



**Audit committee**

**16:30 to 17:45**

**14 July 2020**

Present: Councillors Price (chair), Driver (vice chair), Giles, McCartney-Gray, Sarmezey (substitute for Councillor Peek), Schmierer and Stutely

Also present: Councillor Kendrick, cabinet member for resources

Apologies: Councillors Peek and Wright

**1. Public questions/petitions**

There were no public questions or petitions received.

**2. Declarations of interest**

There were no declarations of interest.

**3. Minutes**

**RESOLVED** to approve the accuracy of the minutes of the meeting held on 10 March 2020.

**4. Annual Audit Report on Internal Audit and Fraud 2019-20**

(The director of resources declared an interest in relation to Norwich Regeneration Ltd (NRL) as a director of the company and said that dependent on the debate he would leave the meeting if appropriate. Councillor Kendrick was also a director of NRL.)

The chair expressed his disappointment that the former head of internal audit or his colleagues at LGSS were not available to present the report or answer questions.

The director of resources introduced the report of the chief internal auditor (LGSS) whose conclusion was an opinion of satisfactory assurance on the internal control environment; a change from good in the previous year (2018-19). The report highlighted the key areas for the change in the assurance level: NRL, the contract management audit review and the corporate risk register. A positive of the report was that the chief auditor's opinion on the key financial systems was substantial. Members were referred to table 1, on page 17 of the report, and advised that there were five essential priority recommendations and 23 important priority recommendations from the internal audit reviews, and the director of resources acknowledged that in some areas, further work was needed.

During discussion, members expressed their disappointment that they were denied the opportunity to ask the former internal auditors direct questions on the report. The director of resources explained that there had been a miscommunication between himself and LGSS about attendance at the meeting which could be rectified for a future meeting. The chair pointed out that the report provided clear explanations for the chief internal auditor's opinion, changing the compliance level of assurance from good to satisfactory. This was due to the work around contract management and the outstanding issues relating to NRL. He also pointed out that the interim internal audit manager could respond to members' technical questions on the audits. Members concurred that it was valid to continue the discussion on the report.

The chair then commented on the report and expressed regret that the chief internal auditor's opinion had been downgraded to satisfactory. He referred members to the contract management work last year, and in relation to NRL, specifically to paragraph 4.1.5 (page 18 of the agenda papers). The chair said that from a personal perspective he strongly supported the recommendation that there should be a full independent audit review of NRL in 2020-21. The interim internal audit manager agreed that it was disappointing that the actions had not been implemented and that the chief internal auditor's comments in the report were valid. These were only two audit reviews where a limited compliance assurance had caused concern. He confirmed that, following discussions with the chair, the committee could expect two reports or a combined report from officers, in response to the issues raised on NRL and contract management at its November meeting, which should provide assurance going forward. Members were advised of a process for monitoring the implementation of recommendations arising from audit reviews to help the committee conduct its role; comprising of full reports to committee where a limited compliance assurance was given, and not as a matrix appended to the quarterly report on internal audit. The chief executive officer had agreed a new regime to support internal audit, where the corporate leadership team (CLT) would consider progress against the recommendations at its meetings, and within each directorate, and with a system to escalate to the audit committee where necessary. The committee would receive quarterly reports about this until the interim internal audit manager was assured that this process was on a sure footing and embedded within the council. Members were also advised that where a high priority recommendation had not been implemented on the recommended date, that date would be struck through in the report but not deleted, making it easier to keep track of deadlines and monitor progress.

The chief finance officer confirmed that the CLT fully supported the interim internal audit manager's proposal to track audit recommendations and considered that it would be a useful tool. She assured members that the council's leadership team were working to address the outstanding recommendations and that this information would be shared with the interim internal audit manager. The recent recruitment of two non-executive directors would further strengthen the governance.

The interim internal audit manager said that he was unaware of the origins of the request for a full independent audit of NRL and explained that the focus of his report would be on the completion of the actions, with some work around the capital programme. The chair explained that he had requested a full independent audit review of NRL and that it was not in reports or minutes because it was not a view shared by all members of the committee.

During discussion, in response to a member's question, the interim internal audit manager confirmed that he considered that in relation to paragraph 4.6.1 and 4.6.2, Policies and Procedures, there was room for improvement and actions would be included in the matrix attached to the Annual Governance Statement (AGS) to be considered at the next meeting. This review would include identifying what was a key policy, rather than 30 to 40 minor policies, and identifying responsible officers and dates for review.

In reply to a member's question, the director of resources explained that when selecting a contract for internal audit, the most complicated and high value contract had been selected on purpose to benefit from lessons learned through the audit review. He explained that the timescale for the implementation of the essential contract recommendations were still being worked on and were subject to negotiation. The interim internal audit manager confirmed that there would be an officer report on contract management at the next meeting of the committee which would include information on implementation dates.

The chair commented that the corporate risk management register should be updated as there were key details missing and asked how this would be carried out. The interim internal audit manager said that the risk management register formed an important part of the AGS and progress on it would be part of the AGS updates throughout the year. The register would look very different to members when it was presented to committee in January. The chief executive officer wanted to start again with the corporate register. The risk register needed to be embedded in service plans and it would take more than one year to achieve this. The chair welcomed this approach.

**RESOLVED**, having considered the Annual Report on Internal Audit and Fraud 2019-20 to note the work of the internal audit team for 2019-20.

## **5. Draft Annual Governance Statement**

The interim internal audit manager presented the report. The draft AGS would be reviewed up to its publication date (30 November), to ensure that it was current at the time of publication. Actions associated with the AGS would be reported during the year to the audit committee. During the presentation members were referred to Section 6, *Governance issues and actions*, of the AGS, and the interim internal audit manager highlighted the issues under each of the following headings, *Covid-19*, *Joint Venture Insourcing* and *Risk Management*, and pointing out that there would be some changes in the final version.

During discussion the interim internal audit manager confirmed that an action plan of key governance issues would be incorporated into the final AGS and presented to the committee in November. The chair said that he appreciated that an action plan was being included and referred to guidance on AGS and said that it should form a template for future statements. The interim internal audit manager explained that the action plan would contain details of the responsible officer and expected due date, and actions would be reported to committee until that action was cleared.

Discussion ensued on Section 6 and members confirmed that there were significant issues to the council around Covid-19 and bringing joint ventures in house.

A member suggested that a no-deal Brexit was a considerable threat. The interim internal audit manager advised members that Brexit was an identified risk on the corporate risk register but in terms of governance related issues, as set out in Section 6 of the AGS, did not require a specific reference. The director of resources commented that the governance arrangements relating to Brexit had an impact on county or unitary local authorities with social care responsibilities, rather than to the governance of a council as an organisation. The chair pointed out that Brexit had been included in other authorities' statements, and had a direct impact on managing capital programmes, business rates and funding. The interim internal audit manager said that the financial recovery plan would address shortfalls in business rates, short and long term savings plans, and loss of income from car parks. This would be populated in the action plan under the review of the Medium Term Financial Statement (MTFS) which would come before the committee in the future. The chief finance officer explained that the revised corporate risk register would incorporate these issues along action plans. The chair said that the AGS was a customer/resident facing document and that although the detail was in other documents, Brexit was an ongoing risk to the governance of the council and should be given the same clarity as the text on Covid-19, in the AGS.

A member referred to paragraph 20 relating to partnership and other joint working arrangements and said that assurance was needed to ensure that the mistakes with the governance arrangements were not repeated when setting up new partnerships such as Norwich East. The chair referred to the Covid recovery plan and said that there was a proposal to set up a body to oversee the development of parts of Thorpe Hamlet, Crome and Lakenham wards, to the east of Norwich. In reply, officers confirmed that the governance arrangements for NRL were unique to this wholly owned company but that they would take on board members concerns and feedback to colleagues progressing the Norwich East project and other partnership arrangements. Members were also advised that the AGS was for the period 2019-20 with some future projections, but it was not the right place to include governance arrangements for a partnership or body which had yet to be established. During discussion, members pointed out that when this project went forward there would need to be good governance arrangements in place to ensure that it provided good value for money and was accountable, specifically as public and private funding would be used. The chair pointed out that ensuring that the right governance arrangements were in place was a function of this committee. Officers confirmed that the members' concerns would be followed up.

Discussion ensued on the committee's recommendations for governance issues to be included under separate headings in Section 6 of the AGS. The chair also proposed that the capital programme and its funding should be included as a heading. It was suggested that it was important to monitor the governance issues surrounding this programme.

The chair moved and Councillor Schmierer seconded each of the recommendations, which were put to the vote separately. On being put to the vote the committee voted unanimously to include Brexit, and with 5 members voting in favour, 1 member voting against, and 1 member abstaining, to include future partnership arrangements under Section 6, and with 2 members voting in favour, 4 members voting against and 1 member abstaining, the proposal to include the capital programme in Section 6 was lost.

The chair referred to Camden Council's AGS which included a section on the council's achievements and asked why this council did not include its achievements during the period covered by the AGS. The interim internal audit manager said that the council's AGS covered the main governance issues going forward, suggesting that "brevity was key". He suggested that achievements against the action plan could be incorporated into the AGS in future years.

**RESOLVED** to note the draft AGS and to recommend that under Section 6, Governance issues and actions, that *Brexit* and *Future partnership working* are included as headings and narrative text.

(The committee took a short break at this point and reconvened with all members listed above as present.)

## **6. Statement of Accounts 2019-20**

The chief finance officer and interim corporate finance business partner introduced the statement and gave a presentation. (The presentation is available on the council's website.) The chief finance officer referred to the revised timetable for the publication of the statement of accounts and said that it was a credit to the finance team and budget managers that the draft accounts had been submitted in July, well in advance of the revised deadline of 31 August 2020. The interim corporate finance business partner said that the external audit was underway, and the audited statement of accounts would be presented to the committee at its meeting on 24 November 2020. She pointed out that there was no requirement for the committee to approve the unaudited accounts. The public inspection period for the accounts was from 13 July to 23 August.

During discussion the chief finance officer and interim corporate business partner answered members' questions on the statement of accounts. This included assurance that the council's cash flow was monitored on a weekly basis and remained above the minimum balance of £10 million, and was not cause for concern. The council had chosen to fund some of its capital programme in the short term from cash reserves (internal borrowing), thereby saving on external interest charges. Members were also advised that the council had purchased investment properties during 2019-20 and this was shown as "Additions" on the table at the top of page 73 (Statement of Accounts) as part of the agreed borrowing set out in the capital programme. The chief finance officer explained that the movement in pension liabilities related to the triennial valuation undertaken by the pension fund actuaries. These figures fluctuate year on year but movement were reversed out through the Movement in Reserves Statement and therefore did not have an impact on the council tax requirement. In reply to a question from the chair, the chief finance officer explained that in relation to *Cost of Services*, there was an in-year revaluation loss of the council's HRA dwellings showing of £8 million as against the revaluation gain of the previous year. The council's HRA social housing properties amounted to £700 million so the revaluation movement of £8 million was not significant.

The chief finance officer explained that then General Fund prudent minimum level of reserves, which was set at £4.2 million as part of the budget approval, did not factor in the earmarked use of reserves. The council was looking to make in-year savings in 2020-21 to partially offset Covid-19 impacts and ensure that reserve levels remained sustainable and resilient going forward. The chair pointed out that it was

prudent that £4 million had been set aside should NRL fail to repay its loan balance. The chief finance officer confirmed that the accounts reflected this risk and that the related earmarked reserve had been increased following the decision at budget setting council.

The chair commented that the statement of accounts was a “weighty document” with a lot of detail. He drew members’ attention to note 30, *Cash Flow Statement – Operating Activities*, and referred to income generation from car parks and the council’s corporate estate, which the chief finance officer clarified comprised the council’s commercial properties. The chair commented that he was pleased that note 37, *Officers Remuneration* was in the public domain and put into context the pay of senior officers and councillors’ allowances. The chief finance officer explained that discretionary benefits referred to pension benefits through the Local Government Pension Scheme. Officers had received a pay increase in 2019-20.

Discussion then ensued on the correlation between increased borrowing and investment in 2019-20. The interim corporate finance partner explained that £38 million was the amount that was required to borrow to cover capital investment, but as she had explained, the council had chosen to borrow £20 million externally and fund the remainder from internal cash balances instead.

The chief finance explained that note 4, *Assumptions made about future and other major sources of estimation*, was a key note in the statement of accounts, highlighting all the areas where an estimation had been used. Members were advised that there was a higher degree of uncertainty than usual around the valuations on pension and property assets and that the narrative text in the final report would be amended to reflect information available nearer the time.

**RESOLVED** to note the draft Statement of Accounts 2019-2020.

## **7. External Audit Plan 2019-20**

(Mark Hodgson, Associate Partner (external auditor) and Mark Russell, manager, Ernst & Young Ltd (external auditors) attended the meeting for this item.)

The external auditor presented the report which set out their approach and scope for conducting the audit of the council’s financial statements 2019-20 and highlighting the key audit and value for money risks and audit strategy for those risks. The audit process should provide a true and fair view of the council’s financial statements at 31 March 2020.

During discussion the external auditor answered members’ questions on the audit process. The external auditor explained that in relation to property evaluation reference would be made to a market evaluation model and expertise within the company. He confirmed that if there was a difference from the council’s figures then a discussion would be held with officers. The figure needed to be correct so that the auditors could provide assurance that it was correct.

In reply to a question, the external auditor said that the risk of fraud was in every set of accounts and that management override rarely occurred in the public sector but, as seen in the press, it did occur. The external audit needed to provide assurance that no one had overridden a control at any one time.

Discussion ensued on the new financial system and the specific “red” risk identified in the external audit. The chief finance officer explained that the risk was to ensure that all information had migrated to the new financial system which had been operating since November 2019. It had been a two year project and had been a large undertaking. The migration had taken place pre-Covid-19. The auditor would check processes to ensure that data had transferred and was mapping data into the accounts correctly. The external auditor confirmed that they would check that the data set from the old system had transferred into the new system by testing income and expenditure driven by the data to give that assurance rather than testing the number of transactions. This was a relatively short piece of work.

In reply to a question, the external auditor explained that there was no change to the designation of risk or focus in relation to valuation of land and buildings, pension valuations and disclosures, and group accounts, was comparative to the risk on the balance sheet and the designated level of materiality (£3.4 million) and assessment of inherent risk had not changed in the previous year. He explained that the risk was not high where valuations had been conducted by an expert. The risk to the Group Accounts was in the consolidation process to ensure that the correct figures were added in correctly. The chair said that he considered that there should be more scrutiny of the NRL accounts.

A member referred to the proposed increase in fees and the discussion at the previous meeting. The external auditor said that Public Sector Audit Appointments (PSAA) was the regulator that set the fees and had not reviewed them for several years. The level of tests and assurance required from the audit had increased. The risks were set out in the audit plan, including the commercial activity of the council. The external auditor had written to the chief finance officer providing the rationale for increasing the fees and as the basis for the ongoing discussions. The chief finance officer said that the council was not alone in facing the potential increase in external audit fees. A joint letter, representing all Norfolk councils, had been sent to the PSAA, requesting clarification on what was considered an appropriate increase and seeking guidance to inform the discussions with the external auditors. In reply to a member, the external auditor said that the increased fee was to a new base for the minimum amount of work to provide an audit opinion. When pressed, he explained that the current fees did not cover the amount of work required and were not sustainable.

The chair referred to the committee resolution at the last meeting to write to the PSAA and Secretary of State, Department of Housing, Communities and Local Government and explained that because of Covid-19 the deadlines for the publication of accounts had changed, and following consultation with the vice chair, cabinet members and CLT, the action had not been taken. During discussion, Councillor Giles moved and Councillor Stutely seconded, that the chair and cabinet member for resources wrote to the PSAA and Secretary of State to call on the PSAA to support local authorities in the negotiations on the proposed increase of fees, and with the agreement of Councillor Kendrick, and all members it was resolved accordingly.

The chair then commented on the Value for Money section of the plan and welcomed that the impact of Brexit on service provision would be included on operational risk registers. In reply to a question from the chair, the external auditor explained the actions set out as bullet plans in the report, and said that this would be

part of the compliance certification work around the scrutiny of decisions made by NRL and how the council had oversight of that. The chair said that he considered that this was a very vital piece of work and as discussed (under the previous item), £4 million had been put aside to cover the risk to the council of the loan not being paid in full. The external auditor then referred to the actions set out under the *Financial Resilience* heading and commented that the deployment of resources was how the council would use its reserves to compensate for any loss of income. The chair in summing up said that this was an important piece of work as the council was under pressure to maintain services and balance its accounts.

**RESOLVED** to

- (1) agree the approach and scope of the external audit as proposed in the audit plan;
- (2) ask the chair and cabinet member for resources to write to the Secretary of State, Department of Housing, Communities and Local Government and the chief executive of the Public Sector Audit Appointments regarding the proposed increase in baseline fees and requesting that the PSAA supports the negotiation process.

**8. Annual Audit Committee Report 2019-20**

The chair presented the report which was based on the minutes of the meetings and said that both he and the vice chair had been consulted on the content.

The vice chair commented on paragraph 7 of the Annual Audit Committee Report and said that he considered that the work of the external auditors was value for money.

**RESOLVED** to approve the content of the annual audit committee report 2019-20 and recommend that the council adopts it.

CHAIR