ITEM 3

PAPER NO. WRWA 887

WESTERN RIVERSIDE WASTE AUTHORITY

MEETING	16th September 2019
REPORT AUTHOR/ DATE	Treasurer (Chris Buss-Tel 0208 871 2788) 6th September 2019
SUBJECT	Report of the Treasurer on the status of the Authority's Audit of the Accounts for 2018/19
CONTENTS	
STATUS	Open-circulation of this paper is not restricted.
BACKGROUND PAPERS	No background papers were used in the production of this report

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EXECUTIVE SUMMARY AND BACKGROUND

1. As reported to the Authority at its meeting on 15th July and at the meeting of the Audit Committee on 31st July, the external auditor (Deloitte) have not been able to conclude the audit of the Authority's accounts by the deadline of 31st July 2019. At the Audit Committee officers stated that they would update the Authority at the next meeting regarding progress on the conclusion of the audit.

ACCOUNTS AND AUDIT 2018/19

2. At the meeting of the Audit Committee on 31st July 2019, the Members were advised as to the reasons why at that time the External Auditor had been unable to complete the Audit. The primary outstanding reason was the ongoing discussion with the Auditors on the accounting treatment of certain items under the WMSA and in particular the facilitation payment of £3.5 million received in 2018/19. Deloitte emailed the Treasurer with a further list of enquiries on the morning of the Audit Committee. These are attached as Appendix A. The Authority responded in full to these enquiries on 20th August. The response (excluding appendices) is attached as Appendix B. As at the date of this report no formal response has been received from the Auditors. It is understood that this is due to the annual leave of the lead auditor. Any response received before the Authority meeting will be reported verbally to the Authority at the meeting on 16th September.

3. Once a response is received by the Authority, it is likely that further discussions and deliberations may be required but eventually there will be one of three outcomes. These are:

    1) That the Authority and the Auditor agree the accounts without any qualifications. This is clearly the preferred outcome.

    2) That the accounts are agreed but qualified in one instance. This is not an unusual outcome and in 2017/18 occurred in 29 cases.

    3) An adverse opinion is given. This occurred 5 times in 2017/18. The final auditors report will need to be reported to the Authority or a committee of the Authority and agreed by them.

4. The Authority is not unique in not getting its accounts signed off in the current year. Press reports indicate that 40% of accounts were not signed off by 31st July 2019, this compares with only 13% in the preceding year. However, as the Authority meets only four times a year, it is possible that there could be an extended period between the Auditor's report being completed and the Authority meeting. As previously explained the report has to be approved by either the Authority or a committee of the Authority. In the light of this it is recommended that the Authority re-establish the Audit Committee on the same basis as that set up for the July 31st meeting of one member per constituent Council.

5. This note has been circulated to S151 officers of each constituent council in advance of the Authority meeting and any comments received will be reported verbally.

6. During the audit process, it was identified that an updated Service Level Agreement with Wandsworth was required for the provision of financial and administrative services and a separate formal agreement required relating to the cash invested by Wandsworth Council on behalf of the Authority. A draft SLA was appended to Paper No. WRWA 883 which has had very minor amendments and a Treasury agreement has also been written. Both have now been agreed with the Council.

RECOMMENDATIONS

7. The Authority is recommended to:

(a) note the report and the current state of the Audit discussions as set out in the report and appendices;

(b) agree the establishment of an Audit Committee on the same basis as the Committee on 31st July 2019 to agree the Accounts once a report has been received from the Auditors; and

(c) otherwise receive this report for information

Western Riverside Waste Authority
Administration Office
Smugglers Way
LONDON SW18 1JS

CHRIS BUSS
Treasurer

6th September 2019

APPENDIX A

REQUEST FROM AUDITORS.

Please find below a note summarising what we'd discussed on confirming the accounting for the Authority's contracts, and areas of potential accounting complexity where would wish to be clear the logic and accounting rationale for the treatment adopted. Due to the complexity of the contracts, this should not be taken as a comprehensive list, as the overarching request is to understand the features of the Authority's arrangements with potential accounting consequence (across the agreements as a whole) and how that has been determined.

This analysis may need to have consideration of the position under the 2008 contract at inception of EfW provisions, the change at 2017, and changes at 2018.

- The overall features of the contracts that the Authority has with Cory, including in respect of Authority Site Services Contract and the EfW contract, including:
  - The Authority and Cory's obligations under the contracts
  - How pricing is determined over the life and why appropriate to take on "cash" basis each year
  - The circumstances, if any, which can lead to non-standard outcomes and consideration of the accounting implications of this in evaluating the contracts, including (but not limited to termination circumstances) in respect of:
    - EfW Contractor Default Termination
      - In particular if in the case of insolvency, as indicated in WRWA 864
    - Authority Default
      - How does this provision work? In principle could Authority intentionally default in order to get £1.5bn business for a lower price – what (other than reputation) is the contractual protection here? Is the limitation that price would include an "open market" element and so prevent gain here?
    - Force Majeure
    - Other termination provisions
  - Any aspect of the arrangements under which the Authority effectively has a "share" of liabilities or of life of asset
    - *" In the run up to Financial Close in 2008, the Authority's gate fee at the EfW Facility essentially became a balancing figure within the Financial Model to make the project bankable and the gate fee increased significantly in the last few months before Financial Close, in particular due to variances in LIBOR and Foreign Exchange rates."*
    - *"However, it was also recognised in 2008 that the Authority would not be able to benefit from the full 35-year design life of the EfW facility within the lifetime of the WMSA, although the Authority, through its General Waste gate fee, would have paid all of its share of the original £540 million debt within that timeframe."*
  - The functioning of the Residual Value Agreement, and the rights/benefits of the Authority beyond 2032,
    - including *"an option to recover value post-2032, either as a Royalty (valued at around £11.4 million per annum in today's terms) or via a significantly reduced gate fee for all, or part, of its General Waste. These residual rights are protected for the Authority via a lease arrangement over the Cory land on which the Energy from Waste Facility is built."*

        - With provision that appears to include a debt service costs within this
    - Whether the price paid under the gate fee represents a "market" price for transaction, or is higher (or lower) than this during the term, in particular if associated with other rights or benefits
    - Any related entitlements to payments e.g. in respect of capital receipts on disposals of assets between parties.
    - Any options that may apply (e.g. if refinancing occurred extending past end of term, would there be any obligations for Authority in respect of this)
    - Consideration of whether any element of service concession accounting applicable to the agreement
- With respect to the above, consideration in particular of any provisions of the contracts that may indicate:
    - Control of assets not currently recognised on balance sheet, including consideration whether the agreement includes a lease under IFRIC 4
    - Features affecting the amounts receivable/payable under the contract beyond the current contract term
    - Financial guarantees (e.g. in case of EfW Contractor Default Termination)
    - Insurance under IFRS 4 (in particular in respect of Force Majeure obligations, where potential outcomes involve net outflow)
    - Contingent liabilities
    - Other areas of accounting complexity or judgement

  Particularly in these areas, are there any features of the agreement which will require reassessment under accounting standards in issue but not yet effective (e.g. IFRS 16, IFRS 17) (Not in terms of actually assessing treatment or concluding on these, but to note as areas requiring reassessment in future during transition process).
- Following on from the above, are there any disclosure requirements in respect of the arrangement under any standards
- With respect to the 2017 refinancing
    - What are the other changes in the agreement at this point, how do they affect the obligations of the parties, and does this affect the accounting analysis above in respect of any of these?
    - What is the rationale for the profile of spreading of the refinancing benefit to be equivalent to the cash reduction?
    - If the value of the benefit is changing (as indicated in discussion of 2018 refinancing up from 11m to 14.5m), then how is that accounted for and why in light of above
- With respect to the 2018 changes to agreement and £3.5m payment, rationale for treatment in light of above.
    - What are the other changes in the agreement at this point, how do they affect the obligations of the parties, and does this affect the accounting analysis above in respect of any of these?
        - In particular, if this is varying whether the authority has any obligations past 2032 (indicated in some of the EY calculation of value of the removal of the DS component of agreement), then what is the impact of this and any
- Please can we also have:
    - Confirmation whether any other changes to the agreement have occurred
    - A complete conformed copy of the agreement and related schedules and accompanying agreements – we have received individual documents, but do not believe have received full documentation that will link back to this analysis.
- Other specific queries:
    - **Force Majeure:**

    - *If the contract terminates following a Force Majeure event and if the contractor has not opted to retain the contract assets rather than hand them over to the Authority (Schedule 15 clause 20);r* Does it mean that if the factory / assets worth more than the liabilities after the FM event, can Cory keep the assets and Authority doesn't have to pay back Cory?
- **£3.5m** (some of which is covered within WRWA 864)
    - What is the grounds for Authority claiming they can get money on refinancing, what is the legal basis for that?
    - What would be the amount they would have been able to claim?
    - What is the legal basis for Cory refuting that?
    - What was the legal assessment of the likely success of the Authority's claim?
    - Why is £3.5m commensurate compensation?

APPENDIX B

NOTE FROM TREASURER of WRWA to External Auditors.

Background.

This note has been prepared in respect of a detailed request from the Authority's external auditors received on 31st July 2019. The request concerns further detailed questions with regard to the way that the Authority's contract with Cory (WMSA) has been structured both commercially and how this is then interpreted in terms of accounting standards. Before the questions can be answered in full it is necessary to give a narrative as to how the Authority's contractual relationship has developed since the contract was let in 2002.

CONTRACTUAL DEVELOPMENT.

The contract commenced in 2002, following an EU procurement. The contract length was 30 years. The contract allowed for landfill to continue until Cory built what at that time was envisaged to be a merchant EfW facility, with the contractor being responsible for dealing with the Authority's waste at a tendered rate on a take and pay basis. The contract also envisaged the development of some assets on Authority land (MRF and new Civic amenity site) and an EfW facility on contractor land.

Following a long planning process the EfW facility was granted planning permission but restrictions in terms of delivery of waste by land meant that without access to the Authority's two riverside facilities the asset was effectively stranded and unbankable. The Authority therefore had the choice of either modifying the contract or terminating. It chose to modify the contract. This effectively meant that the Authority took on certain potential liabilities in extremis situations. These are detailed in Appendix D to paper 604 A attached.

The contractual arrangements allowed for the EfW rate to be index linked and for adjustments to that rate to be varied in certain circumstances in addition to when a qualifying refinance occurs. This has happened three times. Firstly, when a contingency sum in the EfW construction contract wasn't spent reducing the rate by £6 effective from 2014/15, secondly a reduction of £6.66 following an operational management adjustment effective from October 2015, and lastly an adjustment in respect of business rates and fly ash recycling of £3.31 from 2016/17.

The EfW facility was commissioned in October 2011 and the landfill arrangements, that had existed from 2002, ceased.

ACCOUNTING ARRANGEMENTS.

As previously stated, the contract was originally let as a merchant contract , the Authority effectively paying a price per tonne for the waste delivered. There is no guaranteed minimum tonnage or payment. The Authority effectively paid the market rate as determined by the competitive tendering process. In effect the Authority paid the "cash" rate for the waste disposed. The rate was modified in 2008 due to the impact of a number of factors principally construction, foreign exchange and Libor rate costs. The appropriateness of these changes was extensively analysed at the time by specialist waste management, quantity surveying, financial and legal advisors. This arrangement has been unchanged since then and has not been challenged by any of the Authority's external auditors since that date.

A retrospective review of the main changes to the Accounting standards since 2002 has been undertaken and is appended. Where appropriate changes have been made to the accounts to reflect the changes in accounting standards. However, nothing has happened that has, in the view of the Authority or it's previous auditors, changed the main basis of accounting for the transactions between the Authority and its contractor on a "cash" basis. The relationship is the same as what it was in 2002 effectively, the Authority delivers waste, the contractor disposes of it.

It is important to recognise that the accounts of the Authority have a primary purpose as set out in Section 1.8.1 of the CIPFA code which is shown below for ease of reference:

PURPOSE OF THE STATEMENT OF ACCOUNTS

1.8.1 The Code has been prepared on the basis that the purpose of a local authority's published Statement of Accounts/Annual Accounts (Scotland) is to give electors, those subject to locally levied taxes and charges, members of the authority, employees and other interested parties clear information about the authority's finances. It should answer such questions as:

- *What did the authority's services cost in the year of account?*
- *Where did the money come from?*
- *What were the authority's assets and liabilities at the year end?*

It is the Authority's view that the current accounting basis meets the above, to adjust individual elements of the contract for perceived or potential future events or benefits or liabilities will distort the cost of services and will not present a true cost of services.

The CIPFA Code also states that the accounts have to present a true and fair view. The relevant extract is as follows:

2.1.1.7 Financial statements shall give a true and fair view of the financial position, financial performance and cash flows of an authority. A true and fair view requires the faithful representation of the effects of transactions, other events and conditions in accordance with the definitions and recognition criteria for assets, liabilities, income and expenses set out in the Code. Although the IASB framework does not deal directly with such a concept, the application of the principal qualitative characteristics and compliance with the Code is presumed to result in the financial statements that convey a true and fair view. Nevertheless it remains the responsibility of the authority to ensure that its financial statements present a true and fair view of the financial position, performance and cash flows of the authority.

The Authority is of the view that the current accounting arrangements present a true and fair view of the Authority and to do otherwise would make comparability, verifiability, timeliness and understandability difficult, if not impossible, as many of the issues suggested by the Auditors are extremely difficult to price even if they were to occur.

Turning to the CIPFA Code it is important to look at each of those issues and the relevant extensive extract is repeated below:

2.1.2.13 Comparability, verifiability, timeliness and understandability are qualitative characteristics that enhance the usefulness of information that is relevant and faithfully represented. The enhancing qualitative characteristics may also help determine which of two ways should be used to depict a phenomenon if both are considered equally relevant and faithfully represented.

2.1.2.14 Comparability – information about an authority is more useful if it can be compared with similar information about other authorities and entities and with similar information about the same authority for another period or another date. Comparability is the qualitative characteristic that enables users to identify and understand similarities in, and differences among, items. Unlike the other qualitative characteristics, comparability does not *relate to a single item. A comparison requires at least two items. It should be noted that: „ Consistency, although related to comparability, is not the same. Consistency refers to the use of the same methods for the same items, either from period to period within a reporting entity or in a single period across entities. Comparability is the goal; consistency helps to achieve that goal. „ Comparability is not uniformity. For information to be comparable, like things must look alike and different things must look different. Comparability of financial information is not enhanced by making unlike things look alike any more than it is enhanced by making like things look different. Application of the terms of the Code will ensure adequate disclosure and consistency, and thus comparability.*

2.1.2.15 Verifiability helps assure users that information faithfully represents the economic phenomena it purports to represent. Verifiability means that different knowledgeable and independent observers could reach consensus, although not necessarily complete agreement, that a particular depiction is a faithful representation. Quantified information need not be a single point estimate to be verifiable. A range of possible amounts and the related probabilities can also be verified.

2.1.2.16 Verification can be direct or indirect. Direct verification means verifying an amount or other representation through direct observation; for example, by counting cash. Indirect verification means checking the inputs to a model, formula or other technique and recalculating the outputs using the same methodology.

2.1.2.17 It may not be possible to verify some explanations and forward-looking financial information until a future period, if at all. To help users decide whether they want to use that information, it would normally be necessary to disclose the underlying assumptions, the methods of compiling the information and other factors and circumstances that support the information.

2.1.2.18 Timeliness means having information available to decision-makers in time to be capable of influencing their decisions. Generally, the older the information, the less useful it is. However, some information may continue to be timely long after the end of a reporting period because, for example, some users may need to identify and assess trends.

2.1.2.19 Understandability – classifying, characterising and presenting information clearly and concisely makes it understandable. Some phenomena are inherently complex and cannot be made easy to understand. Excluding information about those phenomena from the financial statements might make the information in those financial statements easier to understand. However, those statements would be incomplete and therefore potentially misleading.

2.1.2.20 The financial statements are prepared for users who have a reasonable knowledge of business and economic activities and who review and analyse the information diligently. Some economic and other phenomena are particularly complex and difficult to represent in local authority financial statements and some users may need to seek the aid of an advisor to assist in their understanding of them. All efforts should be undertaken to represent economic and other phenomena included in the financial statements in a manner that is understandable to a wide range of users. However, information should not be excluded from financial statements solely because it may be too complex or difficult for some users to understand without assistance.

2.1.2.21 Enhancing qualitative characteristics should be maximised to the extent possible. However, the enhancing qualitative characteristics, either individually or as a group, cannot make information useful if that information is irrelevant or not faithfully represented.

2.1.2.22 Local authorities derive their powers from statute and their financial and accounting framework is closely controlled by primary and secondary legislation. It is a fundamental principle of local authority accounting that, where specific legislative requirements and accounting requirements conflict, legislative requirements shall apply. However, the Code deals with such conflicts by showing the position required by the Code's accounting requirements in the Comprehensive Income and Expenditure Statement, and the effect of the legislative requirements in the Movement in Reserves Statement.
The Authority believes that by making appropriate disclosures with regard to future potential events in the accounts, albeit for the first time, is the most appropriate way of dealing with any future liabilities occurring. The Authority maintains the view, which it believes is supported by the CIPFA guidance manual, that "*For an item to be able to be recognised, its cost or value must be capable of reliable measurement. It follows, therefore, that if an item cannot be measured with reliability, it cannot be recognised in the financial statements.*"

Much of what is being requested by the Auditors is not capable of reliable measurement.

Turning to the request from the Auditors, this is set out below with the Authority's response in blue italics below each segment of the request.

REQUEST FROM AUDITORS.

Please find below a note summarising what we'd discussed on confirming the accounting for the Authority's contracts, and areas of potential accounting complexity where would wish to be clear the logic and accounting rationale for the treatment adopted. Due to the complexity of the contracts, this should not be taken as a comprehensive list, as the overarching request is to understand the features of the Authority's arrangements with potential accounting consequence (across the agreements as a whole) and how that has been determined.

This analysis may need to have consideration of the position under the 2008 contract at inception of EfW provisions, the change at 2017, and changes at 2018.

- The overall features of the contracts that the Authority has with Cory, including in respect of Authority Site Services Contract and the EfW contract, including:
    - The Authority and Cory's obligations under the contracts

The Authority's primary obligations are set out in clause 13 within the Agreement, but the two principal ones are:

a. to use its Power of Direction to direct all Authority Waste to Cory (clause 13.1.1); and

b. to pay for the services provided by Cory (clause 13.1.3).

Cory's principal obligation is to now provide the Services. In 2008, there were also obligations to construct or provide various assets e.g. principally the EfW Facility, MRF and HWRC but these have been discharged.

- How pricing is determined over the life and why appropriate to take on "cash" basis each year

Pricing was fixed in 2002 with EfW gate fee price modified 2008. All prices are then indexed annually as set out in the Payment Mechanism. Modifications have been made as explained earlier. The Authority's rationale for cash payments has also been set out earlier in this paper.

- The circumstances, if any, which can lead to non-standard outcomes and consideration of the accounting implications of this in evaluating the contracts, including (but not limited to termination circumstances) in respect of:
  - EfW Contractor Default Termination
    - In particular if in the case of insolvency, as indicated in WRWA 864
  - Authority Default
    - How does this provision work? In principle could Authority intentionally default in order to get £1.5bn business for a lower price – what (other than reputation) is the contractual protection here? Is the limitation that price would include an "open market" element and so prevent gain here?
  - Force Majeure
  - Other termination provisions
- Any aspect of the arrangements under which the Authority effectively has a "share" of liabilities or of life of asset
  - *" In the run up to Financial Close in 2008, the Authority's gate fee at the EfW Facility essentially became a balancing figure within the Financial Model to make the project bankable and the gate fee increased significantly in the last few months before Financial Close, in particular due to variances in LIBOR and Foreign Exchange rates."*
  - *"However, it was also recognised in 2008 that the Authority would not be able to benefit from the full 35-year design life of the EfW facility within the lifetime of the WMSA, although the Authority, through its General Waste gate fee, would have paid all of its share of the original £540 million debt within that timeframe."*
  - Any aspect of the arrangements under which
- The functioning of the Residual Value Agreement, and the rights/benefits of the Authority beyond 2032,
  - including *"an option to recover value post-2032, either as a Royalty (valued at around £11.4 million per annum in today's terms) or via a significantly reduced gate fee for all, or part, of its General Waste. These residual rights are protected for the Authority via a lease arrangement over the Cory land on which the Energy from Waste Facility is built."*
  - With provision that appears to include a debt service costs within this

Please find attached Appendix D to Paper No. WRWA 604A, March 2008 which was produced by DLA (the Authority's legal advisors at the time) and explains the Authority's ownership and control of assets in various termination scenarios during different phases of the WMSA from financial close in 2008 up until the end of the Residual Value Period. In response to your question relating to EfW

Authority Default termination, the Authority would not gain by engineering an EfW Authority Default termination as it would (inter alia) have to pay open market value for the shares and subordinated debt, which was the standard position adopted under PFI contracts at the time the WMSA was entered into.

The Debt Service provisions post 2032 were removed as part of the negotiations around Cory's 2018 refinancing.

It should be noted that the residual value period rests upon a big assumption that post 2032 the EfW is still functioning. If it is not accepting waste post 2032 then the RVA value is nil. On that basis the Authority would contend that taking any of the RVA value into the accounts now would not be prudent.

Any aspect of the arrangements under which

- Whether the price paid under the gate fee represents a "market" price for transaction, or is higher (or lower) than this during the term, in particular if associated with other rights or benefits
- Any related entitlements to payments e.g. in respect of capital receipts on disposals of assets between parties.

The Authority has set out its reasoning earlier as to why the gate fee represents the market rate. With regard to Capital receipts these only apply in relation to ASS as set out in Schedule 12. In reality has only applied to a limited number of redundant items of mobile plant and equipment. These tend to be low value and as such would not be accounted for as Capital receipts.

- Any options that may apply (e.g. if refinancing occurred extending past end of term, would there be any obligations for Authority in respect of this)

No. The Debt Service provisions post 2032 were removed as part of the negotiations around Cory's 2018 refinancing. See Paper no 864 attached. Paper no 833 deals with the 2017 refinancing.

- Consideration of whether any element of service concession accounting applicable to the agreement
- *The Authority can see no reason why service concession accounting is applicable to the WMSA.*

- With respect to the above, consideration in particular of any provisions of the contracts that may indicate:
  - Control of assets not currently recognised on balance sheet, including consideration whether the agreement includes a lease under IFRIC 4
  - Features affecting the amounts receivable/payable under the contract beyond the current contract term
  - Financial guarantees (e.g. in case of EfW Contractor Default Termination)
  - Insurance under IFRS 4 (in particular in respect of Force Majeure obligations, where potential outcomes involve net outflow)
  - Contingent liabilities
  - Other areas of accounting complexity or judgement

  Particularly in these areas, are there any features of the agreement which will require reassessment under accounting standards in issue but not yet effective (e.g. IFRS 16, IFRS 17) (Not in terms of actually assessing treatment or concluding on these, but to note as areas requiring reassessment in future during transition process).

There are no assets not currently recognised on the balance sheet.

The Authority has considered the terms of the RVA which deals with potential income post 2032, and as stated does not consider it neither proper accounting practice or prudent to take into account at the present time potential financial benefits that may or may not accrue to the authority. The potential income is dependent upon external factors that the Authority has no control over. Further, if the Authority chooses not to send any tonnage whatsoever to Belvedere under the RVA (which is the default position if the Authority does not positively elect to send tonnage), it will have no cost exposure post 2032.

The issue of whether there are financial guarantees, insurance and contingent liabilities arising from the WMSA have been addressed in earlier papers submitted to you. It is not proposed to further extend the work done in those papers which are appended for ease of reference.

The Auditor's attention is again drawn to the statements made at the beginning of this paper on the overall accounting arrangements.

Future changes to accounting standards will be dealt with at the appropriate time having regard both to the Accounting standard and the CIPFA code and guidance. Any future changes to the WMSA will also include a note from the Authority's financial advisors on the accounting treatment of any payments.

- Following on from the above, are there any disclosure requirements in respect of the arrangement under any standards

There are no known additional disclosure requirements above those included in the draft accounts.

- With respect to the 2017 refinancing
  - What are the other changes in the agreement at this point, how do they affect the obligations of the parties, and does this affect the accounting analysis above in respect of any of these?

The changes to the WMSA, as a consequence of the 2017 refinancing, were as described in Paper No. WRWA 833 in June 2017 which included, as appendices B and C, separate reports from Shakespeare Martineau and EY the Authority's legal and financial advisors respectively.

  - What is the rationale for the profile of spreading of the refinancing benefit to be equivalent to the cash reduction?

The Authority has taken the view that the benefit of reduced charges should be applied across the remaining life of the WMSA. There is no readily understandable methodology for apportioning this benefit which is reflected in the charges made to the Constituent Councils. The cash benefit increases with inflation over the life of the contract which means that the real value is maintained.

  - If the value of the benefit is changing (as indicated in discussion of 2018 refinancing up from 11m to 14.5m), then how is that accounted for and why in light of above

That was a short hand analogy for the benefit of Authority members. In simple terms, the £3,5 million is not a refinancing benefit but as described previously and elsewhere is a facilitation payment. It does not impact on any of the contractual benefits or costs arising as the risk profile up until 2032 does not change, unlike in 2017 where there was a change.

- With respect to the 2018 changes to agreement and £3.5m payment, rationale for treatment in light of above.
  - What are the other changes in the agreement at this point, how do they affect the obligations of the parties, and does this affect the accounting analysis above in respect of any of these?
    - In particular, if this is varying whether the authority has any obligations past 2032 (indicated in some of the EY calculation of value of the removal of the DS component of agreement), then what is the impact of this and any

The changes to the WMSA, as a consequence of the 2018 refinancing, were as described in Paper No. WRWA 864 which included, as appendices A and B, separate reports from Shakespeare Martineau and EY the Authority's legal and financial advisors respectively. Further detail is included further in this paper.

- Please can we also have:
  - Confirmation whether any other changes to the agreement have occurred
  - A complete conformed copy of the agreement and related schedules and accompanying agreements – we have received individual documents, but do not believe have received full documentation that will link back to this analysis.

The 2018 conformed copy has all changes incorporated. We have sent a full set of documentation to you.

- Other specific queries:
  - **Force Majeure:**
    - If the contract terminates following a Force Majeure event and if the contractor has not opted to retain the contract assets rather than hand them over to the Authority (Schedule 15 clause 20); Does it mean that if the factory / assets worth more than the liabilities after the FM event, can Cory keep the assets and Authority doesn't have to pay back Cory?

Sorry but we do not understand this question. Clause 20 does not permit the contractor to opt to retain contract assets following a FM termination.

  - **£3.5m** (some of which is covered within WRWA 864)
    - What is the grounds for Authority claiming they can get money on refinancing, what is the legal basis for that?
    - What would be the amount they would have been able to claim?
    - What is the legal basis for Cory refuting that?
    - What was the legal assessment of the likely success of the Authority's claim?
    - Why is £3.5m commensurate compensation?

All of these points are set out in Paper No WRWA 864 and its accompanying appendices, which have been previously sent to you. However, the following extracts may assist.

The Authority's claim was based on its interpretation of the WMSA   Paras 21 and 22 of the report summarise the Authority position.

> *"In 2008, whilst the refinancing provisions within Schedule 15 of the WMSA were drafted on the basis of the debt being repaid within the term of the WMSA, the potential for debt to carry on beyond 2032 wasn't overlooked. Schedule 18, which sets out the Authority's Residual Value rights post-expiry of the contract, confirms that an addition to the General Waste Option Rate would need to be calculated, sufficient to repay the Authority's share of any Permitted Borrowings that remained outstanding. This additional element is defined as "DS" (short for Debt Service) in Appendix 1 to Schedule 18 of the WMSA.*
>
> *The RVA also clearly sets out the Authority's right either to receive royalties post 2032 or, subject to the final agreement of some commercial terms, the right also to have the Authority's residual waste treated at the EfW Facility. The main terms, i.e. the mechanisms with respect to tonnage, price and term, are all fixed and the WMSA states that other terms, to the extent applicable, shall be consistent with the terms of the WMSA. The Authority considers this to be far more than simply an "agreement to agree". "A fuller analysis is contained in Appendix A"*

The Authority's initial claim is set out in the EY report at the end of page 11 and was for £6 million. This was based on the Authority's view of the claim. However, due to the differences in interpretation of the refinancing clause this was highly unlikely to succeed.

The basis of the Cory argument is set out in the legal report appended as Appendix A, together with the Authority's rebuttal.

The following extract, from the legal assessment set out in Appendix A, summarises the reasons why a deal was struck:

> *"… if the matter were made subject of litigation the court might form a different view. Secondly, any litigation would be expensive and cause significant delay at a time when the Authority is seeking to work constructively with Cory on other projects including without limitation the redevelopment of Cringle Dock. Thirdly, even if the Authority won all the arguments in court, Cory could simply cancel the refinancing at any time, leaving the Authority with nothing. A negotiated settlement was therefore preferable if it could be achieved."*

If the matter had gone to court then it is highly likely that the window of opportunity for refinancing would have passed, leaving the Authority with no benefits and potential significant costs.

The settlement of £3.5 million needs to be taken in the context of the original Cory offer of £1.2 million. Any such settlement, where there is a dispute over interpretation, means that any sum achieved is subject to interpretation. It is wrong to call this sum compensation, it was a facilitation payment to enable the refinancing to proceed.

The Authority has taken the view that this receipt is an exchange transaction as set out in the CIPFA Code and earlier note on IFRS 15. However, it could also be seen as a non-exchange transaction. The relevant extracts from the code are as follows:

2.1.2.32 Revenue transactions can be broadly divided into two types ie those which are exchange transactions and those which are non-exchange transactions. Exchange transactions are transactions in which one entity receives assets or services, or has liabilities extinguished, and directly gives approximately equal value (primarily in the form of cash, goods, services, or use of assets) to another entity in exchange. Non-exchange transactions are transactions that are not exchange transactions. In a non-exchange transaction, an authority either receives value from another entity without *directly giving approximately equal value in exchange, or gives value to another entity without directly receiving approximately equal value in exchange.*

2.1.2.33 There is a further group of non-exchange transactions where an entity may provide some consideration directly in return for the resources received, but that consideration does not approximate the fair value of the resources received. In these cases, the authority will need to determine whether there is a combination of exchange and non-exchange transactions, each component of which is recognised separately.

2.1.2.34 For non-exchange transactions: revenue shall be recognised when the event that triggers the payment to the authority has taken place and: a) it is probable that the economic benefits associated with the transaction will flow to the authority, and b) the amount of the revenue can be measured reliably.

In either scenario the impact is still the same the payment is treated as an in year transaction and not spread.

LIST OF APPENDED PAPERS

Authority Papers : 604 A appendix- D , 833 , 864.

List of accounting standard changes since 2002.

Notes on IFRS 9 and 15 , contingent liabilities and insurance .