

Medway Council
Meeting of Audit Committee
Wednesday, 28 July 2021
7.00pm to 8.44pm

Record of the meeting

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

Present: Councillors: Gulvin, Hackwell (Chairman), Maple, Paterson and Tejan

In Attendance: Jan Guyler, Head of Legal Services, Licensing & Local Land Charges
Wayne Hemingway, Head of Democratic Services
Jonathan Lloyd, Finance Business Partner - Corporate Services
Andy McNally-Johnson, Finance Business Partner - Corporate Reporting
Phil Watts, Chief Finance Officer
Darren Wells, Key Audit Partner, Grant Thornton

192 Apologies for absence

There were none.

(The Chairman advised the Committee that Councillors Maple and Paterson had replaced Councillors Browne and Osborne on the Committee).

193 Record of meeting

The record of the meeting held on 24 June 2021 was agreed and signed by the Chairman as a correct record.

194 Urgent matters by reason of special circumstances

There were none.

195 Disclosable Pecuniary Interests and Other Significant Interests

Disclosable pecuniary interests

There were none.

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Other significant interests (OSIs)

Councillor Gulvin declared an OSI in agenda item 6 (Statement of Accounts 2019/20 and Audit Findings Report 2019/20) because he is a Director of Medway Development Company Ltd (MDC) and he relied on a dispensation granted by the Councillor Conduct Committee to take part and vote in any discussions.

Other interests

Councillor Hackwell disclosed that his wife is a part time tutor for the Medway Adult Education Service in relation to agenda item 6 (Statement of Accounts 2019/20 and Audit Findings Report 2019/20).

Councillor Maple disclosed during the meeting that during the period in question (2019/20), he had been involved with three organisations who were tenants in the Pentagon Centre, in relation to agenda item 6 (Statement of Accounts 2019/20 and Audit Findings Report 2019/20).

196 Treasury Management Outturn Annual Report

Discussion:

This report provided an overview of treasury management activity during 2020/21. The report stated that throughout the period the Council had complied with its legislative and regulatory requirements and it outlined the key actual prudential and treasury indicators detailing the impact of capital expenditure activities during the year, with comparators.

The Finance Business Partner – Corporate Services highlighted a number of key factors for Members' attention. In particular, since the report had been presented to Cabinet on 13 July 2021, officers had received clarification from CIPFA that re-organisation debt owed to Kent County Council should not be taken into account when comparing external debt with the Capital Financing Requirement (CFR) but that repayments did reduce the CFR, therefore, this represented a better position than reported to Cabinet. He provided further information on the position relating to borrowing, highlighting that short term borrowing remained in favour. He also referred to the treasury position stating that of the £45m repayable in the year ending 31 March 2022 some £25m had been repaid by 22 June 2021. He also detailed other borrowing amounts as set out in the report.

He provided a commentary on investment performance highlighting that cash balances were kept low for day-to-day requirements. He also referred to the three property investment funds in-year performance, stating that two out of the three funds had delivered dividend returns which exceeded the capital losses on them.

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Members then raised a number of questions and comments which included:

Public Loans Work Board (PWLB) loans – in response to a question whether there were better loans available to the Council for the financing of Capital Programme projects recently approved by Full Council, the Finance Business Partner – Corporate Services stated that rates would vary depending on when loans had been taken out and the duration of those loans. With regards to PWLB loans, he explained how those rates were set at a premium over equivalent gilt yields and he advised the Committee that the Council did receive a discount on the loan rates because they shared the plans for the capital projects with the PWLB. He further advised that PWLB had increased their rates in the last year in an attempt to dissuade borrowing by local authorities for purely investment reasons.

Brexit – in response to a question regarding the impact on Council finances, the Chief Finance Officer stated that there had been no impact on the Council's treasury function so far, however, inflation could have an impact on the Council's capital projects, which would have to be managed.

Historic Debt to Kent County Council (KCC) – in response to a question as to what might happen to this debt in a scenario where a new North Kent unitary authority was formed, the Finance Business Partner – Corporate Services advised that when Medway Council was formed it had taken on some of KCC's assets which included a proportion of the related debt. Any new Council would be likely to be required to take on these assets and debt. The Chief Finance Officer added that the debt portfolio held by Medway and KCC could be disaggregated and novated to the successor authorities.

Investment portfolio – in response to a question as to whether the cumulative performance of the investments could be included in the table at paragraph 5.6 of the report, the Finance Business Partner – Corporate Services advised that he had highlighted the total in-year return on investments in the table, however, he could include another column to show the cumulative performance. He also advised further on short term and long-term borrowings.

Counterparty risk – in response to a question on the level of risk, the Finance Business Partner – Corporate Services advised that there were counterparty limits in place (£20m), as set out in the Treasury Management Strategy.

Debt profile – in response to a question regarding whether there were any proposals to refinance any of the short-term debts, the Finance Business Partner – Corporate Services advised that he expected to refinance these debts. Most of the relevant loans were from other local authorities. If refinancing was not available from other authorities at the relevant time the PWLB would remain a source for refinancing.

Decision:

The Committee approved the treasury management outturn annual report.

197 Statement of Accounts 2019/20 and Audit Findings Report 2019/20

Discussion:

This report provided details of the audited Statement of Accounts 2019/20 for Medway Council, as set out in Appendix 1 to the report. It also provided an update on the ongoing audit by Grant Thornton with their Audit Findings Report (AFR), as set out in Appendix 2 to the report. In addition, two addendum reports had been provided to Members on various matters.

The Finance Business Partner - Corporate Reporting highlighted a number of issues for Members' attention including the fact that 91 Local Authorities still did not have their accounts for this period finalised (at the time of writing). He provided an update on the addendum reports including reference to some errors in the balance sheet which had now been corrected (although the net assets figure had been correctly stated).

The Key Audit Partner, Grant Thornton (GT), advised Members of the work undertaken with the Council since November 2020 and paid particular attention to the issue of capital additions, which had also impacted on prior years. He stated that this had been a complex audit and 16 recommendations had been made to the Council's management which had been accepted and he thanked the Finance Team for their assistance and patience.

He referred to the issue of capitalisation of salary costs which did not follow accounting standards and that this had been a historic practice going back 6-10 years. GT had asked management to review this and estimate the costs for 2019/20 (and historically) by restating these costs in line with correct accounting standards. GT had reviewed this and determined it was not material for 2019/20 and previous years, therefore, these figures had not been adjusted in the AFR. He also referred to the schedule of errors as set out in the AFR. He concluded by stating that the process had almost been concluded and he advised the Committee that GT intended to issue an unqualified audit opinion, and this would include an emphasis of matter paragraph relating to property, plant and equipment values. He also referred to the management letter of representation which would highlight the issue of capital additions.

Members then raised a number of questions and comments which included:

Qualified conclusion (Children's Social Care) – in response to a question to this reference (page 8 of Supplementary Agenda No. 1 refers), the Key Audit Partner, Grant Thornton, advised that the Auditor followed the National Audit Office's code of audit practice which meant that the Auditor was obliged to take into consideration the findings of any relevant regulators which called into question the Council's ability to provide efficient and effective services, therefore, on this occasion the Ofsted inspection was being referenced in this instance. This was set out in the Auditor's report as an exception to the overall

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conclusion on the Authority's arrangements for securing economy, efficiency and effectiveness in its use of resources.

Frequency of changing Auditors – in response to a question relating to how regularly a local authority should change its Auditor, with particular reference to the issue of capital additions, the Key Audit Partner, Grant Thornton, advised that whilst freshness did help, an audit did rely on sampling and sampling was often random. He explained that the issue of capital financing had not been discovered in GT's first year, however, it had been picked up in 2019/20. The Chief Finance Officer agreed with the Key Audit Partner's comments.

Protecting the public purse – in response to a question asking whether the Council was doing all it could to protect the public purse in challenging times, the Key Audit Partner, Grant Thornton advised that this was not an easy question to answer as he could not give the level of assurance being sought. However, the Auditor was reporting openly and honestly and any relevant matters had been reported accordingly. He stated that there were opportunities to make improvements and that dialogue with management was positive in this regard.

Reference to "well connected" – it was suggested that the reference to "well connected" (page 50 of the main agenda refers) should be reviewed in light of issues relating to the railway link in the HIF programme.

NNDR – clarity was sought on Note 11 (NNDR – page 106 of the main agenda refers) on the shift from £68M to £55M). The Chief Finance Officer advised that in 2018/19 the Council had been part of a pilot on 100% business rates retention, nevertheless, he would clarify the differential for the two financial years outside of the meeting.

Contingent Assets – clarity was sought on whether the negotiations around fire doors (page 182 of the main agenda refers) had been concluded. The Chief Finance Officer advised that he would look into this outside of the meeting.

Salaries – a comment was made around the level of increase in the Chief Executive's salary in 2019/20 (page 109 refers).

Capitalisation of salaries – in response to a question on the issue of capitalisation of salaries and the likely impact of now following the correct standards, the Finance Business Partner - Corporate Reporting advised that IAS16 (property, plant and equipment) could not be used to charge general overheads to such costs, and this was being taken account of for 2020/21 and within the Medium Term Financial Strategy as well as income targets for the current year. Clear guidance was also being provided to the services setting out which costs could be charged to capital going forward. The Chief Finance Officer also provided some context to the charging of these costs to capital, however, he accepted the audit findings.

Acquisition of the Pentagon Centre – In response to a question regarding the risks relating to the acquisition of the Pentagon Centre (page 215 of the main

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agenda refers), the Chief Finance Officer stated that whilst he would not have supported the acquisition as a purely commercial investment, the acquisition had been made on regeneration grounds. He explained that the acquisition was expected to deliver a net return of £1M per year, however, the pandemic had affected all high streets, including Chatham. He also advised that the losses were not as significant as possibly anticipated given that the cost of borrowing was £1.3M and the budgeted income was £2.3M. There had been no significant write-off of debts thus far.

Education debtors – in response to a question on the significant increase in the value of the debtors (page 154 of the main agenda refers), the Finance Business Partner - Corporate Reporting advised that this related to long term loans for schools. The Chief Finance Officer undertook to provide a fuller response outside of the meeting.

Short term deposits with financial institutions – in response to a question relating to the significant increase of the latter (page 155 of the main agenda refers), the Chief Finance Officer referred to the grant funding received from the Government during the pandemic, including an initial sum of £39M.

Adjustments to flats – in response to a question (page 189 of the main agenda refers), the Finance Business Partner - Corporate Reporting explained that these related to the reconfiguration of some particular flats.

Contingent liabilities – Some comments were made around the possibility of arbitration in such cases.

Decision:

- a) The Committee noted the issues raised and judgements made by the Auditor, as presented at Appendix 2 to the report.
- b) The Committee approved the Statement of Accounts 2019/20 at Appendix 1 to the report, as amended by the revised balance sheet (page 88 of the main agenda refers), set out at Appendix 1 to Addendum Report No.2.
- c) The Committee agreed the Management Representations letter, as set out in Appendix E to the Audit Findings Report (Addendum Report).
- d) The Committee noted that there would be responses outside the meeting as highlighted above.

198 External Audit Plan and Audit Fee 2020/21

Discussion:

This report provided details of the plan of Medway Council's External auditors, Grant Thornton, for the audit of the Council's Statement of Accounts for the

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financial year 2020/21, together with a proposal for an increase in the audit fee charged.

The Finance Business Partner - Corporate Reporting highlighted a number of matters within the report for Members' attention. The Key Audit Partner, Grant Thornton also advised the Committee on the planned work for 2020/21 in the context of the delays in finalising the 2019/20 accounts as well as other factors, including the preparation of group accounts and materiality given the number of errors from 2019/20. He expected to start work on the audit in October 2021 with an expected finish of December 2021. This would be a transition year with the hope that 2021/22 would return to normal. He highlighted particular risks around grants and capital addition and the treatment of salaries.

Members then raised a number of questions and comments which included:

Group accounts – in response to a question around group accounts, the Chief Finance Officer explained that the South Thames Gateway Building Control Partnership was a partnership between four local authorities and each element was reflected in each Council's individual accounts. Medway Norse was a joint venture and group accounts were provided by NCS (Norse Commercial Service Ltd).

Valuation of lands and buildings – in response to a question as to how heritage assets were valued, Finance Business Partner - Corporate Reporting explained how these types of assets were valued, noting insurance valuations were provided.

Grants – in response to positive comments around the Council's award of grants during the pandemic, the Chief Finance Officer thanked Members for their comments.

Training – in response to a question around training for Committee members on value for money, the Chief Finance Officer undertook to look into a presentation to Members on this.

Sampling – in response to a question on the process of sampling year on year, the Key Audit Partner, Grant Thornton explained that each year, for example, in relation to debtors, he would ask for a complete transaction list and then sampling would be undertaken by the Auditor firstly based on judgement/knowledge and identifying anything which looked unusual and secondly, a random sample based on materiality and population size.

Decision:

The Committee noted the proposed Audit Plan for 2020/21 including the variation to the core fees from 2019/20 to the remainder of the contract.

199 Annual Governance Statement 2020/21

Discussion:

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This report provided details of the requirements for reporting and approving an Annual Governance Statement (the Statement) covering the financial year 2020/21. The Head of Legal Services highlighted a number of matters within the report for Members' attentions.

During discussion, the issues of the process in place for the award of grants made during the pandemic and the number of urgency decisions taken in response to the pandemic were raised.

Decision:

The Committee commented on and approved the Annual Governance Statement.

Chairman

Date:

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