they have read and understood the letter, the absence of training increases the risk that employees on the Insider List will be unaware of their obligations in relation to Inside Information and the Council’s credit rating. The Head of HR (Interim) recommended to the Bond Governance Project Board on 5 December 2017 that the Solicitor delivering the training reconcile attendance with the Insider List, and advise of any persons on the Insider Lists yet to attend a training session, for the purposes of delivering training where required. The reconciliation has taken place and 44 individuals on the Insider List have yet to be trained. A recommendation is included for tracking purposes.

<u>Recommendation</u>		
Bond training should be delivered to all persons on the Insider Lists.		
<u>Service Response / Action</u>		
Agreed.		
<u>Implementation Date</u>	<u>Responsible Officer</u>	<u>Grading</u>
June 2018	Solicitor	Important within audited area

2.7.4 The Head of Finance and the Head of Legal and Democratic Services delivered training to the Extended Corporate Management Team on 2 February 2017, by going through the contents of the report to Council on 14 December 2016, covering the Council’s credit rating assessment and the legal implications for the Council, having issued Bonds. This included: the definition of Inside Information, Insider Lists, sanctions, the process for obtaining the Council’s initial credit rating, the requirement for an annual credit rating re-assessment and governance implications. Attendance at the meeting was unavailable.

2.7.5 An On-line Interactive Learning (OIL) training module is being developed. Progress was reported to the Bond Governance Project Board on 5 December 2017, including that the script has been drafted, however a date for the required filming of staff asking questions and answers being delivered, is yet to be arranged. Once developed the module will be used for refresher training, new starts and event specific persons.

2.7.6 It was also reported to the Bond Governance Project Board on 5 December 2017, that the Board members and Chief Officers of ALEOs are to receive a shortened version of the Bond training. The Senior Accountant (Finance) and Team Leader (Legal & Democratic Services) delivered the first session to the Board of Sport Aberdeen on 3 November 2017. Training will be delivered to Bon Accord Care in January 2018. Legal Services will arrange a final training session for the remaining ALEOs. A recommendation has already been made at paragraph 2.7.3 in relation to training persons on the Insider Lists.

2.7.7 A video has been added to the eInduction module on the Zone, which describes the reason the Bond was taken out; what bonds are; the credit rating; the Insider List; Inside Information and the requirement to treat such information confidentially and report it to the LSE before making public; the Market Abuse Regulation; implications for breaching MAR

including repaying bonds, fines and imprisonment. The induction checklist on the Zone includes the requirement to explain the governance arrangements including responsibilities relating to the Bond, with a link to the video. The video is also shown on a continuous loop outside meeting rooms.

2.8 Persons Discharging Managerial Responsibilities

2.8.1 Article 19 of MAR requires persons discharging managerial responsibilities (PDMRs) and persons closely associated with them, to notify the issuer (the Council) and the FCA of transactions relating to debt instruments (Bonds) of that issuer, within 3 business days of that transaction. The threshold for disclosing transactions is €5,000 per annum. PDMRs are not permitted to conduct any transactions in the 30 day period prior to the announcement of a year-end report which the Council is obliged to make under national law or the LSE rules.

2.8.2 Article 19 of MAR also requires the Council to ensure the information that is notified to the FCA, is disseminated to the public no later than 3 business days after the transaction, using a Regulated Information Service such as RNS Submit. The requirement for the Council to make a public announcement using a regulated information service is not included in the Protocol. This increases the risk that an announcement will not be made as required within 3 business days of a relevant transaction.

Recommendation

The Protocol should be updated to include the requirement to make a public announcement in the event of a PDMR transaction.

Service Response / Action

Agreed.

Implementation Date

Implemented

Responsible Officer

Solicitor

Grading

Important within audited area

2.8.3 The Council is required to notify PDMRs in writing of their obligations under Article 19 of MAR. According to the Protocol, the Head of Finance will advise all PDMRs of their obligations prior to the Committee approving quarterly and annual financial results. The quarter 2 financial statement was noted by Finance, Policy and Resources Committee on 1 December 2017. An email was sent to all Councillors and Extended Management Team by the Head of Finance on 13 October 2017, which included a letter describing the responsibilities and restrictions of PDMRs under MAR.

2.8.4 The Council is also required to maintain a list of PDMRs and persons closely associated with them under MAR. The list was reviewed and checked to see if the same sample of 15 individuals on the permanent Insider List was present on the PDMR list. 11 officers with managerial responsibilities were included on the list, 2 were not included as expected because they did not have managerial responsibilities and a further 2 were absent from the list as they had left the Council.

2.9 Bond Governance Programme Board / Project Board

2.9.1 On 14 December 2016, Council instructed the Head of Legal and Democratic Services to ensure that any proposals arising from the Governance Review are aligned to the requirements and expectations of holding and maintaining a suitable credit rating and being an issuer of Bonds, as well as to develop and maintain the Insider List(s) on behalf of the Council.

- 2.9.2 The Bond Governance Programme Board (the Board) was established in April 2017, according to the Programme Brief, to provide assurance that governance is in place to enable the Council to retain its credit rating through the re-assessment process, so that the City Centre Masterplan and Aberdeen's infrastructure objectives can be met, to allow for continued inward investment and economic diversification of the region's industries. The programme formed part of the Transformation Programme and the Board reported to the Change Delivery Portfolio Board, which reported to CMT.
- 2.9.3 Outputs of the Board include producing an Insider List, with procedures to support the Insider List; a credit rating re-assessment; a Bond compliance framework; review governance documents to reflect requirements of the Bond; train Elected Members and Staff; adapt Communications Protocol to include Bond guidance; and establish the Economic Policy Panel.
- 2.9.4 The Programme Sponsor and Chair is the Head of Legal and Democratic Services. The Programme Board includes representatives from Finance, Communications, HR, Legal Services and Economic Development. Project leads were identified for the LSE / regulatory compliance; credit rating re-assessment; financial planning; training, development and employment contracts; economic factors and communications. A Programme Manager is in place to monitor and co-ordinate projects and report progress of the programme to the Programme Sponsor and the Board.
- 2.9.5 The Programme Brief included a detailed preparation plan covering the following initial tasks: core programme resourcing; stakeholder analysis; vision and blueprint; benefits; governance and risks. This included start and completion dates where applicable.
- 2.9.6 The Terms of Reference dated 5 April 2017 detail the purpose of the Board, the remit and responsibilities; membership; support arrangements; and governance and reporting arrangements. The draft Terms of Reference were noted at the Board's first meeting on 4 April 2017. The draft Programme Brief and preparation plan were also reviewed at this meeting with changes made as required by Board members.
- 2.9.7 The Board has met nine times in total between 4 April and 5 December 2017, meeting every month except July 2017. The meetings have been well attended by all Services. Standing agenda items include the Programme Plan; Governance Tracker; Risk Assurance and Risk Register; Stakeholder Analysis; Insider List and Protocol; Credit Rating Reassessment; Training; and the review of third party contracts. Action notes were prepared for all meetings following the first meeting, describing the actions from the previous meeting, the officer and the deadline.
- 2.9.8 The Programme Plan tracks the outstanding actions from all previous meetings, identifying the objective; lead officer; deliverable, such as Insider List, milestone, detailing each stage, date to complete; designated officer and the status (green, amber, red). This is reviewed at the start of every meeting and updated as required. The Governance Tracker also tracks completion of tasks to date by month and is also reviewed at each meeting by the Board members. These documents are maintained by the Programme Manager and adequately track the Board's progress.
- 2.9.9 The Stakeholder Analysis is used to classify each stakeholder based on 'power' and 'interest' for the purposes of determining the level of engagement required by the Board and the Communications Team with interested parties. This is also updated as required at each meeting by the Programme Manager.
- 2.9.10 The Performance and Risk Manager maintains the Risk Assurance and Risk Register in relation to the Bond. These were first presented to the Board on 14 June 2017 when the Bond risk was included on the Corporate Risk Register: 'Risk of reduced credit rating for

Council and the Bond issue impacting the capital programme funding'. This included the potential impact; causes; controls; mitigating actions; assessments of the effectiveness of each control; and an overall risk assessment of very serious impact but low likelihood. The Risk Assurance document takes each assurance source resulting from the Programme, such as the Insider List and Communication Protocol, identifies a lead officer, and is used to assess the assurance from each source as strong, moderate or inadequate.

- 2.9.11 CMT agreed to remove the Bond risk from the Corporate Risk Register on 28 September 2017. The risk LD007 'Risk that Bond governance arrangements are ineffective' is now included on the Legal and Democratic Services Risk Register and continues to be monitored by the Board. The Risk Register and Risk Assurance documents are reported at each meeting and updates are required to be provided by each lead officer as appropriate.
- 2.9.12 The remaining standing items are monthly updates by the relevant designated officers on the progress completing Insider Lists, developing the Protocol, completing the credit rating reassessment and reviewing third party contracts. The Board has also received updates on the review of the Scheme of Governance documents (delegated powers, Committee terms of reference, Financial Regulations, Procurement Regulations); the Communications Policy; and Staff Contracts to ensure they reflected the requirements resulting from the Bond issue.
- 2.9.13 The Bond Governance Programme Board has been operating as the Bond Governance Project Board since 12 September 2017. It was agreed at the Project Board meeting on 5 December 2017 that due to the progress of the Board establishing governance arrangements in relation to the Bond issue since April 2017, the Project Board will now meet on a quarterly basis in a monitoring capacity, with the same membership, from April 2018. The standing agenda items of training; Insider List; Communications; Credit Rating – Finance; and Economic Policy Panel were agreed as was the membership, which included the current representatives from Legal Services; Finance; HR; Communications and Economic Development.

2.10 Governance Review

- 2.10.1 A Governance Review is underway to update the main governance documents for Council approval in March 2018. The main purpose is to ensure that the documents can support the Council during the transition to the Target Operating Model and that they reflect CIPFA's Principles of Good Governance, against which the Council is reviewed each year. However the governance documents also require to take account of the additional responsibilities placed on the Council as a result of the credit rating and Bond issue. An update on progress reviewing the governance documents was provided to the Board on 5 December 2017 by the Programme Manager (Governance Review).
- 2.10.2 The documents being reviewed and updated as appropriate include the Committee Terms of Reference (the powers delegated from Council to the Committees within the new structure); Delegated Powers (powers delegated to Chief Officers within the new structure); Procurement Regulations; and Financial Regulations.
- 2.10.3 The Board made relevant recommendations for changes to the Delegated Powers, Procurement Regulations and Financial Regulations at the meeting of 5 December 2017. This included the Delegated Powers being updated for the Head of Legal and Democratic Services responsibility to develop and maintain the Insider Lists and Protocol and for the Head of Finance to be given the power to approve disclosures to the LSE. The Procurement Regulations should be updated to reflect the need to identify deal specific Insider Lists through the Commissioning Function. Further details of the review by Commercial and Procurement Services Legal Team are provided in section 2.11. In

addition, the Financial Regulations are to be updated to reflect the requirements in relation to quarterly reporting of Financial Statements and the credit rating. Recommendations are included for tracking purposes.

Recommendation

- (a) Delegated Powers should be updated to reflect the Head of Legal and Democratic Services powers in relation to development and maintenance of Insider Lists and the Protocol.
- (b) Delegated Powers should be updated to reflect the Head of Finance’s power to approve disclosures to the LSE.
- (c) Quarterly reporting details and credit rating references should be included in the Financial Regulations.

Service Response / Action

Agreed. This will be captured as part of the work being currently undertaken to update the Scheme of Delegation which is due to be considered by Full Council in March 2018.

Implementation Date

March 2018

Responsible Officer

Head of Legal and Democratic Services

Grading

Significant within audited area

2.11 Procurement

2.11.1 As part of the Bond Governance Programme, Commercial and Procurement Services (C&PS) Legal Team are undertaking a review of all standard terms and conditions by the Council when contracting with a third party, to ensure that the Confidentiality clause clearly states that the supplier must not disclose any Inside Information to a third party, as required by the Market Abuse Regulation. C&PS are also reviewing the Council’s Procurement Regulations and procurement template documentation, to determine whether any changes are required in order to ensure compliance with the Bond requirements. In addition, major contracts are being reviewed to identify which contracts need to be varied to ensure the Confidentiality clause is adequate.

2.11.2 The C&PS Legal Team Leader provided an update on progress to the Bond Governance Project Board on 5 December 2017, stating that the C&PS Legal Team had agreed with the Programme Management Office that future Business Case templates shall have a section on the Bond with wording being currently drafted. Also a list of major projects has been received by the C&PS Legal Team for the purpose of reviewing existing contract clauses. It was recommended to the Bond Governance Project Board that the C&PS Legal Team finish the review. Recommendations are included for tracking purposes.

Recommendation

- (a) C&PS Legal Team should finish reviewing all standard terms and conditions used by the Council when contracting with a third party to ensure that the Confidentiality clause meets the requirements of the Market Abuse Regulation.
- (b) C&PS Legal Team should finish reviewing major projects with a view to identifying which contracts need to be varied to meet the requirements of the Market Abuse Regulation.
- (c) C&PS should finish reviewing Procurement Regulations and procurement template documentation to ensure compliance with the Market Abuse Regulation.

(d) C&PS should finalise the revised Business Case template, including the section on the Bond.

Service Response / Action

(a) Agreed. The confidentiality clause has been prepared. All solicitors in the C&PS Legal Team are aware of this updated clause but some work still needs to be done to ensure that all C&PS colleagues (i.e. Category Managers and Procurement Specialists) are aware of this new version. All C&PS colleagues will be made aware of these changes by February 2018.

(b) Agreed. This review is ongoing.

(c) Agreed. Draft revised Procurement Regulations have been prepared which take into account the requirements of the Market Abuse Regulation. These will be reported to Full Council on 5 March 2018 for approval. The Team Leader – C&PS Legal Team found no changes were required to procurement template documentation following a review to ensure the templates complied with MAR.

(d) Agreed

Implementation Date

Responsible Officer

Grading

(a) February 2018

Team Leader – C&PS
Legal Team

Significant within audited
area

(b) July 2018

Team Leader – C&PS
Legal Team

(c) March 2018

Team Leader – C&PS
Legal Team

(d) April 2018

Strategic Infrastructure
Plan Programme Manager

AUDITORS: D Hughes
A Johnston

Appendix 1 – Grading of Recommendations

GRADE	DEFINITION
Major at a Corporate Level	The absence of, or failure to comply with, an appropriate internal control which could result in, for example, a material financial loss, or loss of reputation, to the Council.
Major at a Service Level	<p>The absence of, or failure to comply with, an appropriate internal control which could result in, for example, a material financial loss to the Service/area audited.</p> <p>Financial Regulations have been consistently breached.</p>
Significant within audited area	<p>Addressing this issue will enhance internal controls.</p> <p>An element of control is missing or only partial in nature.</p> <p>The existence of the weakness identified has an impact on a system's adequacy and effectiveness.</p> <p>Financial Regulations have been breached.</p>
Important within audited area	Although the element of internal control is satisfactory, a control weakness was identified, the existence of the weakness, taken independently or with other findings does not impair the overall system of internal control.