

Minutes



Audit Committee

Date: 26 January 2017

Time: 5.00 pm

Present: Mr J Baker (Chair), Councillors D Davies, E Garland, J Guy, H Thomas and R White

In Attendance: Rhys Cornwall (Head of People and Business Change), Mike Dickie (Business Service Development Manager), Rachel Kalahar (Senior Performance Management Officer), Meirion Rushworth (Head of Finance), Owen James (Assistant Head of Finance - Technical and Development), Andrew Wathan (Chief Internal Auditor), Dona Palmer (Audit Manager) Anthony Veale and Gareth Lucey (WAO) and Michele Chesterman (Democratic Services Support Officer)

Apologies: Councillors R Bright and M Spencer

1 **Declarations of Interest**

None.

2 **Minutes of the Meeting held on 1 December 2016**

The Minutes of the meeting held on 1 December 2016 were submitted.

Agreed

To confirm the Minutes of the meeting held on 1 December 2016.

3 **Corporate Risk Register Update**

Members considered the latest update of the Corporate Risk Register. There were eight risks identified in the register, all medium. Since the last update all risks remain unchanged.

In connection with Risk 7: City Deal, Members were advised that this was heavily reliant on external factors and little action could be taken by the Council to mitigate the risk. The same could be said for Risk 8: Brexit; that the financial implications of leaving the European Union have a negative impact on the Council's financial position.

Discussions included the following:

- Risk 6: Investment in Friars walk Development; the present score of the risk (December 2016) was 12 and it was asked whether this was still a valid score? - The Head of Finance advised members that it was considered that medium was appropriate. If there was not an active buyer it would be high. It is not low as it is in

progress. There were still one or two hurdles to overcome with the buyer but medium looked about right at the current time.

- It was not Audit Committee's role to query the score of the risk but the process around deciding on the score but it was felt that this process was a little bit disjointed and queried whether it was within the current situation? - The Head of Finance explained that the risk was around the developer being unable to sell. From a Council perspective he was confident that if the sale did not go ahead it was nothing to concern the Council.
- How whistleblowing is being picked up in risk? - It was explained that this is picked up through the process in place and would be discussed at SLT level it felt to be serious enough. Members' attention was directed to page 14 of the Risk Register; the Risk Table which highlighted the ongoing process and the wide ranging areas and it was explained that the process is a live one, with Risk officers taking a view on whether the risk is high enough to go on the Corporate Risk Register.
- Whether there was a maximum number in connection with risks and were any higher than 16? - It was clarified that the upper number was 25 and the Council tried to focus on the most important areas. While some risks had been scored at 20 a couple of years ago, at the current time, they were all medium, amber category (16).

Agreed

To note the contents of the Corporate Risk Register.

4 Treasury Management Report

Members considered a report on the Treasury Management Strategy 2017/18, Prudential Indicators, Investment Strategy and the Minimum Revenue Provision (MRP) policy. Both the Prudential Code and Welsh Government required Audit Committee to review and consider the Council's Treasury Management Strategy and Prudential Indicators before they were approved by full Council.

The overarching recommended Treasury Strategy remains unchanged from the current strategy which in summary:

- Limits the need to actually borrow cash by using the positive cash-flow the Council has to fund capital expenditure funded from borrowing, wherever possible;
- Borrow and invest in the short-term to manage the shorter term cash-flow requirements of the Council.

In practice the overarching strategy limits the activities of long term borrowing and investments.

The strategies within the report set the Council's approved borrowing and investment limits, based on planned capital spending. The report was prepared in line with the Council's Medium Term Revenue Plan and would be presented to full Council as part of the overall budget report for approval in March 2017.

During 2016/17 the Council repaid approximately £4 million of borrowing, mainly relating to activities related to the Friars Walk, which are being kept on short-term periods and reviewed regularly – and therefore did not represent any formal repayment but rather the management of the Council's cash-flow and limiting the external borrowing taken out at any point in time. New temporary borrowing of approximately £20 million was anticipated to be required before the end of 2016/17 financial year.

In December 2013 the Council approved a loan of up to £89.1 million to Queensberry Real Estates (Newport) Ltd (QRE) to fund the building of the Friars Walk Development. The Council's own borrowing to make the onward loan was kept separate from the Council's other borrowing requirements and incurred, as needed, up to a maximum of £89.1 million. Whilst kept separate, the actual borrowing was affected by the Council's overall cash-flow management. If the sale was not successful the Council would need to re-finance the scheme which required the current borrowing, maturing up to the end of July 2017 to be re-financed.

Included in the report was a paragraph on the 'City Deal' project. While no formal decision had been made at this stage, any agreement to enter into the 'City Deal' would have a significant impact on capital expenditure and the minimum revenue provision. Figures for this were not included in this report and a further report would need to be brought to Committee when a decision had been made on the scheme.

The Assistant Head of Finance outlined to the Members the basics of the Treasury Management Strategy.

A review of the MRP policy was currently being undertaken. Currently this was a charge through equal instalments over the life of an asset on a straight line basis. A review was being undertaken to move from this method, to using the annuity method. The annuity method still had asset life as its main basis but took into account the time value of money. Therefore the charge in year one would be less than the charge in say 25 years' time, increasing year on year. The method was prudent and still kept asset life as its main basis and therefore the repayment would be the same over the life of the asset in both the equal instalment and annuity basis. The Council's auditors were being liaised with to obtain assurance that the application of the method was correct and would look to be implemented in the near future. The Assistant Head of Finance stressed this was not a change to the MRP policy but a change to the method of calculation and therefore to be noted by the Audit Committee.

Discussions included the following:

- Was the Council putting off repayment off debt until later? - The Head of Finance explained that the MRP policy keeps the cash within the organisation. Cash can then be used to repay loans. The same cash will be generated to put aside to repay loans in the future, thus fulfilling the Wellbeing of Future Generations requirement and it was prudent. The only difference was the change to the method of calculation.
- Is the Council better off? - The Head of Finance explained that the strategy was the cheaper option of managing borrowing and investments and the policy was about keeping our cash as low as possible to delay taking out new loans. The Assistant Head of Finance added that if the Council is told by the Treasury Advisors that interest rates are going up then it may take that on board and borrow earlier to make sure that interest rate rise is taken into account.
- How long can the Council make forecasts into the future; 10 years? - The Head of Finance replied that the longer the Council forecasts into the future the less certain it is. The Council forecasts long term, weekly and by financial year. Planning is undertaken on different levels. The Treasury Strategy is about longer broad term plans and shows the direction of travel.
- With regards page 48 (Investment Training) – Could opportunities for investment change? - The Head of Finance explained that the Council's Treasury Advisors run a number of free events, meeting with Finance three times a year for a balance sheet review keeping the Council abreast of new opportunities, etc.
- Is there any overnight investing undertaken by the Council? - The Assistant Head of Finance replied that the Council's investments are now minimal, very short term, very safe 1 day, 3 day places, with advice obtained from the Treasury Advisors. He directed Members to page 53 Appendix C of the report 'Counterparty Limits for

Banking – UK Institutions’ and advised that the Council does not undertake any risky investments.

- If the Council borrows money when the interest rates are low, is the loan arranged to use in future or are the funds accessed straight away? - The Assistant Head of Finance explained that this was not a time for the Council to undertake long term borrowing if not needed. If there is an interim period when the funds are not accessed there will be a cost of carry until the loan is needed. Redemption or redeeming early would carry a cost. The Council undertook early redemption in 2015/16 to take advantage of cheaper interest rates. The Head of Finance added that if the Council borrows earlier it would need to find a home for the cash and would have to run the risk that the banks were safe.
- Is the Council vetted on further interest rises? - The Head of Finance explained that the Council’s Treasury Advisors provide advice on interest rates forecasts and that they meet 3 times a year.
- How much do we pay Treasury Management? - The cost was £9,000 a year which includes on call and courses. Members noted this was very cheap for peace of mind. The Head of Finance added that there were two firms in the UK providing this advice to local authorities. The company used by Newport City Council was CAPITA which was used by several Welsh authorities.
- The Council uses Prudential limits but there is no Treasury Management strategy for the bond of £40 million and though we anticipate rolling forward the £40 million, is this good or bad? Should the strategy say the level of detail and whether we carry forward or minimise - The Head of Finance replied that the overall strategy was as per the report: the Council defers the day it needs to borrow cash for as long as possible. When the £40 million bond leaves the Council on the day payable the Council will re-finance the amount needed – whether that be 38 or 40 million. The strategy does not put a limit on the borrowing amount.
- Whether the reason for the method of calculation for the MRP being carried out is for short term gain and if the Council is extending the period is it deferring the inevitable building up a potential liability / mortgage in the future? - The Head of Finance explained that the change to the method of calculation for the MRP would lead to a saving in the short term but greater costs in the future. However, overall, it would be the same costs in total. There would be a permanent but short term impact.
- Whether it was appropriate to do this?
 - The Head of Finance replied that it depended on the reason. If there was a compelling reason to save in the short term to allow time to plan for the long term then it was valid. With regards the new Capital Programme 18/19 over the next four years it would be cheaper to fund that if the MRP policy was changed. It would be for Cabinet and Council to decide if that was a worthwhile way forward. The reason why it was acceptable was that the same total was being charged over the asset life.
 - The Assistant Head of Finance directed Members attention to page 59 (Appendix E – Minimum Revenue Provision (MRP) Statement 2017/18) 2. Option 3: Asset Life Method was the option the Council uses now. The policy has not changed in a number of years. The same policy is being recommended but within that the calculation is being changed.
 - The Head of Finance stated that he would be taking forward the Audit Committee’s comments including the one around the strategy itself in that it deals with the direction of travel but does not deal with the total borrowing of the Council and borrowing limits which are not there and whether they should be considered.
- Whether the Treasury Management Strategy is sufficient for Audit Committee to look at, as it was felt at the moment there was a gap and that the guidance did not advise what to do with the £40 million?
 - The Head of Finance felt the overarching strategy did tell us what will happen to the £40 million but he would look at the wording to make it more explicit on what was happening with the redemption of major loans next year and the year after that. Because of the strategy of holding as little cash as possible and deferring

loans when existing loans are redeemed it will not be cash to redeem them but another loan.

- The need for the Audit Committee Members to be happy with the strategy as if the strategy was approved, the Council would be minded to go ahead on the basis of what the Audit Committee had said. -The Head of Finance stated that he would find a form of words to make it practical and take the comments of the Audit Committee on board to explain the practical implications of the Strategy.

Minor typing errors were identified on: page 35 paragraph 5, second line (delete has) and; page 39, paragraph 26 ('a' missing), which were noted.

Agreed

1. To recommend to Cabinet for approval the Prudential Indicators, Minimum Revenue Provision Policy, the Treasury Management Strategy and the Annual Investment Strategy as detailed in the report subject to the above Audit Committee comments being included.
2. Head of Finance to amend Treasury Management Report wording to take on board Audit Committee's comments.
3. To note the potential change in calculation method of MRP policy from equal instalment method to annuity method.

5 Internal Audit Plan - Progress Quarter 3

Members considered a report on the Internal Audit Section's progress against the 2016/17 agreed audit plan for the first nine months of the year and information on audit opinions given to date and progress against key performance targets.

The team currently operated with an establishment of 9 audit staff. At the start of the year there were 5 audit staff with 4 vacancies in the team. An Auditor was appointed and started in the team during Q1, a Principal Auditor was appointed in Q2 and started in Q3.

The Section had not been involved in so many special investigations but this had now changed and was involved in a special investigation with half the team involved with the audit and half with the special investigation.

The performance for Quarter 3 2016/17 was compared to the same period for the previous year:-

- 50% (43%) of the audit plan had been achieved so far which was better than last year's performance and in line with the profiled target of 50%;
- The promptness of issue of draft report (comparing timescale between finalising all fieldwork and issuing the draft report to management) averages at 14 days (15 days) which was above the target time of 10 days;
- The promptness of report finalisation (comparing timescales from meeting with client to discuss issues raised in the draft report to issue of finalised report to management) averages 3 days (3 days) which was within the target time of 5 days.
- Coverage of the plan at this stage of the year was in line with expectations; the target being 50% for Quarter 3, despite there being a reduced audit resource in the team. The Section had started to get involved with some sensitive and time consuming special investigations. Although performance may have dipped throughout the year, historically things had picked up the final quarter; this year

would depend on sufficient audit resources being available to complete the audit plan. All key financial systems would be reviewed by year end.

- 53 (51) days had been spent finalising 18 (15) 2015/16 audit reviews; 17 of which had been finalised.
- A vacancy/secondment provision was taken into account in the planning stage which related to the Chief Internal Auditor's work with Monmouthshire, a Principal Auditor post and two Auditor posts.
- Inevitably there would be some overruns on reviews undertaken within the team which might result in not as many reviews being undertaken as were planned for the year, but there had been a significant improvement in this over previous years.
- There had been 90% positive feedback from service managers via the evaluation questionnaires and this would continue to be collated throughout the year and fed into the annual audit report for 2016/17.
- 21 jobs completed to at least draft report stage by 31 December 2106 warranted an audit opinion: 4 x Good; 13 x Reasonable, 3 x Unsatisfactory and 1 x Unsound. Of the 2 community centre accounts undertaken, opinions for both were *Unqualified*. Other reports have been completed which did not warrant an audit opinion or related to the Annual Governance Statement, the Council's performance indicators, grant claims and provision of financial advice.

Discussions included the following:

- What is the process if there is a serious issue which could take a lot of time to address? - The Chief Internal Auditor replied that a period of 6-12 months is given to resolve issues, following which they are referred back to Audit.
- On Page 71 Unsatisfactory and Unqualified related to Street Scene – was there a problem? - It was explained that the reviews were up to Q3 and there were opinions that had not yet been issued. It would be reported to senior management and risk areas would inform the 2017/18 plan. If it was felt that an area was more at risk than others, a plan would be put in place.
- Whether there are sufficient numbers of staff in Audit to carry out special investigations? - The Audit section has an allocation of time for special investigations which had not been used up at Quarter 3. Agency staff required additional support and time from the manager and therefore a secondment was in place. It was not known how long the special investigation would take.
- Will the result of the special investigation be fed back to Audit Committee? - Where a special investigation led to a disciplinary outcome this would not be reported to Committee, due to confidentiality issues. If the issues arising from the special investigation affected a service area the Head of Service would be circulated.
- Will the number of grants allocated become a challenge and who has responsibility for them? - Grants depend on terms and conditions, which are not always followed and this sometimes resulted in money being recouped. The funding organisation expects the operational manager to follow the conditions of the grant and sometimes internal or external certification is required.
- What does qualified and unqualified mean? - The term qualified refers to the terms and conditions not being complied with, while unqualified means the terms and conditions have been complied with.
- Page 71 refers to finalised – will there be feedback given? - Finalised refers to reports which had been finalised, while those not finalised are still in draft. The Audit Section meets with the relevant manager and there are timescales for implementation. A further meeting takes place to follow up whether those implementations have taken place. It is the manager's responsibility to make sure it is done and the Audit Team's responsibility to make sure they monitor that the actions have been completed.

Agreed

To note the progress on the delivery of the audit plan opinions given to date.

6 Work Programme

The Internal Audit Unsatisfactory Audit Opinions (6 monthly report) had been deferred until the next meeting 30 March 2017.

Agreed

To note the Work Programme.

7 Any Other Business

Andrew Veale of Wales Audit introduced Gareth Lucey to the Audit Committee and advised that Gareth would be replacing Terry Lewis as the new WAO Audit Manager.

8 Date of Next Meeting - 30 March 2017

The date of the next meeting was confirmed as 30 March 2017.

The meeting terminated at 6.35 pm