AUDIT AND MEMBER STANDARDS COMMITTEE

22 JULY 2020

PRESENT:

Councillors Greatorex (Chairman), Ho (Vice-Chair), Checkland, Grange, A Little, Norman, Robertson, Spruce and White

Observer: Councillor Strachan, Cabinet Member for Finance, Procurement, Customer Services and Revenues & Benefits

Officers in Attendance: Miss W Johnson, Ms Rebecca Neill, Mr Anthony Thomas and Ms Christie Tims

Also Present: Mr John Gregory (Grant Thornton UK LLP) (External Auditor) and Ms Laurelin Griffiths (Grant Thornton UK LLP) (External Auditor)

INTRODUCTION:

The Chairman welcomed everyone to the first Audit & Member Standards Committee Meeting to be held online and streamed live.

1 APOLOGIES FOR ABSENCE

There were no apologies for absence.

2 DECLARATIONS OF INTEREST

Councillors Greatorex, A Little and White all declared a personal interest in any discussion relating to Staffordshire County Council's Pension Plan actuarial valuation timetable as they are also Members of that Authority.

3 MINUTES OF THE PREVIOUS MEETING

The Minutes of the Meeting held on 5 February 2020, as printed and previously circulated, were taken as read and approved as a correct record.

4 ANNUAL TREASURY MANAGEMENT REPORT

Mr Anthony Thomas (Head of Finance and Procurement) delivered a Presentation on the Annual Treasury Management Report and explained to the committee the reasons why the report is prepared:-

- The Constitution assigns responsibility for scrutiny of treasury management to this committee;
- Treasury management includes capital expenditure, funding, borrowing, investments and prudential indicators;
- There are three cyclical treasury management reports:-

  (1) Treasury Management Strategy – what we plan to do.
  (2) Mid-Year Treasury Management Report – how we are doing.
  (3) Annual Treasury Management Report – what we did.

Mr Thomas talked through the key points of the report focussing on:-

- Capital Expenditure – an underspend of £13.4m (85% of the approved budget) with the most significant item of £10.5m being due to no investment in property due to a PWLB consultation on debt for yield schemes and subsequent CIPFA advice to Chief Financial Officers.
- Balance Sheet – the impact on the balance sheet of the year end pension valuation of the long-term liability provided by the Pension Fund Actuary, £12.2m lower than budget and £10m lower than last year's valuation. This was due to changes in financial and demographics used by the Actuary in the valuation.
- Strategic Investments – as at 31 March 2020 the Council had invested £6m in property and diversified income funds with their valuation being £5.5m as at 31 March 2020 and £5.6m as at 10 July 2020. In June 2020 in line with the strategy and to take account of lower asset prices, the Council had invested a further £2m in a diversified income fund.
- Prudential Indicators – the Council was compliant with all indicators for 2019/20.

In terms of Covid-19 and treasury management, further information was provided:

- A report to Cabinet on 7 July 2020 had projected the financial impact for the Council (after grant) could range from £1.3m to £4.5m.
- In terms of managing the risk, the Council had £7m in confirmed general reserves, financial stress testing had been undertaken, enhanced financial monitoring of income streams was taking place, a further £0.14m of government grant had been received, a sales, fee and charges income loss sharing agreement had been announced and there was also going to be the ability to spread council tax and business rates collection fund losses over three years rather than one.
- The Council had not undertaken investment in property funded by borrowing and therefore was not exposed to additional financial risk.
- In terms of the risk of investments not being repaid, the Council's approach had always been to diversify investments to manage risk, no new investments were undertaken without firstly obtaining Arlingclose advice and there were no known problems with the Local Authorities where the Council had investments.

A query relating to the decision taken 3 years ago to borrow up to £45m was raised and it was asked if the Council had any plans to cancel this agreement. Mr Thomas said at this point a decision had not been made on the plans for the approved budget of £45m. He said the PWLB consultation was focussed on debt for yield schemes and from the Council's perspective this was high risk because the property investment strategy was overly commercial, however, it does not preclude borrowing from the PWLB to fund place-shaping or housing investment.

It was asked if an assurance could be given that this decision would be coming to the Strategic O&S committee as well as this committee before any changes are made. Mr Thomas said the £45m budget was part of the MTFS approved by Council on 18 February 2020 and in line with the budget framework, only Council can therefore approve changes to this budget. Therefore, the options for this budget would form part of the development of the MTFS that will be scrutinised by both the Strategic O&S committee and this committee prior to ultimate approval by Council. Councillor Strachan, Cabinet Member for Finance, Procurement, Customer Services and Revenues & Benefits, advised on the specific point that the Treasury's move, and, the subsequent advice from CIPFA was to address concerns around an emergent bubble in asset prices using easily accessible government funds to buy property but if the bubble was to burst this then becomes a large risk factor. Councillor Strachan said if we were to borrow to invest in building/housing we were still able to invest in these types of projects but he absolutely undertook that this would be part of the over-arching MTFS and assured all the committee members that any decision would go through the correct governance channels and this would be a Cabinet discussion in the future.

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The Balance Sheet investments having increased £11.1m higher than the working capital and reserves was questioned and Mr Thomas explained that the level of working capital had increased with lower debtors in part due to the corporate debt team and higher creditor amounts including the surplus made on the collection fund that will be paid over in 2020/21. Usable reserves had also increased due to a variety of reasons such as lower capital and revenue spend in the year. He said these were likely to increase significantly this year to manage timing differences between the receipt and spend of grants to offset the impact of the pandemic.

In relation to the service investments particularly, the ICT Cloud one, it was queried that there was a variance of £39,000 costs more than was budgeted. It had been noted that it said it was a project change and Mr Thomas was asked to explain more.
Mr Thomas said that when this project was approved an approach based on a particular partner was envisaged, however, an alternative approach with an alternative partner had now been approved and, therefore, we are not going to generate the savings we had predicted and he confirmed it would be a budget pressure moving forward, Mr Thomas said it would be a key issue.

The Property Fund book value was discussed and it was asked how much of that was exposed to retail - were the reserves not covering the book loss? Mr Thomas was asked which direction this would take and he said the Council was not exposed to the level of some property funds as we were a low risk organisation who are in it for the longer term therefore less volatility. He said the CCLA do not invest in high street retail – they mainly invest in industrial/distribution as they believe it is not exposed to the level of some property funds. Moving forward Mr Thomas said it was a good question. One of the reasons for setting up the reserves in the first place was to manage the volatility. In addition, there is also a statutory override in place until 31 March 2023 that means any reductions in value do not have to be charged to revenue and Mr Thomas said he had already raised this point in Government Returns that this will need to be extended given the impact of the pandemic on investment values.

It was noted that looking at the numbers and figures in Appendix A, a great deal of capital projects had slipped back, investment in the property company especially, it was asked if there was a real chance that this may slip in to 2021/22 and how long we could allow the investment in the property company to slip back before it had an impact on the MTFS.

Mr Thomas said the investments in the property company consist of 2 elements: an equity investment of £225,000 that we undertook in May; and a £675,000 loan for up to 5 years. He said we have only built income from the loan into the approved MTFS i.e. £4,000 in 2020/21 and increasing to £22,000 in 2023/24. At this stage, no income from dividends from the company had been included in the MTFS. In terms of the investment in property budget, the MTFS assumes a contribution of £87,000 in 2020/21 increasing to £658,000 in 2023/24 and therefore if investment does not take place or result in income, then the funding gap will increase.

RESOLVED:- (1) The Report was reviewed and noted;
(2) The actual 2019/20 prudential indicators contained within the report were reviewed and noted.

5 RISK MANAGEMENT UPDATE

Ms Rebecca Neill (Internal Audit Manager) presented the Risk Management Update report which provided the Committee with their routine risk management update. She summarised the key points and reminded all that at the previous committee meeting it had been agreed to review the risk register to align it with the new strategic plan and also to incorporate the 3 lines of assurance model. She said this work had now been completed and was detailed at Appendix 1 of the report. She said that Covid-19 has had a significant impact on the Council's risk management and this was reflected in the New Strategic Risk Register. She explained that the table at 3.6 illustrated the linkages between what were the previous corporate risks and what are the new strategic risks going forward.

Ms Neill said that following the leadership team's risk management workshop, 7 strategic risks had been identified and they are reflected at section 3.7 of the report. She said there were 2 risks currently outside of appetite at the moment – SR1 (non-achievement of the Council's key priorities due to availability of finance) and SR2 (resilience of teams to effectively respond to a further disruption to services). The Chairman stated with regards to SR2 that considering what has happened in terms of the pandemic, he personally thinks the District Council has responded well and although it is a negative report, in terms of that risk, how much worse could it get?

Ms Neill said that there was a feeling of fatigue amongst managers and the leadership team, who have had to deal with the Council's response to Covid-19. With this risk, it was felt that if there was to be a multi-layer disruption, for example, a second wave coupled with flooding or seasonal flu pressures and Brexit then this may strain the Council's resilience and response.

Councillor Grange stated that the way that the register was now presented was better and the 3 lines of assurance model was welcomed. However, she stated that some of the risks as described were not necessarily of a strategic nature i.e. SR1 – non-achievement of key priorities due to the availability of finance - she felt that there are other reasons that could result in non-delivery and SR2 picks up on this a little. She asked if broadening out these risks and making them less specific for the future could be considered. Also, she stated in terms of SR6 – failure to innovate and take the learning from the Covid-19 situation could be broadened to include any situation, not just Covid-19. This was noted.

The Committee asked in terms of SR1 and SR2 that these needed to be actively managed and the committee asked whether it was possible to get a high level brief on what was being done to manage these risks. Ms Neill explained that the actions were detailed within the actions column on Appendix 1. Mr Thomas, as risk owner of SR1, stated that Local Governments have been subject to significant financial planning uncertainty with the spending review, the move to 75% business rates retention, the fair funding review and the review of the new homes bonus and this had been exacerbated by the Covid-19 pandemic. Mr Thomas advised that all of these reviews had now been delayed by a further year until 1 April 2022 and a one year settlement was therefore being implemented for 2021/22. He said at the current time the impact that the Covid-19 pandemic has on the Council's financial position is very uncertain with the report to Cabinet on 7 July 2020 indicating a range of between £1.281m and £4.541m. However, since the report, the government has provided additional funding to the Council of £140,417, introduced an income "quarantee" sharing sales, fees and charges losses and enabled business rate and council tax collection fund deficits to be spread over 3 years rather than one.

Mr Thomas said as part of the development of the MTFS, we have commenced earlier than normal with an enhanced service and financial planning process where we have encouraged Heads of Service to consider the impact of ongoing funding reductions of c10% together with options for mitigating the impact.

> **RESOLVED:** The Committee noted the risk management update and received assurance on actions taking place to manage the Council's most significant risks.

6 INFORMING THE AUDIT RISK ASSESSMENT - LDC

Mr John Gregory from Grant Thornton presented a report - Informing the Audit Risk Assessment Lichfield District Council 2019/20 which was a series of questions on particular areas e.g. arrangements re: fraud/laws and regulations/going concern/related parties/accounting estimates and the responses received from the Council's management which is done annually. Mr Gregory said this had actually been written for the previous meeting which had had to be cancelled because of the pandemic so was really retrospective but the committee was asked to consider and comment.

No comments were received.

> **RESOLVED:-** The Committee noted the Informing the Audit Risk Assessment report for Lichfield District Council 2019/20.

7 AUDIT PLAN FOR LICHFIELD DISTRICT COUNCIL 2019/20 & ADDENDUM

Mr John Gregory from Grant Thornton presented the External Audit Plan for the year ending 31 March 2020 which provided an overview of the planned scope and timing of the statutory audit of Lichfield District Council for those charged with governance. Members' attention was specifically drawn to the addendum which reflected the unprecedented global response to the Covid-19 pandemic. Mr Gregory highlighted the 3 significant risk areas and referred to the additional risk of Covid-19 in the addendum which had been prepared once the seriousness of Covid-19 had been realised.

In the Audit Plan the implementation of IRFS16 was discussed and Mr Gregory stated that this had now actually been deferred for a year so it was no longer a risk for us as specified in the Audit Plan.

Mr Gregory referred to the materiality page, which was in line with Grant Thornton's normal approach, a 2% benchmark is used for those authorities they consider to be well-run. He referred to the value for money page which says that risk assessment remains in progress as over taken by events and the impact of Covid-19 on the financial situation – so this may be labelled differently as "impact of Covid-19" moving forward.

Mr Gregory explained that the addendum showed the additional significant risk re: Covid-19 and he explained that this was initiated back in March because it was not known what impact Covid-19 would have on Lichfield District Council in producing the accounts nor Grant Thornton's ability to audit the accounts i.e. no one knew how much sickness would be incurred or how remote working would work and what the actual impact of Covid-19 would be on the accounts. Mr Gregory referred to the impact valuations of land and buildings for example – valuations done on a market basis which took a hit towards the end of the year. It is then an additional significant risk for a number of reasons.

It was questioned what arrangements had been put in place bearing in mind this year is going to be even harder to make sure the pension valuation would not be revised and updated very late in the day like last year. Also, it was noted that it seemed likely that the valuation would be significant different. Mr Gregory said there were 2 aspects to this, it was partly about the timing of when the actuaries do their assessment and whether they do a second review and also the timing of the assurance work done for us by the auditors of the Staffordshire Pension Fund. He said that McCloud was the main issue last year and also the difference between the estimated asset values and the actuals a couple of months later. He said he was hoping McCloud would not be an issue this year but said there is a potential "fly in the ointment" in that the government is now consulting on the actual remedy. The fact that asset values become so volatile at year end is causing problems and means that the accounts will need to reflect the actual asset values as opposed to ones estimated 3 months in advance. He said in terms of getting the assurance of the auditors at Staffordshire Pension Fund, Grant Thornton had been in touch for that assurance but the County Fund Managers have said the delivery of the assurance is not going to be early – September is the expected date as it is dangerous to give assurance on the pension fund before that time.

Mr Thomas said that the big issue last year for Staffordshire was that the investment returns were different at the end of the financial year compared to the date the valuation took place which was an estimated value (in December). In that period there was a material difference in the return so the valuation changed. He said it was being managed now by delaying the valuation report to take this into account. He said the Staffordshire County Council Auditors, EY, had advised him they hoped to have this done by the end of August which would mean September/October we could finalise our accounts and approve but we were currently in the lap of the Staffordshire Pension Fund and Auditors unfortunately.

Mr Gregory said it was a complicating factor where pension funds have significant property assets the valuers will be valuing them with a material uncertainty and we may need to consider whether there is a material uncertainty as to asset values in the accounts as well – this will need to be dealt with going forward.

The Chairman agreed that McCloud was and is a real issue – equalisation of member benefits is the issue to be valued and recipients have been given 2 options. There has been no ruling from judges yet, which would affect how this valuation is going to go and so it was so very difficult for the County Treasurers/Local Authorities & Staffordshire Pension Fund and their Auditors.

A query was received on the statement in relation to the housing benefit fee about self-interest. Confirmation was sought that there was no issue there for Lichfield District Council because of the small nature of the fee. Mr Gregory responded and said self-interest is one of the 6 threats identified in the Auditor's Ethical Standards and is one of the ways you can judge whether an auditor is likely to be independent. He explained the circumstances in which self-interest could be a problem – for example, if non-audit service fees were much higher than the basic audit fee. Mr Thomas reminded the committee that they had gone through the options available for this specific audit previously and agreed and took the decision that to have the same auditor covering housing benefit work as well as the main audit as this would be less problematic and saved costs.

RESOLVED:- The Committee noted the External Audit Plan for Lichfield District Council 2019/20 & Addendum for year ending 31
March 2020.

8 ANNUAL AUDIT FEE LETTER

A letter setting out a variation to the external audit fee for 2019/20 was presented by Mr Gregory of Grant Thornton. He referred to the fact that the letter had been written in January and had already been discussed with Mr Thomas but he explained the reasons for the increase over and above the fees original prescribed. Mr Gregory referred to the additional fees which had been charged in previous years for the McCloud case and additional work around PPE. He advised that there had been a lot of feedback received from Local Authorities regarding the additional fees and requests had been made that these should be agreed up front this year and, so, following discussions with PSAA (who is their fee setting body) they had done so.

In summary, the costs have gone up because of the increased depth of external audit work now involved around pensions and PPE, following FRC feedback. There was also a change in how the FRC determines what is an acceptable standard for an audit. It used to be that it would only fail an audit at the initial stage but now it can be considered to be a fail at either of the 2 lower stages. The FRC can apply sanctions to the auditors, if they see fit, and understandably this has made them more cautious and focussed.

Mr Thomas advised the committee that he had already agreed the fee to enable Grant Thornton to achieve the financial reporting standards expected accepting that the environment has changed for all external auditors.

There was just one query received regarding the justification for the fee increase relating to the IRFS16 standard now this had been delayed and it was asked if this would show as a saving of £1500 on the balance sheet in these new circumstances. Mr Gregory said there was no plan to do so at the moment as Grant Thornton were waiting to see what the impacts of Covid-19 were rather than withdrawing the £1500 - it was expected that this £1500 would probably be transferred to the Covid-19 related additional work instead. However, this was noted.

RESOLVED:- The Committee noted the Annual Audit Fee Letter 2019/20 for Lichfield District Council.

9 WORK PROGRAMME

The Work Programme for the Audit & Member Standards Committee 2020/21 was discussed. The Chairman explained that the additional list of reports at the end of the Work Programme had already been pre-circulated to all members of the committee from the individual officers and published in a supplementary agenda as those reports were for noting and endorsement only.

Members acknowledged receipt of the additional reports and it was appreciated and useful as any queries or questions were dealt with on receipt direct with the Officer/Author of the report. Congratulations were passed on to all Officers involved in the pre-circulation.

Item 1 – Chair of the Audit Committee's Annual Report to Council – Noted and Endorsed

Item 2 – Annual Report for Internal Audit (including year-end progress report) – Noted and Endorsed

Item 3 –Internal Audit Plan, Charter & Protocol 2020/21 – Noted and Endorsed

Item 4 – Quality Assurance and Improvement Programme/Public Sector Internal Audit Standards – Noted and Endorsed

Item 5 – RIPA Reports Policy & Monitoring – Noted and Endorsed

Item 6 – Annual Governance Statement – Noted and Endorsed

The Chairman asked for any additions/alterations to the Work Programme to be forwarded to him and stated that there may be a need for an additional meeting late September time to accept the Statement of Accounts and this was agreed.

Mr Thomas stated that the pension fund was the key issue on the timing of the accounts and it looked like the earliest we could approve the accounts would be late September and the latest would be November. He noted that there was already a scheduled Audit & Member Standards meeting set for 12 November but because of there being a lot of agenda items for that meeting on the Work Programme, it may be beneficial to hold an additional meeting for the signing of the Statement of Accounts and it would be an opportunity to move some items forward. This will be reviewed and communicated to all members of the committee.

(The Meeting closed at 7.10 pm)

CHAIRMAN