

NORTHUMBERLAND COUNTY COUNCIL

AUDIT COMMITTEE

At a meeting of the **Audit Committee** held at County Hall, Morpeth on Wednesday, 24 January 2018 at 10.15 a.m.

PRESENT

Councillor G Hill
(Chair)

COUNCILLORS

G Castle
M Purvis

E Simpson
D Towns

CO-OPTED MEMBERS

A Hall

A N Haywood-Smith

OFFICERS IN ATTENDANCE

K Angus
A Elsdon
B Haigh
B J McKie
C Mellons
A Mitchell
K Norris
S Reid
A Stewart

Director of Human Resources
Director of Finance
Corporate Fraud Manager
Group Assurance Manager
Ernst & Young, External Auditor
Chief Internal Auditor
Democratic Services Officer
Ernst & Young, External Auditor
Finance Manager

ALSO PRESENT

Councillors B Flux, N Oliver

26. APOLOGIES FOR ABSENCE

Apologies for absence were received from Councillors Hepple, Rickerby and Swinburn.

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27. MINUTES

(a) Wednesday, 22 November 2017

RESOLVED that the minutes of the meeting of the Audit Committee held on Wednesday, 22 November 2017, as circulated, be confirmed as a true record and signed by the Chair.

(b) Wednesday, 6 December 2017

RESOLVED that the minutes of the meeting of the Audit Committee held on Wednesday, 6 December 2017, as circulated, be confirmed as a true record and signed by the Chair subject to the minute numbers being amended to start from no. 22.

28. REPORTS OF THE EXTERNAL AUDITOR

(1) ANNUAL AUDIT LETTER FOR THE YEAR ENDED 31 MARCH 2017

Mr Stephen Reid, External Auditor EY, introduced the above report stating that detailed findings had previously been discussed by the committee on 22 November 2017 and matters highlighted in this report were the most significant areas of the audit process for the Council. He did not have anything further to add and invited questions from members. (A copy of the document is attached to the signed minutes as Appendix A.)

Councillor Towns requested clarification regarding Ashington Football Club having been valued on a depreciated replacement cost basis and asked if any other Arch assets had been valued in that way. Mr Reid stated that it had been valued on how much it would cost to rebuild and rental yield had not been taken into account. It was possible other assets had also been valued on that basis as it was sometimes appropriate to use that method if there was not an active market value, however, that was not the case for Ashington Football Club.

RESOLVED that the Audit Letter for the year ended 31 March 2017 be received and noted.

(2) AUDIT PLANNING REPORT FOR YEAR ENDED 31 MARCH 2018

The above document set out external audit planning for the Council up to year ending 31 March 2018 (a copy is attached to the signed minutes as Appendix B).

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Mr Reid said there was an accelerated timetable for the preparation of financial statements which would need to be approved by the end of July 2018. Page 5 of the report gave an overview of the audit strategy and highlighted the risks for all audits. Land and buildings was the most significant balance on the Council's balance sheet and judgement on valuation methods used would continue to be made in conjunction with External Audit's expert valuer team. Similarly other very technical matters such as the pension liability would be considered by External Audit's pension specialists. Changes in group structure had been identified as a new risk for this year and decisions by Arch and their entities would be looked at.

Reference was made to page 6 of the report which highlighted the planned materiality level, performance materiality level and audit differences. It was intended to report differences of £900,000 or above. The rest of the report highlighted significant risks identified for the current year and the expected audit approach.

Section 3, page 15 summarised areas around value for money based on past activities. It was pointed out that the issues referred to around Arch was not an exhaustive list and that would be under review as part of the audit report.

The timetable showing the key stages of the audit and the deliverables was set out on page 25 and it was noted that this had been agreed with management.

Mr Reid drew members' attention to page 27 of the report which confirmed he was independent and could continue as the Council's External Auditor. Details of fees were set out on page 31, Appendix A. It was envisaged that additional work would be required and any proposed fee variation would be discussed in due course.

In response to questions the following information was provided:

- Highways was not included in value for money risks as there had been a national withdrawal from a proposed accounting treatment
- With regard to engagement quality review, that was for higher risk issues. A second party would be involved to challenge judgments in such circumstances but that was not deemed applicable for this audit. In terms of the quality review process, there was an internal process whereby issues were examined by someone separate from the team and there were also external inspections.

RESOLVED that the Audit Planning Report for year ending 31 March 2018 be received and noted.

29. REPORTS OF THE DIRECTOR OF FINANCE

(1) STATEMENT OF ACCOUNTS 2017-18

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Alison Elsdon, Director of Finance, introduced the above report which provided members with an overview of the changes to the timetable for publishing the 2017-18 Statement of Accounts and reporting to Audit Committee; the Accounting Policies to be adopted and an update regarding the anticipated outturn position for the Council. (A copy of the report is attached to the signed minutes as Appendix C.)

Mrs Elsdon referred to the accelerated timetable for publishing the draft Statement of Accounts which was now 31 May 2018 and the final audited Statement of Accounts which would need to be published on or before 31 July 2018.

She said there was no change to the accounting policies which had been used to produce Statements for the previous year and these had been brought before members early for approval. In terms of anticipated outturns, the estimated balance for 2017-18 was an underspend of £15.20 million although, because of contingencies and the fact that there were a number of estimates within the forecast, there would most likely be some movement on that figure.

It was noted that the Annual Governance Statement would be brought to the March meeting and the Draft Statement of Accounts would be ready in June for which it was proposed to hold 2 workshops for members to review the document and ask questions.

RESOLVED that

- (a) the changes to the timetable for publishing the 2017-2018 Statement of Accounts and the reporting to Audit Committee be noted;
- (b) the Accounting Policies to be adopted for the 2017-18 Statement of Accounts be agreed;
- (c) the anticipated outturn position for the Council and the anticipated movement on reserves and provisions be noted.

(2) TREASURY MANAGEMENT STRATEGY STATEMENT FOR THE 2018-19 FINANCIAL YEAR

Andy Stewart, Financial Manager, introduced the above report which set out the Treasury Management Strategy, Treasury Management Policy Statement, the Annual Investment Strategy for the Financial Year 201-19, Prudential Indicators 2018-19 - 2020-21 and the Minimum Revenue Provision Policy 2018-19.

An update to the main report had also been circulated detailing some minor changes resulting from a subsequent amendment to the proposed capital programme for 2018-21 for the inclusion of a provision of £7 million per annum for a 'Loans Fund to Support Start-Up Businesses and, in addition, an amendment to

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clarify the revision to the Minimum Revenue Provision (MRP) policy. (A copy of the reports are filed with the signed minutes as Appendix D.)

Mr Stewart referred to the provision of some Treasury Management training, as discussed at the last meeting, for which some proposed dates would be circulated to determine an appropriate time.

It was noted that the Treasury Management Strategy would go to full Council for approval at its meeting on 21 February as part of the budget setting process.

Mr Stewart gave a brief summary of the report and highlighted the following points:

- The borrowing and investment strategy were shaped by the economic outlook and the longer term economic forecast was provided at Appendix 1.
- Taking the current strategy into account, borrowing from internal balances was used to reduce external borrowing requirement, for which the annual savings were currently projected to be around £3.4 million.
- Required borrowing next year would be around £190 million.
- Given the current economic forecast it was envisaged that the borrowing requirement would be met by short to medium term borrowing with the flexibility to take advantage of rates over a longer term.
- In terms of investment at 30 November 2017 investments were £199.45 million, this was forecast to reduce to £90 million. Investment balances would fluctuate between £40 million and £100 million next year.
- Priority would continue to be given to protecting capital, liquidity whilst achieving the best rate of return possible on investments.
- The Credit and Counterparty policy for investments is attached at Appendix 2. The criteria for the Credit and Counterparty Policy attached at Appendix 2 remained unchanged.
- In terms of Non Treasury Management Investments (loans to third parties for policy reasons), the report set out the forecast position.
- Prudential Indicators for 2018-19 - 2020-21 were set out in Appendix 4. These would be submitted to full Council for approval along with the budget and Treasury Management Strategy.
- The policy for MRP, which covers the Council's policy for the repayment of debt was set out in Appendix 5. It had been updated to clarify that MRP would now be provided on those long term capital debtors where principal was repaid on maturity and the loan term was greater than 5 years.
- In terms of the Treasury Management Practices, there were no proposed changes for the current year. Once training had been undertaken by committee members and the senior management structure was in place, work would be carried out with internal audit to consider and, where appropriate, revise these practices and a report brought to a future meeting.

The Chair requested that 3 dates be offered to members for Treasury Management Training and the most suitable date would be chosen.

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Mr Hall asked if there was any benchmarking available for members' information. It was confirmed that there was and members would get sight of it in the out-turn report.

Mr Haywood-Smith referred to page 9 of the report and asked if the figures quoted in the third paragraph were appropriate considering they were based on an average interest rate which varied. The Finance Manager said figures were calculated at a point in time on a combination of all loans and investments and the figure could change on different 'snapshots in time'. Mr Haywood-Smith raised concerns about using average rates over a historic period of time which could be over more than one year or less than one year. The Director of Finance said the forecast had to be based on an average rate as it was not known what the rate would be until that point in time. It was based on a differential of external and internal borrowing.

RESOLVED that members agree the following be recommended for approval by County Council subject to the updates circulated and attached to the report.

- (a) The Treasury Management Strategy Statement which includes the Treasury Management Policy Statement, the Annual Investment Strategy and Borrowing Strategy for the Financial Year 2018-19.
- (b) The Prudential Indicators (Appendix 4) for three years 2018-19 to 2020-21 to ensure that the Council's capital investment plans are affordable, prudent and sustainable.
- (c) The Minimum Revenue Provision Policy (Appendix 5) 2018-19.

(3) CORPORATE FRAUD TEAM - INTERIM FRAUD REPORT

Barry Haigh, Corporate Fraud Manager, introduced the above report which updated the committee on work undertaken by the Corporate Fraud Team within the Council. (A copy of the report is attached to the signed minutes as Appendix E.)

Information was provided regarding internal and external fraud referrals received during the period 1 April 2017 to 30 September 2017.

With regard to internal fraud, it was stated the number of referrals in the first 6 months was equal to that in 12 months the previous year, but most of them did not require any investigation. Four of those referrals were with the legal department at the current time, details of which were explained to the committee. In terms of external fraud, referrals continued to be generated via the hotline and email, and numbers were similar to those received the previous year.

Details of other work were provided and these included:

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- revenue created from cases involving single person discounts for Council Tax;
- the initiative in conjunction with Homes for Northumberland in relation to Right to Buy applications;
- a vetting and checking service on Right to Buy/Acquire applications for Karbon Homes, covering all of the Northumberland and Tyneside area;
- liaising with internal partners in the Insurance Team following concerns about the robustness of Zurich, the Council's insurers, in investigating suspicious claims;
- liaising with the Homelessness Team regarding false allegations of homelessness and illegal evictions;
- continuing to run the North East Tenancy Fraud Forum Group;
- offering a chargeable monthly investigation service for RSL's which would generate income for the Council.

Questions were then invited from members, in response to which the following information was provided:

- It was confirmed that the team did investigate evictions in the private sector and action was taken against private landlords who did not follow the correct legal procedure.
- Between 20 and 30% of Right to Buy applications were withdrawn upon intervention from the team.
- National Fraud Awareness work and publicity around abandonment had been undertaken.
- The figures quoted regarding the recovery of properties were based on the nationwide average of the cost of having to rebuild replacement homes, had the properties not been recovered.
- Action would be taken to recover the overpayment of wages regardless of whether any action was taken against the employee. It could not always be determined why overpayments were made but the employee had a legal responsibility to report errors.
- With regard to single person discount on Council Tax, fraudulent claims were often identified via data matching exercises whereby another person was seen to be living at the property. The percentage figure was not to hand.

RESOLVED that the progress in work undertaken by the Corporate Fraud Team since the last report and the steps being taken to recover any monies owed to the Council be noted.

(4) ARCH BORROWING

The above report had been requested for information by the Audit Committee at its meeting in December 2017. Alison Elsdon, Director of Finance, introduced the

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report which summarised the current annual financial impact for the Council of the cumulative value of the advances to Arch to the end of December 2017. (A copy of the report is attached to the signed Minutes as Appendix E.)

It was stressed that borrowing was undertaken for the whole of the capital programme, and not just for Arch or particular activities; and, that rates in the report were weighted average external borrowing rates at a particular point in time and would be subject to change.

As at 31 December 2017, outstanding loans to Arch amounted to £269 million for which a number of different loan rates applied. The majority of loans to Arch were over a 40 year period with a weighted average rate of just over 5% which amounted to annual interest due to the Council of £13.7 million. The weighted average rate of Council external borrowing was 2.81% so the notional cost to the Council of advances to Arch was £7.5 million. Mrs Elsdon stressed that this was a notional figure as the rates quoted were weighted average rates and were at a particular point in time and that they could effectively change on a regular basis. It was also noted that in terms of the interest that the Council did benefit.

It was noted that Arch only paid interest on the loans. Mrs Elsdon provided a detailed explanation of Minimum Revenue Provision (MRP) which in order to simplify she likened to a mortgage on a repayment term. If at the end of the period you had set aside money to repay the debt, the asset was yours and you could continue to deliver services or generate income from that asset, or indeed you could choose to sell it. If, however, only interest was paid there would be no readily available money to repay the debt when it was due so the property would then either have to be sold to realise the capital to repay the debt or be remortgaged. Therefore, at the end of the term Arch would either have to sell the asset or borrow the money again. The net benefit to the Council, before MRP, was £6.1 million but after the MRP of £6.7 million this left an annual net revenue impact (cost to the Council) of £592,158.21. It was noted, however, that some of the figures would change because of the varying interest rates.

In response to a request for further clarification, it was confirmed that the Council in order to be prudent and consistent had set aside the MRP 'principal repayment' as it would have to satisfy its debt with the lender.

Concerns were raised that there did not appear to be any provision for risk insurance. The Cabinet Member for Corporate Services & Cabinet Secretary said each development was considered on a case by case basis and it was important to justify investments made by having clear outcomes. The Council could not invest in schemes where the margins were very tight as, over 40 years, it was not known what would happen to the retail landscape. There would be opportunities to make large investments in the future but assurance was needed to protect the next generation against risk.

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Discussion ensued and members comments included:

- There was a potential risk as the Council was putting money aside to pay principal loans but who was putting money aside for contingency funds for voids, tenants leaving etc?
- There would be instances where money was paid into a scheme for social benefit but had not been described as such to justify it.
- Arch was set up as a regeneration organisation but it was drifting away from that.
- It was extremely important for the Arch Board to say they could derisk their investments. Risks could go sour and it was imperative to know what the risk strategy of the new organisation would be.
- It was important to have a separate lender and borrower. If figures were looked at in terms of interest only, 5.09% was the weighted average. Annual interest was currently being paid so what was the Council paying by way of interest only on those loans?
- It was up to the borrower to build up a fund to repay the capital.

In response the Director of Finance said that there were two transactions. In the first instance, the Council would need to repay the money that it had borrowed and as the Council had lent that money on to Arch, Arch needed to ensure that it could repay the money that it had borrowed from the Council.

The Cabinet Member for Corporate Services & Cabinet Secretary reiterated that money was being put aside for repayment and was not therefore available to provide services to residents. Another issue was gearing and how much borrowing a client may have.

The Chair referred to paragraph 2.3 of the report in relation to cash flow and borrowing and queried if this method had been reported anywhere. In response the Director of Finance said she was not aware that it had.

Councillor Towns asked if the committee could request information from Arch as to what provision was being made for contingency funds and for refurbishments/on-going maintenance. He added that it would be interesting to know if they intended to make some capital payments.

The Cabinet Member for Corporate Services & Cabinet Secretary said work was being carried out on the restructure of governing procedures of Arch and decisions had already been made by Arch not to do work outside of the County or be involved in speculative purchases. There was a lot of work being done around governance to make procedures transparent and decisions justified.

The Chair thanked the Director of Finance for the report.

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RESOLVED that the contents of the report be noted and Arch be requested to provide information regarding what provision was being made for contingency funds and for refurbishments/on-going maintenance.

30. REPORT OF THE CHIEF INTERNAL AUDITOR

PREPARATION OF THE STRATEGIC AUDIT PLAN 2018-19

Allison Mitchell, Chief Internal Auditor, introduced the above report which outlined the approach to preparing the 2018/19 Strategic Audit Plan, for consideration and endorsement by the Audit Committee. The report also ensured the Audit Committee, as a key stakeholder of Internal Audit's work, was engaged at an early stage in the planning process. (A copy of the report is filed with the signed minutes as Appendix G.)

The Chief Internal Auditor said that proposals for next year would be brought to the meeting of the Audit Committee in March. The report explained the process and Mrs Mitchell invited members to contact her if there were any items which they wished to put forward for her consideration. It was felt it would be beneficial to hold two sessions, prior to the March meeting, for one or two members to look at the preparation of the plan in detail and the Chief Internal Auditor said she would circulate an email to see who was available to attend.

RESOLVED that the approach to the preparation of the 2018/19 Strategic Audit Plan be endorsed and one or two members of Audit Committee attend up to two sessions (before presentation of the proposed Strategic Audit Plan to Audit Committee in March) to look at the preparation of the plan in detail.

31. EXCLUSION OF PRESS AND PUBLIC

RESOLVED that under Section 100A (4) of the Local Government Act 1972, the press and public be excluded from the meeting during consideration of the following item on the Agenda as it involved the likely disclosure of exempt information as defined in Part I of Schedule 12A of the 1972 Act and as indicated below

Agenda Items	Paragraph of Part 1 of Schedule 12A
9	Information relating to the financial or business affairs of any particular person (other than the authority holding that information). Information in respect of which a claim to legal professional privilege could be maintained in legal proceedings; Information relating to any action taken or to be taken in connection with the prevention or investigation or prosecution of

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a crime;

AND the public interest in seeking this exemption outweighs the public interest in disclosure because disclosure could adversely affect the business reputation or confidence in the person/organisation, and could adversely affect commercial revenue.

- 10-11 Information relating to the financial or business affairs of any particular person (including the authority holding the information) **AND** the public interest in seeking this exemption outweighs the public interest in disclosure because disclosure could adversely affect the business reputation or confidence in the person/organisation, and could adversely affect commercial revenue.

32. MINUTES

RESOLVED that the confidential minutes of the meeting of the Audit Committee held on Wednesday, 6 December 2017, as circulated, be confirmed as a true record and signed by the Chair subject to the minute numbers being amended to start from no. 22 and the following amendment:

Page 7, paragraph 4, line 8 should read:

“He then referred to a Freedom of Information Request which he had submitted in May asking what security had been put in place to secure money Arch had borrowed.”

33. REPORT OF THE CHIEF INTERNAL AUDITOR

RISK MANAGEMENT UPDATE

The Chief Internal Auditor introduced the above report which provided the Audit Committee with an update on progress with the development, implementation and embedding of risk management within the County Council since the last report presented on 25 January 2017. (A copy of the report is filed with the signed minutes as Appendix H.)

The Corporate Leadership Team had identified a number of new corporate strategic risks. The Internal Audit and Risk Management Service had worked with the Chief Fire Officer, in his role as Corporate Risk Champion, and had initially identified the list bullet pointed on page 3 of the report. Since then other potential risks had been identified and risk officers had determined there was a need to revisit the list, refresh the risks presented and add some additional risks.

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Work had commenced in reviewing the risk reporting and escalation protocols. Proposals were being developed and a detailed report would be presented to the Audit Committee in March. It was noted that an option for further training was also available.

RESOLVED that

- (a) the contents of the report be noted;
- (b) a more detailed report on risk management be brought before Audit Committee in March 2018.

At 12:00 noon, the following report was circulated to members and 15 minutes reading time was allowed.

Councillor Castle left the meeting at 12:07 pm.

34. REPORT OF THE CHIEF EXECUTIVE

STRATEGIC REVIEW OF ACTIVE NORTHUMBERLAND: OUTCOMES

The Chair welcomed Mrs Kelly Angus, Director of Human Resources, to the meeting.

Mrs Angus thanked the Chair and members for taking the time to read the summary report which she was presenting on behalf of the Chief Executive who could not be in attendance.

The report summarised the key findings from the strategic review that had been commissioned by Northumberland County Council into Active Northumberland and had also been shared with the Active Northumberland Board prior to its presentation to the Council's Audit Committee, who had contributed to it and agreed its recommendations. The report contained a number of recommendations for Active Northumberland and the Council to address.

Detailed discussion ensued about progress made and the next steps. Clarification was provided on a number of issues and it was noted that, at this stage, the report should remain confidential and this had been agreed with the Active Northumberland Board.

RESOLVED that

- 1) Recommendations a) to f), as set out in the report, be noted;
- 2) Audit Committee consider the findings from the Strategic Review when

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reviewing the County Council's Annual Governance Statement for 2017/18 (which will be brought before Audit Committee early in 2018/19), to ensure that these findings have been adequately reflected in the County Council's assessment of its governance arrangements.

- 3) The Chair of the Active Northumberland Board be invited to the next meeting.
- 4) This report remain confidential at the present time but be made public as soon as possible.

CHAIR:

DATE:

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