

Medway Council
Meeting of Audit Committee
Thursday, 29 September 2016
7.00pm to 8.22pm

Record of the meeting

Subject to approval as an accurate record at the next meeting of this committee

Present: Councillors: Kemp (Chairman), Gulvin, Maple, Osborne and Tejan

In Attendance: Perry Holmes, Chief Legal Officer
Phil Watts, Chief Finance Officer
Katey Arrowsmith, Head of Audit and Counter Fraud Shared Service
Jonathan Lloyd, Principal Accountant
Michael Turner, Democratic Services Officer
Anna Marie Lawrence-Lovell, Performance Manager
Ryan Barlow, Assistant Manager, BDO
Alison Langridge, Audit Manager, BDO

321 Apologies for absence

There were none.

322 Record of meeting

The record of the meeting held on 30 June 2016 was agreed as a correct record and signed by the Chairman.

323 Urgent matters by reason of special circumstances

The Chairman advised that he had agreed to accept the supplementary report on the Annual Governance Report 2015/2016 report (see minute no.326) as urgent because Members needed to consider the information it contained on the latest position in respect of the on-going investigation into an objection to the accounts received by the Auditor before they could decide whether to agree proposed changes required to the Statement of Accounts in order to secure an audit opinion.

As the Committee had to consider and approve the Statement of Accounts before 30 September, consideration of this report could not be delayed.

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The report could not be despatched with the agenda as officers needed sufficient time to prepare the report following discussions with the External Auditor.

324 Declarations of disclosable pecuniary interests and other interests

Disclosable pecuniary interests

There were none.

Other interests

There were none.

325 Review of Risk Management

Discussion:

Members considered a report on the progress of the Council's risk management activities.

A Member queried whether the risk management strategy was compliant with ISO standards and, if not, whether officers were comfortable with the risk management framework and how this compared to the approach of other councils. Officers responded that the strategy was compliant with ISO31000 and following a benchmarking exercise it was clear the Council's risk framework was broadly similar to other councils in the south east.

In view of the number of Council services delivered through alternative service delivery models (Medway Norse and Medway Commercial Group), a Member queried whether those organisations had a similar approach to risk management. The Committee was advised that Medway Norse provided audit information to the Council's audit team, although their specific approach to risk management would need to be looked into. As Medway Commercial Group was wholly owned by the Council, it followed the Council's risk management strategy.

Noting that no audit of risk management had taken place in 2015-16 a Member asked when this was planned. The Head of the Audit and Counter Fraud Service advised that the audit had not taken place due to the implementation of the shared service with Gravesham Borough Council and risk management had been audited at the end of the 2014/15 financial year and was considered to be working effectively. An audit of risk management would happen annually and in addition there was a risk based approach to all audits.

Decision:

The Committee agreed to note progress on the Council's risk management activities.

326 Annual Governance Report 2015/16

Discussion:

Members considered a report regarding the issues raised in the Council's External Auditor's Annual Governance Report, which incorporated the findings following the 2015/16 audit of the Statement of Accounts.

The Chief Finance Officer highlighted that the accounts had been delivered a month earlier than usual and to a higher standard, with BDO recognising the significant improvements made in preparing and finalising the financial statements. Members thanked the finance team for what was a considerable achievement.

The Auditor had been unable to give an opinion on the accounts due to an objection which they had received. An addendum report set out two adjustments to the notes to the Council's Statement of Accounts which, if agreed by the Committee, would enable the Auditor to issue an unqualified audit opinion.

BDO commented that the objection related to Lender Option, Borrower Option (LOBO) loans and as similar objections had been made across the country, the National Audit Office had issued advice on how to deal with this matter. Therefore if the Council was to agree the proposed amendments to the notes then the auditor would be able to issue an unqualified opinion. Work on resolving the objection to the accounts had not been completed and as a result the Auditor was unable to issue a certificate to close the audit. In response to a query about the impact of not being able to issue a certificate, BDO commented that there was no impact in practical terms but the audit could not be closed down until the objection was resolved. At this point it was not possible to say when this might happen.

In order to assist the Auditor in arriving at the unqualified opinion referred to in the revised Independent Auditor's Report, officers had made amendments to notes 19 and 34 of the Statement of Accounts which concerned the treatment of the Council's LOBO loans. In order to legitimise the adjustments made to these two notes, Council would need to review and amend the Treasury Management Strategy in terms of the proportions of loans permitted at fixed and variable rates respectively and the application of these limits in respect of LOBO loans.

A Member of the Committee commented that he had made the objection to the accounts referred to and asked if all other auditors for councils which had received the same objection were taking the same approach. He clarified that the objection was in relation to LOBO loans and not in any way related to the process by which the accounts had been finalised, which was to be commended. BDO commented that the other auditors would all have received the same advice from the National Audit Office but it was not possible to confirm that they had all definitely taken the same approach as BDO.

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Another Member expressed disappointment that the objection had been made given that the LOBO loans had been taken out at lower interest rates than were on offer from the Public Works Loan Board at the time and therefore represented a good deal for Medway. In response, a Member made the point that asking questions about LOBO loans was justified and similar objections to the accounts of approximately another 20 councils had been made. He added that time would tell whether LOBO loans worked out as a better deal in the long term. There had been allegations in the media of some consultants receiving kickback payments for recommending LOBO loans and if that had happened in Medway that would be a concern.

A Member asked for clarification about where the £1.463m in school balances identified by BDO now sat. The Chief Finance Officer responded that this related to a school which had converted to academy status in January with an unusually large balance. The money was still in the Council's accounts at 31 March but BDO had correctly identified that this did not belong to the Council and had recommended that a process was put in place to identify any academy cash balances before the accounts were closed down. However, he did not expect another school to transfer to an academy with such a large balance.

With regard to progress in implementing the recommendation regarding HRA assets within fixed asset register and whether assets were being accurately valued, officers advised that there was a need to fully test the new fixed asset software before implementing this recommendation, which was expected to be done in time for the 2016/17 accounts. Asset valuations happened on a fairly frequent basis and were considered to be accurate

Decision:

The Committee:

- a) noted the issues raised and judgements made by the Auditor as presented in Appendix 1 to the report, and agreed the proposed response as set out at Appendix III to the External Auditor's Annual Report to the Committee;
- b) agreed the amendments to notes 19 and 34 of the Statement of Accounts set out in appendix 2 to the supplementary report;
- c) noted the Auditor's opinion on the Council's financial statements, as set out in appendix 1 to the supplementary report;
- d) approved the Statement of Accounts;
- e) agreed the Management Representations Letter, attached at Appendix VII of the External Auditor's Annual Report to the Audit Committee.

327 Treasury Management Strategy Mid Year Review Report 2016/2017

Discussion:

Members considered a report on the mid year review of the Treasury Management Strategy 2016/17.

Members welcomed the report and congratulated the team on their performance in achieving the returns set out in the report.

A Member referred to the increasing risk in the local government sector of, at some point in the near future, a council being unable to set a balanced budget. Noting that the Council had invested approximately £19.5m with other local authorities, he asked what the implications were if one of these authorities was unable to set a balanced budget, clarifying that he was not suggesting any of them was actually in that situation. The Chief Finance Officer advised that under S.114 of the Local Government Finance Act 1988, the S.151 officer was required to report to the Council if there was, or was likely to be, an unbalanced budget. The S.151 officer would then have powers to curb expenditure that went significantly beyond the voluntary moratoriums imposed by the Council in recent years. However, the authorities that the Council had invested in would still have a contractual obligation to pay the agreed interest on the loans. Therefore he did not see this as a particular risk but undertook to look into the issue in more detail and give a fuller response. In response to another question, officers advised that the Council had not taken out counterparty insurance in respect of these loans.

Referring to the Council's investments in the CCLA property fund a Member asked how these investments were split in terms of location, whether the fund itself had a credit rating, what the risk rating was and whether Capita as the Council's advisor had been involved in recommending that the Council should invest in the fund. Officers advised that the fund did not have a credit rating and investments were in properties across the country including some in large commercial properties as the fund had grown in size considerably since the decision had been taken to invest in the fund, resulting in better returns. Although the capital value of the units invested in were a potential risk, the Council's £3m investment was relatively modest in the context of the overall portfolio and the Chief Finance Officer was pleased with the performance to date. The Chief Finance Officer advised that Capita, as part of its regular discussions with the Council, had suggested the Council should diversify into property funds but the decision to invest in the CCLA property fund had been taken by the Council without help from its advisors. A Member asked what the Council's exit strategy from the fund was and the Chief Finance Officer confirmed that the Council was able to liquidate its investments at short notice.

Referring to the Council's borrowings of £190.378m against a capital financing requirement of £257.978m, a Member asked whether the gap between borrowings and the ceiling was narrowing quickly. Officers advised that the gap was fairly stable with no dramatic movements as there had been no new long term borrowing recently.

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Decision:

The Committee agreed to note the report and the undertaking from the Chief Finance Officer to provide more information about what would happen in the event that a council in which the authority had made an investment was unable to set a balanced budget.

328 Audit & Counter Fraud Update to End August 2016

Discussion:

Members considered a report which provided an update on the work, outputs and performance of the Audit and Counter Fraud Team for the period 1 April to 31 August 2016 and welcomed the new format and frequency for reporting performance.

Members congratulated the Audit and Counter Fraud Team for their success in the Employee Awards 2016 in the Partnerships category and also to Katey Arrowsmith, Head of the Audit and Counter Fraud Shared Service, for being awarded Manager of the Year and for receiving the Chartered Institute of Internal Auditors Inspirational Leader Award.

With regard to the audit of the Innovation Centre Medway, a Member asked if the needs strengthening opinions issued were a matter the Committee should look into given that audits of the Centre had given cause for concern at the Committee in the past. In response the Head of the Audit and Counter Fraud Shared Service commented that the management at the Centre were positive about implementing the recommendations of the review. She was also considering whether the categories of opinion available to the team needed to be revised to allow for more degrees of opinion as “needs strengthening” did not necessarily convey what audits had found. Any such changes would first be considered by the Committee. A Member requested more information on the recommendations and how many had been actioned and the Head of Audit and Counter Fraud Shared Service explained that more robust arrangements had recently been put in place for following up recommendations and for reports to Members about which ones had been implemented.

A Member asked for the split between the time allocated to both councils by the audit team as part of the shared services agreement. The Head of the Audit and Counter Fraud Shared Service replied that the agreement specified an approximately 60/40 split between Medway Council and Gravesham Borough Council.

Referring to the adoption services review a Member asked for clarification about the finding that testing had found four children where payments were being made who were not recorded. The Head of the Audit and Counter Fraud Shared Service advised that this finding related to the administrative arrangements to review ongoing payments and did not mean that adoption allowances had not been paid.

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In relation to the people named in the report who had been convicted of fraud, Members were assured that the Council had robust measures in place to recover monies and did everything in its power to recover them.

Decision:

The Committee agreed to note the outputs and performance of the Audit & Counter Fraud Plan for Medway for the period 1 April to 31 August 2016 as detailed at Appendix 1 to the report.

329 Whistleblowing, Anti Bribery and Money Laundering Policies - Report on Instances September 2015-September 2016 and Proposed Revisions to the Whistleblowing Policy

Discussion:

Members considered a report about the nature of concerns raised, between September 2015 and September 2016, under the Council's Whistleblowing, Anti-Bribery and Anti-Money Laundering Policies and which also proposed some revisions to the Whistleblowing Policy.

In response to a question about how the changes to the policy would be drawn to employees' attention, the Chief Legal Officer advised that a largely digital approach would be taken with the changes highlighted when staff logged on to their computers, via the staff newsletter and also published on the intranet.

A Member asked what arrangements Medway Commercial Group and Medway Norse had in place for whistleblowing. Officers advised that both organisations adhered to the Council's policy.

Decision:

The Committee agreed to:

- a) note the report and;
- b) recommend the revised Whistleblowing Policy to Council.

330 Appointment of External Auditor

Discussion:

Members considered a report which summarised the changes to the arrangements for appointing External Auditors following the closure of the Audit Commission and the end of the transitional arrangements at the conclusion of the 2017-18 audits.

Members supported Option 3 in the report (Opt-in to a sector led body) and also noted that Option 2 (Set up a Joint Auditor Panel) was effectively no longer a realistic option given that most other councils in the area had

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confirmed that they also supported the opt-in to a sector led body approach.

Given the shared audit service with Gravesham Borough Council, a Member commented that it would make sense for both councils to have the same external auditor and queried whether this was something the Council could request. Officers advised that the Council could make that request but it was likely that, in any event, the sector led body which would be responsible for appointing the auditor would more than likely appoint an auditor to cover a specific geographical area and therefore Medway and Gravesham Councils would probably (unlike now) have the same auditor under the new arrangements.

Decision:

The Committee agreed to:

- a) note the future implications for external audit procurement arrangements and;
- b) in respect of the appointment of the External Auditor, recommend Option 3 (Opt-in to a sector led body) to Council.

Chairman

Date:

Michael Turner, Democratic Services Officer

Telephone: 01634 332817

Email: democratic.services@medway.gov.uk