

**NORTHUMBERLAND COUNTY COUNCIL
AUDIT COMMITTEE**

At an extraordinary meeting of the **Audit Committee** held at County Hall, Morpeth on Friday, 22 March 2019 at 10.00 a.m.

PRESENT

Councillor G Hill (Chair)

COUNCILLORS

G.Castle
L Grimshaw
L J Rickerby

M Swinburn
D Towns

CO-OPTED MEMBERS

A N Haywood-Smith

OFFICERS IN ATTENDANCE

K.Angus	Executive Director HR/OD and Deputy Chief Executive
A Elsdon	Service Director - Finance
L.Henry	Legal Services Manager and Monitoring Officer
K McDonald	Group Assurance Manager
D.Lally	Chief Executive
C Mellons	Ernst & Young, External Auditor
A Mitchell	Chief Internal Auditor
J.Roll	Democratic Services Manager

ALSO PRESENT

Councillor N Oliver, Portfolio Holder for Corporate Services & Cabinet Secretary

Press: 3 Press
Public/Other Members 36

27. CHAIR'S INTRODUCTION

The Chair welcomed and introduced those present. She explained that the extraordinary meeting was to receive the final report from Internal Audit's review of the former Arch group of companies, concluded in October 2017 but which had been embargoed from publication at the request of Northumbria Police until February 2019 when the embargo was lifted.

28. APOLOGIES FOR ABSENCE

Apologies for absence were received from Councillors A. Hepple and M. Purvis and Mr. A. Hall (Co-opted member).

28. REPORT OF THE CHIEF INTERNAL AUDITOR

Internal Audit Report relating to Governance Matters within the County Council's Accounting Group Boundary.

Allison Mitchell, Chief Internal Auditor introduced her report and the findings from the review of five specific governance areas of the County Council's wholly owned group of companies, Arch, which had been jointly commissioned by the (then) Interim Chief Executive of Arch and the (then) Chief Executive of Northumberland County Council in 2017, (copies filed with the signed Minutes as Appendices A and B and available on the Council website). An example of the interim reporting format (used to advise the client of emerging findings) is filed with the signed minutes as Appendix C.

She referred to the Terms of Reference and objectives of the Review (as set out in Annex A of the review report) and asked that the Committee consider the findings as part of the ongoing framework of governance, risk management and control of those entities within the 'accounting group boundary of Northumberland County Council.

The objectives set out in the Terms of Reference covered the following areas:

- Consultants and Contractors;
- Employees;
- Property Portfolio;
- Hospitality and Gifts;
- Awards of Major Contracts

and the findings set out in the report presented to Audit Committee were supported by robust factual evidence.

Ms. Mitchell then explained the background and context to the review and the key governance matters/themes arising from the findings, including two primary areas of concern which suggested potential for criminality:

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- Specific issues of governance surrounding the purchase of the former Arch Chief Executive's home, by Arch, at a price which appears to have been unrealistically high to deliver expected rental income yields;
- The disproportionately generous remuneration and package of benefits afforded to a specific contractor (Consultant C).

She reminded the meeting that Arch was established as a property investment, estate management and development company with the aim of attracting investment into Northumberland and with the intention that profits would be returned to the sole shareholder (NCC) for use in delivering council services or reinvestment in other projects. However, evidence around the above referenced areas and others covered in the Internal Audit report pointed to a lack of commercial business acumen; and the decisions made could not be objectively demonstrated to benefit either the company or the Council as sole shareholder.

In October 2017 a number of recommendations were made to Arch Interim Management as summarised in Appendix D (copy filed with the signed minutes). The Internal Audit report and associated documents were also reported to Northumbria Police.

Councillor Nick Oliver, portfolio holder for Corporate Resources and Cabinet Secretary explained that following the election in May 2017, concerns had been raised with the Administration regarding inappropriate behaviour by senior officers and senior Members associated with Arch. Some significant areas of concern recurred such as the relationship between senior officers of Arch and suppliers and the rationale for awarding contracts. He added that Arch did some very good work but speculative purchases such as the Manors Walk Shopping Centre and other decisions, as detailed in the report, had been queried. Arch's rationale of borrowing money at a cheaper rate with the view to ploughing back interest into frontline services had failed. In February 2017, the former Administration approved their budget which included giving the former Leader and former NCC Chief Executive delegated authority to borrow £450m in order to provide loans (mainly to Arch) which could have resulted in a much more serious financial position for the council and thereby the taxpayer.

Councillor Oliver then referred to the investigation and focussed on four main areas covered by the findings, raising a number of concerns:

- **The purchase of the house belonging to the former CEO of Arch**
 - the fact that there were two different proposal reports prepared regarding the Executive Homes Portfolio, one including the property and another excluding it. It was the report excluding the property which was presented to the Investment Committee. This meant the circumstances of the purchase, and that the Arch Chief Executive's property was being purchased by the company, lacked transparency. The same meeting of the Investment Committee approved a scheme of delegated authority for future purchases to the Finance Director, signed off by the CEO or another director. Discussions between senior people following this meeting were very informal;

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- Discussions about marketing the house, and preparation of marketing material for it, clearly took place a month before the Investment Committee meeting at which the creation of the Executive Homes portfolio – under which the house was purchased – was agreed. The purchase price was £395,000 although Arch had struggled to find and maintain a tenant for it, meaning regular rental income commensurate with the purchase price was not secured, and the house was currently being marketed at £355k representing a significant loss on the price paid;
- He questioned whether the executive housing portfolio was set up because the CEO was finding it difficult to sell his house and whether the house was initially marketed at an unrealistic £425k to make £395k look reasonable
- The price paid could not result in the 5% rental yield which was a prerequisite for any home which was to be purchased under the ‘Executive Homes Portfolio’. The actual rent received in the short time the property was able to be rented would produce a yield closer to 3%.
- Councillor Oliver quoted from a number of inappropriate emails regarding the purchase and noted a lack of declaration of interests from the Arch CEO and others involved or knowledgeable of the purchase.
- Finally, Councillor Oliver questioned how the directors of Arch and the CEO of NCC thought the purchase acceptable.

- **Consultant C**

- Consultant C was offered his job before it was advertised and then asked to respond to the advert retrospectively;
- Consultant C asked for an advance of £13,600 to which the (then) NCC CEO replied, asking him to submit an invoice and it would be paid;
- He was supplied with a house worth £180K and a car worth £18.5K. No deductions from the consultant’s daily rate were made and no rent was paid by him;
- Consultant C asked for up-grades to the property, including granite worktops and other extras costing £15,000 which were accepted and paid for by Arch;
- Benefits in kind were not reported to HMRC on end of year P11D returns;
- There is evidence that Consultant C’s contract was at the request of the former Leader who also signed off invoices despite having no authority to perform this authorisation function. The former Leader also approached senior officers after the election demanding that they pay outstanding invoices;
- Consultant C was paid £115,000 in total. £64k between March 2016 and May 2017 for Strategic PR work for which he produced 7 press releases and 3 unpublished newsletter publications. Following the election he submitted more invoices totalling £26,000 which were not paid. Some invoices were from companies no longer in existence.

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- Again correspondence suggested a relationship existed between Consultant C and the former Leader, former CEO of Arch and former CEO of NCC.
 - A letter signed by five Arch Directors sought to commit Arch to honour an 'agreement' with Consultant C (paying over £1000 per week, free house and free car) up to 2027.
 - Correspondence was quoted which indicated that Consultant C was a Northumberland Labour spin doctor who produced political releases. There was evidence of political discourse with the former CEO of NCC and the Labour Leadership. Embargoed or confidential reports were shared with Consultant C.
- **Ashington Football Club**
 - The Chair of the football club was Ian Lavery MP. Other board members included the CEO of Arch, former Wansbeck Labour Party Secretary and members of Ian Lavery's political team.
 - Arch paid for utility bills, bar bill, bar staff and the General Manager's salary, although the Arch HR manager stated they were not Arch employees and ACFC denied employing them. Arch dealt with their redundancies.
 - Over £1.5m was spent on improvements to the Club and a book value stated of £1.9m although a valuation by Ernst Young set the value at £250k. Councillor Oliver questioned the justification for this level of investment.
- **Renewable Energy Company:**
 - Arch Development Projects incurred £2.2m including VAT (June 14 to Mar 17) on solar panel installations and related work.
 - the procurement process undertaken did not follow the tender processes laid down by either NCC or Arch;
 - companies which could never have reasonably be expected to submit bids for energy related work were nonetheless approached to tender for the work and a large Bond was requested which was not stipulated in any other contract, and resulted in 4 companies withdrawing their interest, leaving only one compliant company and effectively removing competition;
 - a substantial amount of business was awarded to this company, some of which was the subject of competitive tender but in other cases this remained unclear.
 - relatives of the former Arch CEO were employed by this company but this interest was not declared by the former Arch CEO;
 - £90k of solar panels were installed at Ashington Football Club without any evidence of competitive quotes being produced and this work was paid for by NCC;
 - Money was loaned from NCC to Aged Miners for solar panels, the Chair of which was the local MP;

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- a golfing trip was organised by the Company to Portugal for senior staff and Directors of Arch which could be deemed as inappropriate. No declarations were made.

- **Other Issues**

- Evidence from correspondence of relationships between senior staff of Arch/NCC and outside companies which were not transparent;
- Staff benefits as detailed on p 29 to 30 of the report, included a £5k car payment were not reported nor declared;
- Rather than hand in his phone after he left, the former Arch Chief Executive requested a PAC code so he could transfer it;
- Relocation expenses appeared to have been paid to someone already living in Morpeth who appeared not to have moved house;
- The Strategic HR consultant was paid £850 per day although Arch had an HR Manager;
- Overpayments and underpayments on legal fees for conveyancing of residential properties meant completion statements did not balance and Arch was owed a substantial refund;
- No clear register of property assets was available;
- Internal Hospitality included £5k on staff parties, £3.5k on trip to FA Vase final;
- Top five suppliers made 119 offers of hospitality for Members and staff.

Councillor Oliver concluded by suggesting that there was sufficient information to raise reasonable suspicion of one or more criminal offences justifying a police investigation. Such an investigation would clearly demonstrate to council tax payers in Northumberland whether or not there is a case to answer or whether no criminal activities have taken place.

The Chair then invited comments and questions on the findings. Members of Audit Committee responded as follows:

- **Purchase of the house of the former Arch CEO**

- One member of the Committee expressed the view that Arch was not a private company, but funded by the public purse and those involved should therefore have focused on maintaining integrity, honesty and accountability at all times. The evidence surrounding this purchase at a price which was unrealistically high and unable to deliver the expected rental yields suggested a lack of propriety and probity, particularly where undue influence could be perceived;
- the aim to generate income to help pay for frontline services had in fact robbed services of funds;

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- concerns were voiced about the lack of transparency surrounding the purchase including the valuation and rent assessment as compared to similar properties, portfolio inaccuracies and lack of declarations of interest by senior people. This could suggest deliberate collusion to ensure the property met certain criteria and a criminal offence;
 - the question was asked why was this not addressed at the time. Advance now had this overvalued property on the market, the price of which had been reduced twice;
 - once the house had been let at £550 per month, the tenancy only lasted 3 months as the property was infested with mice and rats;
 - evidence pointed to criminal acts, the question was raised why had Northumbria Police decided there were no cases to answer. However, this was for the Police to comment.
- **Concerns regarding the recruitment process for the engagement of and the benefits in kind awarded to Consultant C;**
 - Grave concerns were raised as to why five Board Members signed a letter seeking to ensure Consultant C kept the Arch house, car and employment for a further 10 years;
 - The services of Consultant C appear to have been specifically requested by the former Leader of the Council, and that the additional demands such as a financial advance and upgrades to the property were approved. A member asked if the former Leader had been questioned about his justification for this. The Chief Internal Auditor replied that the Counter Fraud Team had investigated processes around the engagement of Consultant C and that the former Leader had provided information but he had not personally been investigated;
 - A Member queried whether it was usual for a senior political leader to be so involved with an appointment. It was stated that appointments were normally an officer function and the level of involvement seemed excessive and unusual;
 - With regard to the letter asking Arch to commit to Consultant C's continued weekly 'salary' fees, house and car being agreed for a further 10 years, a member asked that the five signatories to the letter be named as this was in the public interest. The Monitoring Officer advised against disclosure quoting GDPR guidelines until he sought assurance that an assessment had been carried out, even though some could be identified through the description of their office. These names were subsequently disclosed verbally at the meeting.
 - **Ashington Community Football Club (page 76 - 80 of the report);**
 - the reason for such a significant investment in the Football Club was queried, for example, it was unclear whether the project was an investment or regeneration project;
 - Employees were paid by Arch but worked at the Football Club;
 - The former Arch CEO was a Board Member of the Football Club, alongside the local MP, a senior Parliamentary Adviser and a former Arch Board member but these appointments were not declared;

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- Concern was raised about the significant difference in book value of the asset which was valued at £1, 869m in Arch's Fixed Asset Register but £250k by Ernst Young External Auditors;
 - The lack of declaration of gifts and hospitality (£22,618 plus VAT) and relationships was queried;
 - No declarations were evident at either NCC or Arch.
- **Renewable Energy Company (page 81 - 88 of the report)**
 - A member stated that the tendering process had made it impossible to award the contract to anyone else but the successful company which was based alongside Arch;
 - The former Arch CEO's relation was employed as a project manager for the chosen contractor. Again this was not disclosed by the former Arch CEO.
 - A loan from NCC was given to Arch who then loaned the money to Aged Miners. The Chair of Aged Miners was the local MP. The question was raised why these relationships were not declared stating that even if nothing was untoward the lack of transparency caused questions to be raised and people to make their own minds up;
- **Other issues:**
 - reference was made to the Arch employee benefits listed on page 29/30 of the report which were confirmed as accurate even though they had not been approved by Arch's Senior Team or Board. Members queried the lack of a salary scale and whether it was appropriate for public money to pay for such items as Christmas celebrations;
 - a number of ad hoc payments and pay enhancements had been paid to Arch staff without an appropriate authorisation trail;
 - a number of declarations of benefits had not been declared on PIID forms and had tax implications;
 - it was suggested that the people who could answer the questions being asked were not present and their reasons could therefore only be speculated.
 - the question was raised as to why such a culture was allowed to develop and what role did the Audit Committee at that time, and its chair, play in failing to pick up basic flaws in the governance of Arch and the Council. The Chief Internal Auditor explained that for a local authority, she is legally required to produce an Annual Opinion on the Framework of Governance, Risk and Control within that local authority. To do this, the Chief Internal Auditor of a local authority determines the audit coverage of that local authority and statutorily she must be afforded unfettered access to any and all documents, staff and explanations as she deems are necessary in order to form that opinion. However, Arch as a company was not subject to the same legal requirements regarding Internal Audit as a local authority. Rather than a full Internal Audit service which would have allowed a formal annual opinion to be prepared from Internal Audit, Arch had instead requested a limited 'consultancy' service in which they had requested only

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limited assurance coverage on certain designated areas. Reports to Arch's Audit Committee had been made in the name of the Arch Finance Director;

- A member asked why the Arch Board of experienced councillors did not raise any concerns, given the amount of irregularity uncovered by the full audit;
- A member queried the Chief Executive and s151 Officer being the same person with regard to checking and signing off the accounts stating that this seemed unusual.
- A member asked if Arch had simply been renamed Advance Northumberland. Councillor Oliver responded that this was a new company and that significant work had now been carried out to put new safeguards, structures and proper governance processes in place to ensure compliance and transparency. At the County Council, this included the separation of the roles of CEO and s 151 officer; at Advance, no fettering of access of documents and the requirement of an Annual Opinion.

- **Agree next steps and recommendations.**

- Allison Mitchell was congratulated on producing such a detailed and informative report. It was noted that having identified potential criminality, the County Council had acted properly in referring this suspected criminality to Northumbria Police. The report had been embargoed since then on the advice of the Police.
- Northumbria Police had initially taken advice and stated that the issues warranted a police investigation. However, the situation appeared now to have changed and Northumbria Police appeared to have decided not to undertake a criminal investigation. Northumbria Police advised the County Council in writing in August 2017 that "the information provided by the council would warrant the commencement of a criminal investigation" and Northumbria Police stated at that time that "there are a number of possible offences that are under consideration including more specifically fraud and misconduct in a public office". However in February 2019 (Confirmed in March 2019), Northumbria Police subsequently stated that they have not identified any criminal offences having occurred based on the extensive information which was presented to them;
- The Chair added that she had asked the Chief Constable of Northumbria Police for an update on the Arch investigation at a recent council meeting, stating that not only does there need to be impartiality and no political interference, but that the public needed to have confidence that this was the case. She stated that she was concerned with his reply that the investigation would be conducted by 'the same officers the public would see every day' and she reported that she subsequently received a letter from Northumbria Police warning her not to repeat these concerns about the investigation. The Chair had responded to this letter with some questions about the investigation and invited the Chief Constable to attend a future audit committee meeting but had received no response;
- It was suggested that another police force should investigate the allegations and the Legal Services Manager/Monitoring Officer responded that the Chief Executive and/or Cabinet as "those charged with governance" could

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make such a request. One member objected to this stating that it would undermine the local police authority.

The Chair thanked officers and members for their careful consideration of the evidence and it was **RESOLVED** by a majority that:

1. The Audit Committee note the findings from the Internal Audit review of the Arch group of Companies (October 2017) as part of the Audit Committee's remit in reviewing the County Council's framework of governance, risk management and control (including the effect on this framework from other entities within the accounting group boundary);
2. The Audit Committee seek a position statement on progress made by the companies' interim management on implementing the actions in the schedule of recommendations issued by Internal Audit related to the findings in the report in October 2017;
3. The Audit Committee note that the Arch Group of companies has now been replaced with a new company structure (Advance Northumberland); and
4. The Audit Committee agree that the Chief Executive contacts the Home Secretary requesting that another Police Force investigates the allegations and that simultaneously, Northumbria Police be asked whether anyone has been interviewed in relation to these matters and whether there has been any referral to the Crown Prosecution Service.

CHAIR:

DATE:

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