

ABERDEEN CITY COUNCIL

COMMITTEE	Audit, Risk and Scrutiny Committee
DATE	14 February 2019
REPORT TITLE	Internal Audit Report AC1921 – Bond Trust Deed
REPORT NUMBER	IA/AC1921
DIRECTOR	N/A
REPORT AUTHOR	David Hughes
TERMS OF REFERENCE	2.2

1. PURPOSE OF REPORT

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

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 the Bond Trust Deed.

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. OUTCOMES

- 7.1 There are no direct impacts, as a result of this report, in relation to the Local Outcome Improvement Plan Themes of Prosperous Economy, People or Place, or Enabling Technology, or on the Design Principles of the Target Operating Model.
- 7.2 However, Internal Audit plays a key role in providing assurance over, and helping to improve, the Council's framework of governance, risk management and control. These arrangements, put in place by the Council, help ensure that the Council achieves its strategic objectives in a well-managed and controlled environment.

8. IMPACT ASSESSMENTS

Assessment	Outcome
Equality & Human Rights Impact Assessment	An 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. As a result, there will be no differential impact, as a result of the proposals in this report, on people with protected characteristics.
Privacy Impact Assessment	Not required
Duty of Due Regard / Fairer Scotland Duty	Not applicable

9. APPENDICES

- 9.1 Internal Audit report AC1921– Bond Trust Deed.

10. REPORT AUTHOR DETAILS

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Internal Audit Report

Governance

Bond Trust Deed

Issued to:

Steven Whyte, Director of Resources
Fraser Bell, Chief Officer – Governance
Jonathan Belford, Chief Officer – Finance
External Audit

EXECUTIVE SUMMARY

The Bond Trust Deed (Deed) is a legal agreement, between the Council and the Bond Trustee, detailing the rights and obligations of both parties, in respect of the £370 million of index linked bonds issued by the Council on 1 November 2016, due to be repaid by the Council with interest to the Bond Trustee, by February 2054. The Deed describes the obligations of both parties in relation to the issue of the Bonds as well as the ongoing obligations since.

The objective of this audit was to provide assurance that the requirements of the Bond Trust Deed are complied with. In general, this was found to be the case however recommendations have been made to improve procedures and controls.

Payments to date were accurate based on available bondholder certificates and were made on a timely basis. Controls were also in place to ensure the increase in Bond principal owed by the Council, as calculated by the Calculation Agent, upon which interest is applied, was in line with the increase in retail price index, as required by the Bond Trust Deed.

A Bond Trust Deed responsibilities spreadsheet has been put in place by Governance, which is comprehensive in terms of the coverage of the Bond Trust Deed clauses and conditions and is a useful tool in navigating the Bond Trust Deed and identifying ongoing responsibilities. The Service identified that not all clauses had been allocated responsible officers and did so during the course of the audit.

1. INTRODUCTION

- 1.1 The Bond Trust Deed (Deed) is a legal agreement made on 8 November 2016, between the Council and the Bond Trustee, detailing the rights and obligations of both parties, in respect of the £370 million of index linked bonds issued by the Council on 1 November 2016, which are due to be repaid with interest by the Council to the Bond Trustee, by February 2054. The Deed describes the obligations of both parties in relation to the issue of the Bonds as well as the ongoing obligations since.
- 1.2 The Bond Trust Deed requires the Council to:
- settle Bond principal and interest payments owed in a timely manner;
 - maintain a Calculation Agent and Paying Agent for the purposes of calculating bond interest and principal payments owed and to make these payments to Bondholders on the Council's behalf;
 - withhold tax on interest payments as required and make payments to HMRC;
 - send to the Bond Trustee a copy of the Audited Annual Accounts no later than 180 days after the end of the financial year;
 - provide to the Bond Trustee within 180 days after the end of each financial year a certificate stating no Event of Default or potential Event of Default existed;
 - maintain a Credit Rating;
 - use all reasonable endeavours to maintain the listing of the Bonds on the Official List of the UKLA to enable trading on the London Stock Exchange (LSE);
 - comply with Public Contracts (Scotland) Regulations, so far as they are applicable to any part of the capital programme funded by the bonds;
 - settle the financial liabilities of the Trustee in relation to its duties under the Bond Trust Deed.
- 1.3 The objective of this audit was to provide assurance that the requirements of the Bond Trust Deed are complied with.
- 1.4 The factual accuracy of this report and action to be taken with regard to the recommendations made have been agreed with Fraser Bell, Chief Officer – Governance, Sandra Buthlay, Finance Partner and Deirdre Nicolson, Solicitor.

2. FINDINGS AND RECOMMENDATIONS

2.1 Written Policies, Procedures and Training

- 2.1.1 Comprehensive written procedures which are easily accessible by all members of staff can reduce the risk of errors and inconsistency. They are beneficial for the training of current and new employees and provide management with assurance that correct and consistent instructions are available to staff, important in the event of an experienced employee being absent or leaving. They have increased importance where new systems or procedures are being introduced.
- 2.1.2 Governance has prepared a Bond Trust Deed responsibilities spreadsheet, which lists the Deed clauses and schedules by page, paragraph and heading, identifying the responsible organisation and where related to the Council, the responsible Service. The spreadsheet indicates any required action in relation to Deed clauses / schedules, including “ongoing” responsibilities, such as making financial statements available to the Bond Trustee. Clauses relating to the Bond issue have been marked “complete” whilst other clauses, such as the fact the Trustee can retire on giving 60 days notice, are marked to indicate they had been considered.
- 2.1.3 The spreadsheet is comprehensive in terms of the coverage of the Bond Trust Deed clauses and conditions and is a useful tool in navigating the Bond Trust Deed and identifying ongoing responsibilities.
- 2.1.4 The Bond Governance Project Board is responsible for providing assurance that arrangements are in place for the Council to meet its requirements in relation to the Bond. The Bond Trust Deed responsibilities spreadsheet was reported to the Bond Governance Project Board on 21 August 2018 along with a report detailing the contents of the Bond Trust Deed.
- 2.1.5 The Board agreed that responsible officers would be allocated to the responsibilities spreadsheet. However, all Council Functions and responsible officers have yet to be allocated against Council Bond Trust Deed clauses. A recommendation is included for tracking purposes.

Recommendation

Functions and Responsible officers should be allocated against all Council Bond Trust Deed clauses.

Service Response / Action

Agreed.

Implementation Date

Implemented

Responsible Officer

Chief Officer –
Governance

Grading

Important within audited
area

2.2 London Stock Exchange Listing

- 2.2.1 As stated in paragraph 1.2 the Bond Trust Deed requires the Council to use all reasonable endeavours to maintain the listing of the Bonds on the Official List of the UKLA to enable trading of Bonds on the London Stock Exchange. To maintain the Council’s listing, the Council has 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, in order to reduce the risk of Insider Dealing and misleading investors.

- 2.2.2 The Council's arrangements to ensure compliance with London Stock Exchange requirements were reviewed in Internal Audit report AC1824, issued in February 2018 and have not been revisited as part of this audit. All recommendations made in report AC1824 have been implemented.

2.3 Payments to Trustee

- 2.3.1 The Deed requires that the Council maintain a Principal Paying Agent, responsible for managing payments of interest and principal to Bondholders, and a Calculation Agent, who is responsible for calculating the index ratio to be applied to outstanding principal balances, as well as interest and principal payments due by the Council. The Agency Agreement with the Calculation Agent and Principal Paying Agent was made on 8 November 2016 detailing the respective responsibilities of the Council, Principal Paying Agent and Calculation Agent, who are both the same organisation.
- 2.3.2 The Deed also requires that the Council ensures the Principal Paying Agent keeps full and complete records of all Bond balances outstanding, interest paid, and principal repaid. This is required of the Principal Paying Agent by clause 16.1.1 of the Agency Agreement.
- 2.3.3 The Principal Paying Agent provides an index ratio to Finance in advance of the interest due date. This is applied to the principal outstanding to increase the amount owed in line with the retail price index, as required by the Bond Trust Deed as well as the interest and principal payments. Finance maintains a "Bond Interest" spreadsheet for the purposes of independently recalculating the index ratio, also using movements in RPI. Finance then uses the taxable and non-taxable principal split in the "UK Election Tax Breakdown" spreadsheet provided by the Principal Paying Agent, to calculate the correct tax to be deducted from gross interest owed, enabling the net interest payment to the Principal Paying Agent to be compared to the payment request from the Principal Paying Agent and verified, in advance of payment being made.
- 2.3.4 The Agency Agreement requires the Council to make payment of any interest and principal owed by one business day before the payment comes due, on the last day of February and August, depending on the 6-month period the payment relates to. The Bond Trust Deed enables the Bond Trustee to take actions it deems necessary to obtain repayment of outstanding balances owed by the Council, relating to the Bonds, on instruction of 25% of the Bondholders, should the Council default on any payments of interest or principal and the default continues for a period of more than 5 days.
- 2.3.5 Four 6 monthly interest payments have fallen due since the Bonds were issued in November 2016. All payments were in line with the payment request provided by the Principal Paying Agent, agreed to the "Bond interest" spreadsheet maintained by Finance and were made in a timely manner.
- 2.3.6 The Agency Agreement (clause 10.1) requires the Council to determine whether any deduction or withholding is required to be made in relation to tax, based on Bondholder tax certificates provided by the Principal Paying Agent, in advance of the interest payment date. The tax certificates are prepared by the Bondholders and detail the quantity of securities held by the Bondholders and whether interest should be paid gross or net of tax. According to the Agency Agreement Tax Certification Procedure, upon receipt of tax certificates, the Council is required to confirm to the Principal Paying Agent whether they accept or reject the certificates and provide the total principal amount of Bonds for which interest should be paid gross and total principal amount for which tax should be deducted from interest payment at the prevailing rate, which can be obtained based on the

declarations of Bondholders in the tax certificates. Finance has stated that whilst no formal notification to confirm acceptance has been provided to the Principal Paying Agent, remittance of the requested funds infers confirmation of acceptance. The Principal Paying Agent has not raised any issues or concerns with this way of working.

- 2.3.7 Finance receive tax certificates from the Principal Paying Agent for Bondholders declaring they are entitled to receive interest paid gross. The total principal per the Bondholder certificates relating to interest to be paid gross, for all interest payments made by the Council, agreed to that used by the Principal Paying Agent and Finance to calculate tax to be withheld.
- 2.3.8 The 2017/18 tax withheld from interest payments of £50,716 was reported to HMRC on 12 June 2018 with an acknowledgement received from HMRC on 24 July 2018. This agreed to the tax calculated by the Principal Paying Agent and the recalculation by Finance.
- 2.3.9 Under clause 23.2 of the Deed, the Council is required to report any payments to the Principal Paying Agent which could be subject to the U.S. Foreign Account Tax Compliance Act (FATCA). The FATCA requires financial institutions foreign to the U.S. to report on assets held by U.S. account holders. Finance has advised it is not clear when this applies due to the Principal Paying Agent seeking to keep certain Bondholder details confidential. Finance have sought clarification from the Principal Paying Agent on their responsibilities in relation to the FATCA, who responded and has not indicated the Council has any responsibilities in this regard.

2.4 Credit Rating

- 2.4.1 The Deed requires the Council to maintain a credit rating. To maintain a credit rating the Council's appointed credit rating agency (Moody's) must conduct a review at least once every 12 months. Moody's conducted their annual review on 6 November 2018. A presentation was delivered to Moody's by the Chief Executive, Director of Resources, Chief Officer – Finance, Chief Officer – Governance, and Chief Officer – City Growth. This covered the Council's Governance and Management arrangements; Aberdeen's economy and implications of Brexit; capital investment; the Council's financial performance and financial planning in the medium term.
- 2.4.2 Moody's released their annual credit rating report on 22 November 2018 (prior year credit rating report issued 20 November 2017). The Council's credit rating remained unchanged at Aa3 with a stable outlook. The credit rating report was noted by the City Growth and Resources Committee on 27 November 2018.
- 2.4.3 To support the Council's annual credit rating review, the first annual Economic Policy Panel report was released at the State of the Cities Conference on 2 November and made available to Moody's, in advance of their review. The Economic Policy Panel was formed on 23 August 2017 and is made up of 3 former senior economists from established public and private sector organisations. The Panel's report provided an analysis of the Aberdeen City Region economy, considering various economic indicators, such as trends in: house prices; employment rates; the price of oil; and the population of working age. Economic challenges were identified, and recommendations made to address these. The report was noted by the City Growth and Resources Committee on 27 November 2018, and the Committee approved recommendations to progress the agenda of the Panel.

2.5 Bond Trustee requirements

- 2.5.1 Clause 15.1.7 of the Deed requires that the Council provide confirmation to the Trustee that there has been no event of default, or potential event of default and the Council has

complied with the requirements of the Bond Trust Deed, signed by an Authorised Signatory, no later than 180 days after the end of the financial year. An event of default relates to the Council being unable to pay its debts as they fall due. Clause 15.1.5 of the Deed requires the Council to also provide a copy of the audited financial statements to the Trustee, also within 180 days of the financial year.

2.5.2 The 2017/18 Audited Annual Accounts and confirmation that no event of default or potential event of default had occurred, signed by the Chief Officer – Finance, were sent to the Trustee on 21 September 2018, ahead of the 180-day deadline.

2.5.3 In accordance with the Bond Trust Deed, the Council has paid the Bond Trustee remuneration for its services as specified in the Transaction Fee Letter.

2.6 Bond Trustee Liabilities

2.6.1 Clause 16.5 of the Deed requires the Council to pay or discharge all liabilities of the Bond Trustee in relation to carrying out its duties under the Deed and resolving any doubt concerning the Deed or related transaction documents.

2.6.2 A £5,000 charge was incurred by the Council on 14 November 2017, as a result of such a liability. This related to legal advice provided to the Trustee in relation to certain Bondholders requiring the February payment date be amended to the last day of the month, rather than 28 February, to account for leap years, as it was preferable for their accounting purposes. This required a Consent Solicitation, seeking Bondholders consent by vote.

2.6.3 Should similar Bond Trustee expenses arise again these would be incurred by the Council. Finance has considered the likelihood of such costs recurring and believes such costs would be difficult to quantify and do not lend themselves to insurance cover.

2.7 Procurement

2.7.1 The Trust Deed requires the Council to comply with procurement legislation in relation to the capital programme funded by the proceeds of the Bond issue, which largely related to the Event Complex Aberdeen (TECA) project.

2.7.2 The award of the contract followed a competitive tender process involving 4 suppliers following advertisement of the works in the OJEU on 18 June 2012. The contract is included in the Council’s contract register as required by the Procurement Reform (Scotland) Act 2014, however the contract value according to the contract register was not updated to reflect the outcome of the tender process and subsequent contract variations.

<u>Recommendation</u>		
The contract register should be updated to reflect the revised contract value.		
<u>Service Response / Action</u>		
Agreed.		
<u>Implementation Date</u>	<u>Responsible Officer</u>	<u>Grading</u>
January 2019	Director of Resources	Important within audited area

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.