AUDIT COMMITTEE

MINUTES of a meeting of the Audit Committee held at Committee Room - County Hall, Lewes on 20 September 2018.

PRESENT	Councillors Colin Swansborough (Chair) Councillors Gerard Fox (Vice Chair), John Barnes, Matthew Beaver, Bob Bowdler and Philip Daniel
LEAD MEMBERS	Councillor David Elkin
ALSO PRESENT	Kevin Foster, Chief Operating Officer Russell Banks, Chief Internal Auditor Ian Gutsell, Chief Finance Officer Nigel Chilcott, Audit Manager Marcus Ward, Grant Thornton Darren Wells, Grant Thornton

11 MINUTES OF THE PREVIOUS MEETING HELD ON 13 JULY 2018

11.1 The Committee RESOLVED to agree as a correct record the minutes of the meeting held on 13 July 2018.

12 APOLOGIES FOR ABSENCE

12.1 There were none.

13 DISCLOSURES OF INTERESTS

13.1 There were none.

14 URGENT ITEMS

14.1 None notified.

15 INTERNAL AUDIT PROGRESS REPORT - QUARTER 1, 2018/19

15.1 The Audit Manager introduced the report. The outcomes of the audits for the first quarter of 2018/19 are shown in the graph on page 11 of the report. The majority of opinions were reasonable assurance, and no audits had a minimum assurance opinion. There were two audits that had a partial assurance opinion, both of which related to school audits. The Chief Internal Auditor continues to be able to provide reasonable assurance that the Council has in place an effective framework of governance, risk management and internal control. A summary of investigations carried out during the quarter is given on page 22 of the report. The Key Performance Indicators for the Internal Audit Service are shown on page 23 onwards, all of which are being met.

Preparedness for the General Data Protection Regulation (GDPR) Audit

15.2 The Committee asked how significant the outstanding issues from the Audit are. The Audit Manager responded that he understood work on these issues was underway and that the Information Commissioner's Office (ICO) acknowledged that many organisations would still have work to do in this area after the 25 May 2018. The Chief Operating Officer outlined that regular update reports are produced by Heidi Judd, Data Protection Officer on the implementation of GDPR and no areas of significant concern have been highlighted when monitoring the implementation of GDPR. The Chief Internal Auditor outlined that there will be a follow up audit later in the year, which will look at GDPR compliance as well as implementation of the audit recommendations.

15.3 The Chief Operating Officer added that a County Council Information Strategy Board has been established to overview information governance and GDPR matters, to ensure personal data is held securely and to minimise the risk of data breaches. For example, the access controls for Council mobile phones are robust in terms of what applications can be accessed and used by staff.

School Audits

15.4 The Chair noted that the School audits (on page 21 of the report) received a partial assurance opinion and asked what the issues were. The Audit Manager agreed to provide the Chair with details of the main issues from the full audit report.

Contract Management Audits

15.5 The Committee asked for clarification on whether the audit of contracts, such as the Management of Mobile Phone Contract audit (page 14 of the report), consider conformance with local government transparency code. The Chief Internal Auditor confirmed that audits do look at this issue, but it was not in the scope of this specific piece of work.

15.6 The Committee RESOLVED to note the outcomes of the audits carried out during the reporting period and did not identify any issues that require further action, or any risks for inclusion in the Internal Audit Plan.

16 RISK MANAGEMENT FRAMEWORK AND STRATEGIC RISK MONITORING REPORT - QUARTER 1, 2018/19

16.1 The Chief Operating Officer introduced the report. The report incorporates the latest risk register and outlines the changes since the last strategic risk monitoring report. Section 3 of the report outlines the risk management process.

Schools

16.2 The Committee noted that the risk register has two risks concerning schools but neither appears to be concerned with the long term funding of small schools. The Committee understands that the national funding formula cut off is around 150 pupils, but there are many smaller schools which may get into financial difficulties. This is a risk to the budget of the whole Council as there is a potential impact on capital spending for schools, and an increase in the school transport budget if children have to travel further to school.

16.3 The Committee would like more information on how many schools may be affected, the nature of the problems they may face and how the Council is planning to address this issue. Although this risk may be on the departmental risk register, the Committee would like more detail on why the Council is satisfied that the risk is being controlled.

16.4 The Chief Finance Officer responded that work has been undertaken to model the impact of the proposed changes to the national funding formula based on discussions with Children's Services. The Chief Operating Officer advised that the implications of the national funding formulae would be considered as part of the Reconciling, Policy, Performance and Resources (RPPR) planning process. The Committee's view on the risk to small schools being on the corporate risk register will be referred to the People Scrutiny Committee.

16.5 The Committee commented that the risk to small schools should be on strategic risk register until an assessment has been completed and the Audit Committee is assured that mitigation measures are in place. The work that is being undertaken should be summarised in the mitigation column of the risk register, where it is visible to Members. The Committee recommended that the funding risk to small schools is added to the strategic risk register.

Cyber Attack

16.6 The Committee asked if the Council has the capability to react rapidly to a Cyber-attack. The Chief Operating Officer responded that the Council is well prepared and its information management practices are strong. However, there is always a first organisation to be subject to a new threat. The Chief Operating Officer gave reassurance that the Council has the controls in place to protect the Council's and residents' information.

Disorderly Brexit

16.7 The Committee commented that Brexit is not mentioned on strategic risk register if there is a disorderly exit. There is a risk from an adverse currency fluctuation and higher inflation, plus an impact on ports. Therefore, a disorderly Brexit should be on the strategic risk register. The Chief Operating Officer responded that the Brexit risk had been considered but further review was required to define the risk and mitigations. At present it is difficult to put in place mitigations when the actual impacts remain unknown. However, the Committee's comments have been noted and this risk will be will revisited in November.

16.8 The Committee considered that November is too late to start work on this issue and would like assurance that this work is going on now. The Brexit timeframe is very tight and it is not ideal for it not to be on the register until we have a fully informed approach. Although the Council may not know what the exact impacts will be, it is likely to have impact on the economy and cause transport disruption. The Committee accepts that is difficult to model impacts, but it is better to have made an assessment and examined what the mitigations might be.

16.9 The Committee outlined that the impact of higher inflation and currency fluctuations, plus the impact on ports are the most likely outcomes of a disorderly Brexit. The Committee suggested that it might to helpful to focus on specific areas of risk such as:

1. A break down in the supply chain for the Council's suppliers and local businesses;
2. Blockages to the transport system especially at ports (e.g. Newhaven).
3. The cost inflation impact on staffing and suppliers of an adverse currency fluctuation and higher inflation.

16.10 The Chief Operating Officer explained that the Procurement Team has taken these impacts into account. The fact that Brexit is not on the strategic risk register, does not mean officers are not working on this. However, he accepted the point that the Committee is making about the visibility of the work being undertaken to Members.

16.11 The Committee agreed that it would be good to idea to have a report in November on the impact of a disorderly Brexit, so that the Committee can be assured that work is being undertaken on mitigating the specific impacts. So the risk is defined, quantified and assessed as far as is possible.

Risk Management Framework

16.12 The Committee commented that the strategic risk register contains two types of risk. Some are external factors and some arise due to the failure to do something. In terms of the strategic risk register it would be helpful if officers could include work that is being undertaken, as it is not currently visible to Members. The Committee does not want the risk process to obscure the work that is being undertaken and would like the process to reflect the work that is underway that may not appear on register.

16.13 The Committee RESOLVED to:

1) Recommend that the financial risk to small schools is added to the strategic risk register; and
2) Have a report on the risk arising from a disorderly Brexit at the November meeting, and recommend that it is added to the strategic risk register.

17 MINIMUM REVENUE PROVISION CALCULATION

17.1 The Chief Finance Officer introduced the report and outlined the background and accounting regulations for the Minimum Revenue Provision (MRP). MRP is a charge to the revenue account that reflects the cost of borrowing incurred for a capital asset that is delivering services/adding value in a financial year. The report detailed a number of ways by which MRP could be calculated under previous and current accounting regulations. The report outlined the opportunity to change from the current straight line methodology to an annuity basis, which better reflects the use of the asset over time and the changing value of money.

17.2 The views of the Committee were sought and these would be taken into consideration during the RPPR process and whilst refreshing the Treasury Management Strategy. The Committee will have the opportunity to revisit the issue of MRP when the Treasury Management Strategy was considered by the Committee in November 2018.

17.3 The Committee discussed the MRP calculation method and noted that the current repayment method favours future tax payers. If an annuity method is adopted, ultimately the amount paid is the same but the phasing is different. In the earlier years the MRP payment is less, but in the later years the payment is more. The Committee asked if there was a disadvantage in changing to an annuity method.

17.4 The Chief Finance Officer responded that the report illustrates how the repayment may change over time, but it is difficult to say what the repayment will be in the future, as capital needs and financing will change over time. The MRP is an accounting charge and changing to the annuity method would be more reflective of the time value of money (i.e. it reduces over time). The Chief Finance Officer clarified that the application of the MRP calculation happens as part of the annual Statement of Accountants. The external auditors as part of the year end audit process will assess the reasonableness of the MRP policy applied, within the context of the overall accounts.

17.5 The Committee discussed whether to recommend a change in the MRP calculation method in response to recommendation 3 of the report. The Committee supported a change to the annuity method as it is appropriate on an intellectual and practical basis. In doing so, the view of the Committee would be taken into consideration as part of the RPPR process. Any change to the MRP calculation basis would be part of the Treasury Management Strategy, and need approval of Cabinet and Full Council in due course.

17.6 The Committee RESOLVED to recommend a change to the annuity calculation method for MRP, for inclusion in the RPPR process and approval by Cabinet and Full Council.

18 COUNCIL RESERVES REPORT

18.1 The Chief Finance Officer introduced the report. He outlined that the overriding consideration is that the level of reserves are sufficient to mitigate risk, in its various forms, and to allow for transformation and organisational change. The Robustness Statement in appendix 2 outlines the risks that are taken into account as part of the assessment of the level of reserves needed in the RPPR process. Appendix 4 shows the future plans for reserves at this point in time, but these may change as part of RPPR process.

18.2 The Committee asked if the Council has enough reserves to cope with the move from Rate Support Grant (RSG) to business rate retention funding, and the possibility that the amount of revenue from business rate retention is less than expected. The Chief Finance Officer outlined that the Medium Term Financial Plan (MTFP) has been set out on the basis that the Council does not fully know the impact of business rate retention and the withdrawal of RSG, so the reserves reflect this position. The Council has enough reserves to cope with this situation, but cannot be certain what the impact will be in the longer term.

18.3 The Chief Operating Officer added that reserves can only be used once, and the issue of business rate retention will be ongoing. So it is not possible to give an assurance that reserves can cope with this funding change in the longer term.

18.4 The report sets out the amount of useable reserves as a percentage of the net revenue budget that ESCC has in comparison with our South East Seven neighbouring authorities (table 1, paragraph 2.7 of the report). ESCC's useable reserves as percentage of net revenue are 17.4%. This compares with the average County Council 30%; London Boroughs 58%; Outer London Boroughs 44%; and Metropolitan Councils 40%.

18.5 The Committee asked if the move to a Core Offer of statutory services increases risk. The Chief Operating Officer outlined that the move to a Core Offer addresses the increased risks from the reduction in central Government funding and as such de-risks service delivery. The Chief Finance Officer added that the reserves are held to mitigate the impact of change, and there is an assessment of the risk of moving to the Core Offer. Financial, service and transformation risks are embedded in our approach. So under the Core Offer, if departments have identified increased risk as part of transformation, then the Council will take this into account when assessing the level of reserves.

18.6 The Committee asked for clarification on the term 'useable reserves'. The Chief Finance Officer explained that useable reserves is an entry in statement of accounts that incorporates all reserves that have been listed, as well as carry forwards, under regulation IAS20, of underspent departmental grants. The figures in appendix 3 and 4 do not include unspent grants, so the figure for useable reserves in the statement of accounts is slightly higher.

18.7 The Committee considered that the level of contingency and the General Fund was prudent, and that the general level of reserves appeared to be about right. However, the Committee would like further clarity on how the different reserves could be used (e.g. Service Specific and Strategic reserves), and found the term 'earmarked reserves' unhelpful in describing what the reserves were for and how they could be spent. It was suggested that the way the reserves are presented should be reviewed to help the public understand what they are for, and to emphasise that they could only be spent once.

18.8 The Committee acknowledged that it was difficult to get the level of reserves right as the Council will be criticised if it has too many reserves or spends reserves too much. It discussed the difference between Service Specific and Strategic reserves as detailed in appendix 3.

18.9 The Chief Finance Officer outlined what the Council is able to change (i.e. has a level of discretion to review the risk and need for the reserve) the £75m of reserves which are held as strategic and service specific reserves as detailed in appendix 3. These are subject to review as part of the RPPR process in line with the current reserves policy and an assessment of the robustness of the policy. For example, the Waste Reserve in 2014 was £35m. This was reviewed and a judgement made that the Council did not need to hold that amount of reserve, so it was reduced to £12m. The money released by the review was then reallocated to support the capital programme.

18.10 The Chief Operating Officer outlined that the Chief Finance Officer undertakes an ongoing review of the level of reserves required, and whether they can be used as part of RPPR process. Any recommended changes will be reported through the Audit Committee and the RPPR process as part of the Treasury Management Strategy and Reserves Policy update.

18.11 The Committee commented that it would like to see an explanation of use and review of reserves somewhere, perhaps as part of the Reserves Policy. It agreed that the reserve balances that can be taken into account in the RPPR process is everything listed in appendix 3 apart from those balances held on behalf of others (e.g. school balances).

18.12 The Committee RESOLVED to:

1) Note the current approach to reserves and balances; and
2) Agreed that the reserves and balances that can be taken into consideration within the RPPR process, is everything listed in appendix 3, except the balances held on behalf of other people.

19 WORK PROGRAMME

19.1 The Committee discussed the future work programme and noted that the issue of reserves will be considered as part of the RPPR process.

19.2 The Committee asked for an update on ownership of schools between ESCC and the Diocesan authority, which was previously highlighted in the annual statement of accounts. The Chief Finance Officer agreed to provide an update on progress to the Committee via email.

19.3 The Committee confirmed that it was happy with the agenda items planned for the November meeting.

The meeting ended at 11.46 am.

Councillor Colin Swansborough (Chair)
Chair