

**Medway Council**  
**Meeting of Audit Committee**  
**Tuesday, 5 July 2011**  
**7.00pm to 10.35pm**

**Record of the meeting**

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

**Present:** Councillors: Clarke (Chairman), Griffiths, Jarrett, Mackness and Maple

**In Attendance:** Mrs Mutter-Child, Chair of Governors Woodlands Primary School  
Mr Pugh, Vice Chair of Governors Woodlands Primary School  
Mr Fiddaman, Headteacher Woodlands Primary School  
Geraldine Daly, PKF (Council's External Auditor)  
Robert Grant, PKF (Council's External Auditor)  
Peter Bown, Accounting Manager  
Rose Collinson, Director of Children and Adults  
Neil Davies, Chief Executive  
Philip Honeybone, Principal Auditor  
Joy Kirby, Quality Assurance and Client Manager  
Andy Larkin, Finance Support Officer  
Anthony Law, Democratic Services Officer  
Deborah Upton, Assistant Director, Housing and Corporate Services/Monitoring Officer

**139 Record of meeting**

The records of the meeting held on 29 March 2011 and the Joint Meeting of All Committees held on 25 May 2011 were agreed and signed by the Chairman as a correct record.

**140 Apologies for absence**

There were none.

**141 Urgent matters by reason of special circumstances**

It was reported that the Chairman had agreed to accept the following reports as urgent:

- agenda item 5 (Woodlands Primary School - Update), so to ensure Members were advised and could act upon the latest control information.
- agenda item 6 (Statement of Accounts 2010/2011), so to ensure Members were advised of the latest position, ahead of the submission of the audited accounts in September 2011.

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- agenda item 13 (Outcomes of Internal Audit Activity), so to ensure Members were advised of the latest audit activity, ahead of the next meeting of the Committee in September 2011.

It was also noted that a correction to the Statement of Accounts (Explanatory Foreward) had been tabled and would be considered under agenda item 6 (Statement of Accounts 2010/2011).

The Committee agreed to vary the order of business so that the item concerning Risk Management was considered after agenda item 5 (Woodlands Primary School Update).

### **142 Declarations of interest**

Councillor Clarke declared a personal interest in any references to schools, because his wife is an employee at St Mary's Island Primary School.

Councillor Griffiths declared a personal interest in any reference to schools, because his wife is an employee at Danecourt School and any reference to Medway Community Healthcare as he is a non-executive director of the Trust.

### **143 Woodlands Primary School - Update**

#### **Discussion:**

The Monitoring Officer submitted a report advising Members of the internal audit work into Woodlands Primary School, Gillingham. This followed a report to the Committee on 28 September 2010 that identified potential procurement and other control issues arising from works at the school. A copy of the Internal audit report and its supporting appendices were included within the report.

The Chairman welcomed Mrs Mutter-Child (Chair of Governors), Mr Pugh (Vice Chair of Governors) and Mr Fiddaman (Head teacher) and advised that the intention was to understand the breakdown of the control mechanisms and that it was not within the remit of this Committee to discuss disciplinary matters.

The Monitoring Officer detailed the contents of the report, advising Members of the findings contained within the Internal Audit report, which included:

- the lack of formal documentation, such as a contract with the Antrad Partnership (the main contractor),
- disagreement as to who had been managing the project which had led to a lack of accountability,
- payment of invoices through the school and the lack of supporting documents to enable analysis of the payments made.

Members were also given details of the control measures introduced to facilitate the scrutiny of such projects in the future. This consisted of changes to the procurement process for all Children and Adults capital projects and the establishment of the new Children and Adults Capital Programme Cabinet Advisory Group.

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Members of the Committee critically challenged the Director of Children and Adults Services and the representatives from the school in relation to a number of areas, and in doing so expressed their severe concerns as to the failings identified.

Specific questions and concerns related to the following areas:

- How the failure could happen and whether lessons should have been learnt from other schools.

The Director of Children and Adults Services advised as to the atypical nature of this case, acknowledged that the necessary checks and balances had not been undertaken and that changes had since been made to systems, practices and processes.

- Health and Safety duties relating to effective management of asbestos in schools.

It was confirmed that all Headteachers had now been provided with mandatory training on asbestos management. The Director of Children and Adults gave details of her conversation with Woodlands School when the suspicion of safety risks had been identified and that the school had been able to remain open. The Headteacher added that the Health and Safety Executive had cleared both the contractor and school in relation to asbestos, which had not been reflected in the report to Members. Officers undertook to seek clarification from the Health and Safety Executive on this issue. The school challenged the contents of the MACE report in respect of this aspect and the Monitoring Officer gave details of the health and safety findings listed in the report.

- The risks of resources being allocated from the 'borrowing pot', which had lacked Member oversight and had not been suitably considered by the appropriate internal officer boards and documented.

It was clarified that this 'borrowing pot' had been removed, with the council's processes now requiring clear funding streams and business cases.

- Absence of Supporting documents.

Following concerns raised as to the payments made it was noted that additional financial information had been requested of the proprietor of Antrad, which remained unanswered according to the report. The Chair of Governors however advised that an offer had been made and the Monitoring Officer undertook to look into this offer to enable further review as to whether appropriate invoices had been paid.

- Value for Money, specifically the Committee challenged whether the project represented value for money for Medway when considered against the original project and spend incurred.

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It was noted that the Headteacher had commissioned a review of the works completed, which concluded that the project did represent Value for Money and this had been made available to the Council and MACE group. Officers advised that they had not seen this report and referred to the Internal Audit report and annexed reports from the MACE group that questioned the achievement of Value for Money citing in particular the spend required for remedial works. Officers requested a copy of the school document and information as to its availability.

- **Role of the governing body in monitoring the project**

The Committee questioned the statement contained within the report that the Chair of Governors had indicated a belief that the school was running the project. Members were advised that at this stage the Chair of Governors was relatively new to the post and the 'build' to the school was considered to be the sports centre and not the expansion of the school.

Responding to questions the Chair of Governors advised that they had thought the project was on track until asked to attend meetings at the Council. Increased costs had not been questioned as they did not perceive this to be their build and so were not reviewing the finances. They also referred to site inspections undertaken by the council and proposals for further work by the council.

- **Fiduciary Duty**

Members expressed concern as to the process for approving payments and questioned whether the school was fulfilling its fiduciary duty; specifically the finding that the Headteacher had signed cheques to the contractor without checking the authenticity of the contractor's invoices, which was a requirement of the Medway schools finance manual.

The Headteacher acknowledged the error and that there is a finance policy at the school. He contended that the school was not managing the project and that he was acting, with the council's knowledge, as an agent on the council's behalf following delays when invoices were submitted earlier in the project. The representatives from the school advised that the services had been provided and that cheques were signed to facilitate prompt payment and so not jeopardise the delivery of the project.

During the discussion on this aspect the school questioned the availability of information during the investigation to the school, such as the notes of discussions with Internal Audit.

- **Affordability**

Members expressed concern that building works may not have been specified clearly and/or costed realistically and to the lack of supporting documentation concerning the original commissioning of this work and its

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affordability. Members also referred to the finding that the Headteacher had been defining work, which was disputed by the Headteacher.

- **Potential conflict of interest**

Concern was raised as to whether the school considered the appointment of main contractor a conflict of interest and against the procurement process, in that a school employee was acting as both project manager and main contractor. They also questioned the payment of a management fee and the due diligence undertaken in recommending the appointment of Antrad. The Headteacher and Vice-Chair of Governors stated that the school's position was that they had only made a recommendation concerning the appointment based upon the individual's understanding of the school and skills and that the payment of the management fee had been paid by the Council. It was assumed others would be able to bid for the work. They stated that the proprietor of Antrad had been willing to undertake a tender process and that the school should have reported that the Council was not complying with due process.

- **Computer equipment**

Members questioned the appropriateness of computer equipment being charged to the project with payments made to the main contractor. The Headteacher said he would review this further.

Following their consideration the Committee requested that a further report be brought to the Committee, providing an analysis of the further information that had been reported as available.

The Committee agreed to adjourn the meeting for 10 minutes at the end of this item.

### **Decision:**

- a) The Audit Committee noted the control measures that the Council had put in place.
- b) The Audit Committee requested the Woodlands Primary School Governing Body to provide a copy of the letter from Antrad offering further financial information.
- c) The Audit Committee asked officers to request such further financial information in order that the Committee can seek assurance regarding Value for Money.
- d) The Audit Committee agreed that the Governing Body of Woodlands Primary School be advised that it has severe concerns over their part in the Woodland Project.

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- e) The Audit Committee agreed that a further report be submitted to the Committee setting out details of the further information requested above.

### **144 Review of Risk Management**

#### **Discussion:**

This report updated the Committee on progress with the council's risk management activities.

It was noted that the 2010/2011 Risk Management Audit had confirmed that risk management arrangements had been satisfactory and the report set out details as to how risk training and the creation of directorate risk registers would be taken forward via a phased approach. This included adding risk to Covalent, the council's performance management system, and in-house training for Members on 8 August 2011.

#### **Decision:**

The Audit Committee noted progress on the Council's risk management activities.

### **145 Statement of Accounts 2010/2011**

#### **Discussion:**

The Accounting Manager presented the council's Statement of Accounts for 2010/2011, which were required under the Accounts and Audit Regulations 2003 (as amended). The Cabinet had considered and approved the actions taken in producing the Statement of Accounts earlier on 5 July 2011 and recommended to the committee that it approve the statements as submitted.

The Accounting Manager explained the contents of the core financial statements and their accompanying notes. The accounts detailed a revenue underspend of £3.2 million for 2010/2011 and a reduced requirement from General Reserves of some £2.5 million. Capital expenditure for 2011/2012 amounted to £79.9 million. It was also noted that, subject to review by the external auditors, it was considered that the 2010/2011 accounts were compliant with International Financial Reporting Standards.

The summary financial positions for both the Housing Revenue Account and Delegated Schools Budget were also reported, as were the principal variations to agreed budgets. It was also noted that the Council's pension fund actuaries had recently submitted a revised valuation of the pension fund resulting in a favourable movement of some £4 million. The principal financial statements and accompanying notes had been updated to reflect this change.

A revision to the Explanatory Foreword was tabled at the meeting. It was noted that the borrowing/investments had inadvertently set out the 2009/10 figures

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rather than being updated for 2010/11. A couple of other minor typographical errors were also noted.

Members discussed the contents of the accounts, such as the capital commitments in respect of the academies programme, and requested further clarification on:

- the provisions relating to the clawback of school reserves, particularly where the school is becoming an academy
- the resurfacing work and improved security to the car park listed as for 'Woodlands Place'
- the number, both historic and current, of loans to employees for the purchase of motor vehicles along with details of the eligibility criteria.

The Statement of Accounts would now be subject to scrutiny by the external auditors and reported back to Members in September. Interested parties also had the right to inspect the accounts and make representations to the auditor.

### **Decision:**

- a) The Audit Committee approved the draft Statement of Accounts for 2010/2011.
- b) The Audit Committee requested a briefing note providing clarification on:
  - i) the provisions relating to the clawback of school reserves, particularly where the school is becoming an academy
  - ii) the resurfacing work and improved security to the car park listed as for 'Woodlands Place'
  - iii) the number, both historic and current, of loans to employees for the purchase of motor vehicles along with details of the eligibility criteria.

## **146 Treasury Management Outturn Annual Report**

### **Discussion:**

The Finance Support Manager introduced the report which provided an overview of treasury management activity during 2010/2011. The Cabinet had considered the annual outturn report earlier on 5 July 2011 and recommended its approval to the Audit Committee.

The report covered a number of issues including the Council's treasury position as at 31 March 2011, borrowing activity in 2010/2011, performance measurement, the strategy for 2010/2011, the economy and interest rates in 2010/2011, borrowing and investment rates, the borrowing outturn, compliance with treasury limits and prudential indicators, investment outturn and debt rescheduling. The outturn for the prudential indicators, as contained in the council's Treasury Strategy Statement, was set out at appendix 1 in the report.

The Finance Support Manager explained that overall the Interest and Financing budget had fallen short of the targeted budget. The budget had however been predicated upon anticipated earnings of 2% on internal investments, earnings

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from the fund manager and a contribution from the rate equalisation reserve. In light of the low bank rate, which continued at 0.5% throughout 2010/11, the rate equalisation reserve had been utilised for the full £1.05m. It was also noted that due to low interest rates on investments the council had been using cash balances to finance new capital expenditure or repay existing debt and that the council's priorities for investments were: security of capital, liquidity and then yield.

In response to Members' questions the Finance Support Manager gave details of the breach of treasury limits that had occurred in 2010 and undertook to provide Members with a briefing note outlining the timings of the CHAPS payment that led to the breach of counterparty limits.

### **Decision:**

- a) The Audit Committee approved, in accordance with the CIPFA Code of Practice, the Treasury Management Outturn Annual Report.
- b) The Audit Committee requested a briefing note outlining the timings of the CHAPS payment that led to the breach of counterparty limits in 2010.

## **147 Effectiveness of the Internal Audit System**

### **Discussion:**

The Accounting Manager introduced a report on the effectiveness of the internal audit system.

The Accounts and Audit Regulations required an annual review of the internal audit system. This formed part of the wider annual review of governance issues, leading to the approval of the Annual Governance Statement. The report set out details of assurances obtained under the areas assessed as part of this review and the key issues arising from 2010/2011 were set out in Annex A to the report.

### **Decision:**

The Audit Committee endorsed the approach to the review of the effectiveness of the internal audit system for 2010/2011 and the outcome of the review in support of the Committee's consideration of the Annual Governance Statement.

## **148 Internal Audit Work Programme**

### **Discussion:**

This report provided an overview of the 2010/2011 internal audit work programme and details of the 2011/2012 work programme.

It was noted that the internal work programme was derived from a number of sources including the council's risk identification process, internal audit's view



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of risk, requests from Members and officers and predetermined audits that form part of an agreed arrangement with the external auditor.

Members discussed the content of the 2011/2012 programme, which for the first time was aligned to the financial year. In relation to the cash and banking processes audit Members were advised that income at satellite sites had been excluded in order to focus the audit but would be covered by discrete audits. Members also noted that the schools capital programme audit would be removed from the programme as schools did not manage the capital programme.

Members questioned whether the Housing Benefits audit would include consideration of assisted housing benefit and whether Value for Money was provided from providers. Members were advised that the Chief Finance Officer had commissioned a report on supported accommodation and it had been identified as a possible matter for in-depth review by the council's Overview and Scrutiny Committees. Members agreed that the outcome of this review be reported to this Committee or, if this was not taken forward by the Overview and Scrutiny Committee, that the report be submitted to the Audit Committee for consideration.

### **Decision:**

The Audit Committee approved the 2011/2012 internal audit programme and noted the outcome of the 2010/2011 work programme.

## **149 Internal Audit Annual Report**

### **Discussion:**

This report informed the Committee of the overall opinion on control for 2010/2011 based on internal audit's work. It was noted that the findings would assist Members when considering the Annual Governance Statement.

The report gave details of the opinions for key financial systems, other financial systems and corporate governance. It was noted that whilst operational audit activity did not lend itself to the formation of an overall opinion it had not identified any authority wide risk issues. Details of internal activity undertaken during 2010/2011 were annexed to the report.

### **Decision:**

The Audit Committee endorsed Internal Audit's opinions contained in the report and agreed to consider the comments in section 4 of the report when considering the annual governance statement.

## **150 Annual Governance Statement**

### **Discussion:**

The Monitoring Officer introduced a report that presented the 2010/2011 Annual Governance Statement.

The statement (attached to the report) summarised Medway Council's governance framework and key elements of internal control and the sources of assurance. It provided a review of the effectiveness of those governance and internal controls. It was highlighted that assurances had been provided from the Corporate Management Team that key elements of the control framework were in place during the year, in their respective divisions, and control weaknesses were identified and addressed.

It was noted that section 5 of the Governance Statement set out key areas for the council to focus on. This included the procedures introduced following reports on the Woodlands Primary School and its procurement of an extension to the school buildings; a review of the council's anti-fraud and corruption measures by the council's external auditor; potential overspends on the Homes and Communities Agency funding allocated for regeneration projects; and the challenges facing the council following the reduction in Government grant funding for 2011/12 and Better for Less programme.

### **Decision:**

The Audit Committee approved the draft Annual Governance Statement.

## **151 External Audit Grant Claim Report - Update**

### **Discussion:**

The Accounting Manager introduced this report that updated Members on progress made in addressing issues raised by the council's external auditor on certification work undertaken on 2009/10 grant claims. This had been requested at the March meeting of the Committee.

An update on the measures to ensure that best practice was followed in the preparation of grant claims was set out for the following: Housing and Council Tax Subsidy Claim, Housing Revenue Account subsidy Base Data Return and Teachers Pension Return.

### **Decision:**

The Audit Committee noted the update on action taken in response to the external auditor's grant audit report for 2009/2010 and that a report relating to grant claims for 2010/11 would be submitted to the Committee in due course.

## **152 Outcomes of Internal Audit Activity**

### **Discussion:**

The Accounting Manager introduced this report on the outcome of completed internal audit activity.

It was reported that the audit definitions had been set so to improve managers' understanding of them and that the audit report format was designed so to direct managers more clearly to the key risk areas. A clearer priority ranking system for audit recommendations had also been introduced.

Officers responded to Members' questions on a number of audits. This included confirmation that the civic centre fuel pumps audit had not revealed evidence of any theft of fuel. In relation to the care director payment audit Members were informed of the overpayments reported outstanding and requested confirmation as to whether the outstanding recommendations affected the risk of overpayments.

In relation to the creditor payments audit the Committee were advise as to the controls introduced by the council's exchequer team and Members requested confirmation on how this sample was identified. It was also noted that the governance audit on the prevention and corruption was an annual audit and so the implementation of the recommendations would be reviewed.

### **Decision:**

- a) The Audit Committee noted the outcome of Internal Audit's work.
- b) The Audit Committee requested a briefing note on the controls introduced by the council's exchequer team following the Creditor Payments audit and confirmation as to whether the outstanding recommendations in the care director payments audit affected the risk of overpayments.

## **153 External Audit Fee 2011/2012**

### **Discussion:**

The Accounting Manager introduced a report and accompanying letter setting out the external auditor's fees for 2011/2012.

It was noted that the indicative fee for 2011/2012 was £314,100 and set in accordance with Audit Commission guidelines. Members were also informed that the Audit Commission would rebate the council for the extra costs incurred as a result of International Financial Reporting Standards and that in addition to the fee the cost of Grant Claim work was estimated at £82,000.

**Decision:**

The Audit Committee noted the external auditor's 2011/2012 indicative fee, the Audit Commission potential subsidy and the option being explored by officers to reduce the overall cost to the council.

**154 Outcomes of Counter Fraud Investigations**

**Discussion:**

The Accounting Manager advised Members of progress in investigating allegations of Housing and Council Tax Benefit fraud and other non-benefit fraud during the quarter ending 31 March 2011 and responded to Members' questions. In accordance with a request made at the last meeting the report included details of the length of time it would take for overpayments to be recovered from current benefit claims.

It was noted that since the last report to the Committee there had been 12 successful prosecutions and three cautions for benefit offences. There had also been one case involving Decent Homes Loans Grant that had been successfully prosecuted. Details of these cases were set out in an appendix to the report. Members were also advised that in the 2010/2011 financial year the investigations team had identified £483,654 of fraudulent overpayments of Housing and Council Tax Benefit and £221,397 of Department for Work and Pensions paid benefits.

During the discussion on this item Members requested that the Committee be provided with updates on the instances of employee fraud reported at the last meeting. Members also requested a briefing note setting out how the council could identify changes in individual circumstances and the subsequent options to revise payment orders for outstanding benefit overpayments.

**Decision:**

- a) The Audit Committee noted progress in investigating benefit fraud in accordance with the approved sanction policy.
- b) The Audit Committee requested an update report to the next meeting of the Committee on the instances of employee fraud reported to Members on 29 March 2011.
- c) The Audit Committee requested a briefing note setting out how the council could identify changes in individual circumstances and the subsequent options to revise payment orders for outstanding benefit overpayments.

## **155 Annual Review of Terms of Reference**

### **Discussion:**

The Accounting Manager introduced a report on a review of the terms of reference for the Committee. He explained that it was good practice for the Committee to annually review the terms of reference to see whether any amendments were needed. The committee's existing terms of reference were set out in Appendix A to the report.

Members were advised that there had been no developments or further guidance issued that necessitated a change in the immediate future to the terms of reference. It was however reported that on 30 March 2011 the Department for Communities and Local Government had issued a consultation on the 'Future of local public audit'. The consultation included proposed changes to both the structure and role of audit committees, which were set out as Appendix B to this report for Members' information.

### **Decision:**

The Audit Committee confirmed that the current terms of reference met its current and expected future needs without amendment.

**Chairman**

**Date:**

**Anthony Law, Democratic Services Officer**

Telephone: 01634 332008

Email: [democratic.services@medway.gov.uk](mailto:democratic.services@medway.gov.uk)