

AUDIT AND GOVERNANCE COMMITTEE
Friday 6 February 2015

Present:

Mr G N Cook

Councillors Farthing, T Wright and Mr M Knowles.

In Attendance:

Dennis Napier (Assistant Head of Financial Resources), Tracy Davis (Audit, Risk and Assurance Manager), Mark Kirkham (Mazars), Gavin Barker (Mazars) and Gillian Kelly (Principal Governance Services Officer).

Declarations of Interest

There were no declarations of interest.

Apologies for Absence

Apologies for absence were received from Councillors Speding and N Wright.

Minutes

28. RESOLVED that the minutes of the meeting of the Committee held on 12 December 2014 be confirmed and signed by the Chair as a correct record.

External Auditor – Audit Progress Report

The Director of Finance submitted a report presenting the external auditors' regular Audit Progress Report covering the period up to February 2015.

Gavin Barker reported that Mazars had completed all 2013/2014 audit work, including work on section 256 agreements and on the Port of Sunderland accounts, and were now planning the 2014/2015 audit with the Audit Strategy Memorandum due to be presented to the Committee on 27 March 2015.

Gavin referred to the briefings on fraud from the Audit Commission and National Fraud Initiative (NFI) and which were attached as appendices to the report and would be the subject of a separate item on the agenda. These briefings provided

statistics on identified fraud in Sunderland City Council in comparison to other metropolitan districts and CIPFA nearest neighbours but did not reflect how well the authority was doing and there was a need for Members to more fully understand the arrangements which were in place.

The Chair highlighted the section on 'Questions for Elected Members and Decision Makers' and queried if the Authority was taking advantage of NFI pilot exercises and use of the NFI Flexible Data Matching Service. The Audit, Risk and Assurance Manager advised that the Council did take part in data matching exercises with other organisations as well as the NFI and compared these with the NFI results. The Council also engaged other companies to carry out exercises to identify things such as duplicate payments and it was hoped to make use of the developing Intelligence Hub to bring information in from many different sources.

Councillor T Wright asked about the current position with regard to finalising the Accounts at an earlier stage and Gavin advised that this was to come into effect for the 2017/2018 accounts and that Mazars would undertake planning with the Assistant Head of Financial Resources and his team in order to manage this change.

Having considered the report, it was: -

29. RESOLVED that the Audit Progress Report be noted.

Fraud Briefing for Sunderland City Council

Gavin Barker, Senior Engagement Manager for Mazars and Tracy Davis, Audit, Risk and Assurance Manager delivered a presentation on fraud and law regulations and the arrangements within the Council for preventing fraud and corruption.

The primary responsibility for preventing and detecting fraud and ensuring compliance with laws and regulation rests with management and those charged with governance. There was a wide ranging framework in place to govern this and protecting and detecting fraud was all about good governance.

Gavin summarised the requirements placed on the Council by the Accounts and Audit Regulations 2011 including having in place an internal control system which would enable the prevention and detection of fraud. Under general statute, the provisions of the Fraud Act 2006 and the Bribery Act 2010 were also part of these arrangements. From a financial reporting point of view, the Audit and Governance Committee also had a strong interest in financial statements providing a true and fair view and to support this they needed to be audited in line with professional standards.

Members' attention was drawn to the responsibilities of those charged with governance in relation to prevention and detection of fraud, the compliance with laws and regulations and also the auditor's responsibilities in this area.

Tracy Davis outlined the approach of Internal Audit to tackling fraud and highlighted that this was set out in the Counter Fraud Strategy 2012. The Council had taken a

'zero tolerance' approach to fraud and had many arrangements to deal with this including the Anti-Fraud and Corruption Policy Statement, Whistle Blowing Policy Statement and arrangements for Anti Money Laundering and Bribery Act.

Tracy advised that the Council's Fraud Risk Assessment covered all systems with an inherent risk of fraud mapped against the key risk areas in the Corporate Assurance Map and the fraud risks for each system were then scored for likelihood and impact. There was an auditor within the team dedicated to counter fraud work and tests were undertaken as set out in the risk assessment. Internal Audit would investigate all allegations of fraud, irregularity and corruption and would work closely with Human Resources and the Police, where appropriate. Any weaknesses in systems would be identified and recommendations made to improve controls.

The Committee were provided with an example of how fraud investigation worked in practice in relation to a case where the Insurance team had raised suspicions about a large number of claims from a similar source and a link was found between a group of people who had submitted claims. More evidence was requested than usual and when the case went to court, the claimant admitted that the claim was fraudulent and the individuals running the fraudulent claim company were arrested.

Tracy highlighted that there had also been some cases involving the awarding of contracts and a small number from schools and care homes. In some cases, bribery could have taken place outside of work and the whistle blowing process was relied on to provide information in these cases. It was acknowledged that the risk of fraud could increase when the Council was in the difficult financial position which it was at the current time.

The external auditors were satisfied that the Council had arrangements in place to prevent and detect fraud and corruption and highlighted that Sunderland had detected 2,302 cases in 2013/2014 which represented a value of £1,774,143. This was well above the average for other Metropolitan District Councils which stood at 522 cases, valued at £835,654.

The objective of the external auditor was to identify material fraud and they carried out a fraud risk assessment which aimed to identify and assess the risk of material misstatement due to fraud. Gavin highlighted that Mazars' assessment of Sunderland City Council in relation to fraud risk factors was that there was low risk of material fraud. Auditing standards required 'management override of controls' and 'risk of fraud in revenue recognition' to be considered as 'significant' risks but there were robust audit procedures in place to address these risks.

The Chair asked if the audit procedures to test significant risks mirrored that type of random testing which was carried out by Internal Audit. Gavin stated that there were similarities in the approach, but materiality was always kept in mind and the work would be reported in the Audit Completion report.

Mr Knowles welcomed the comprehensive and thorough presentation and asked if there was anything more which the Committee should be doing to fulfil their responsibilities in being charged with governance.

Gavin said that this was a good question to consider. In his view, the Committee considered a number of ongoing issues and was robust in its approach, but it was always worth revisiting this regularly.

Councillor Farthing highlighted that an area which was always open to fraud was payroll and asked about how the system would be protected given that there were shortly to be huge changes to the pay arrangements for Council employees.

Tracy advised that payroll testing always included checking that staff were being paid on the correct grade and that enhancements were accurate and that work was being done to ensure that the changes were well managed and controlled. Officers were looking at the testing strategy for how payroll would deal with the changes required as a result of the Workforce Transformation project and a lot of work would be carried out between now and April and beyond the implementation date. It was noted that there could be genuine errors as well as fraud in these circumstances and everything possible would be done to mitigate this.

Having thanked Gavin and Tracy for their presentation, the Committee: -

30. RESOLVED that the information be noted.

Treasury Management Policy and Strategy 2015/2016, including Prudential 'Treasury Management' Indicators for 2015/2016 to 2017/2018

The Director of Finance submitted a report informing the Committee of the Treasury Management Policy and Strategy (including both borrowing and investment strategies) proposed for 2015/2016. The report also presented the Prudential 'Treasury Management' Indicators for 2015/2016 to 2017/2018 and asked the Committee to provide comments to the Cabinet and Council on the proposed policy and indicators where appropriate.

The Assistant Head of Financial Resources stated that the Council was required to have regard to the CIPFA Prudential Code and the CIPFA Treasury Management Code of Practice to set Prudential Indicators (including specific Treasury Management Indicators) for the next three years to ensure that the Council's capital investment plans were affordable, prudent and sustainable. The Council was also required to adopt a Treasury Management Policy and to set out a Treasury Management Strategy which comprised the Council's strategy for borrowing and the Council's strategy and policy for managing its investments.

Members were directed to Appendix 2 of the report, the Treasury Management Policy Statement, which set out the Borrowing and Investment Strategies. The Assistant Head of Financial Resources stated that the Council's average rate of borrowing at 3.35% was low in comparison with other local authorities and the rate of return on investments of 0.76% was significantly higher than the benchmark rate of 0.35%. The policy for 2014/2015 had been quite successful and had maintained the continued good performance of the Authority's Treasury Management function.

With regard to Treasury Management Indicators, the Assistant Head of Financial Resources stated that these would ensure that the funds invested provided sufficient cash flow. The Council had set an affordable Borrowing Strategy whilst still having an ambitious Capital Programme and had a responsibility to borrow at the lowest possible rates. The Authority adopted a careful and prudent approach where the prime consideration was the security of the capital funds invested and did not take unnecessary risks. This approach would be maintained in 2015/2016.

Members' attention was drawn to authorised limit and operational boundary for external debt which for 2015/2016 would be set at £454.227m and £360.045m respectively. Mr Knowles asked why there was a large difference between the two figures and the Assistant Head of Financial Resources explained that the operational boundary acted as a warning indicator as the Authorised limit should never be breached, as this was a legal requirement to ensure that borrowing did not exceed the calculated maximum level required by the Authority in any one year. This ensured the level of borrowing by the Authority was effectively capped and the Authorised limit was based on the Council's capital programme borrowing requirements and cash flows in a worst case scenario. In practice action would be taken to resolve any situations where the operational limit could be breached. These limits were an example of the prudent policy adopted by the Council which was well considered and monitored daily to ensure that the limits were appropriate and were being observed.

The Assistant Head of Financial Resources highlighted the more detailed analysis underlying the whole policy within the Treasury Management Strategy Statement for 2015/2016 at Appendix 3. He referred to the table of average PWLB loan rates on page 47 and advised that the Council monitored this and tried to get in at the lowest possible rate. The rate for 50 year lending had dropped further from 2.99% to 2.82% since the report had been published. The Committee were informed that the Council had taken £10m out at 2.84% and would take small chunks of money when there was a trough in the borrowing rates. For information, in 2015/2016 the Council had a potential borrowing requirement of £65m.

The Assistant Head of Financial Resources also explained the new 'bail-in' arrangements that had been referred to in previous reports and the fact that under the new arrangements, risk of financial failure of financial institutions rested with investors and that government support or guarantees were diminishing, and would be removed altogether by January 2016. In fact, one rating agency had already downgraded UK institutions earlier than expected because of this additional risk. This had the effect of downgrading all UK financial institutions' credit ratings. However, UK based banks were taking actions to strengthen their balance sheets in order to be able to cope with a future credit crunch scenario so that investors were provided with appropriate assurance of holding funds with them. In the light of this, the Council's Lending List Criteria had been amended to reflect the changes caused by the 'bail in' arrangements. Recent stringent stress testing carried out by the banks had also revealed that most passed these tests and were improving their positions in this regard. As a consequence, the Authority's Criteria was amended to reflect both the downgrade and also the assurance from the stress testing carried out.

There were no major changes being proposed to the overall Treasury Management Strategy in 2015/2016 and particular areas which would inform the strategy included the extent of potential borrowing included in the Council's capital programme, the availability of borrowing and the current and forecast world and UK economic positions.

Appendix 5 to the report presented an update on the global situation and underlined some potential threats moving forward and the position and possible risks would continue to be monitored.

The Lending List Criteria and approved Lending List were also set out at Appendices 6 and 7 of the report. The reduction referred to in the credit ratings of UK institutions had been reflected within the criteria and lending list and in the level of maximum deposit able to be held with each institution.

Mr Knowles referred to the fixed and variable lending limits and queried the year on year variation. The Assistant Head of Financial Resources advised that this variation was due to the opportunities which would be available each year and there was a mechanism to assess the likelihood of money being taken from each type of lending as required to maintain the necessary levels identified. The limits set out provided the flexibility needed for the coming year ahead.

Having given the report detailed consideration, it was: -

31. RESOLVED that: -

- (i) the proposed Annual Treasury Management Policy and Strategy for 2015/2016 (including specifically the Annual Borrowing and Investment Strategies) and the Prudential 'Treasury Management' Indicators 2015/2016 to 2017/2018 be noted; and
- (ii) the Council be advised that the Committee was satisfied that the arrangements for Treasury Management were in an excellent position for the next and future years.

(Signed) G N COOK
Chair