London Borough of Hammersmith & Fulham

Audit, Pensions and Standards Committee

Minutes

Thursday 27 September 2012

PRESENT

Committee members: Councillors Michael Adam (Chairman), Marcus Ginn, PJ Murphy and Lucy Ivimy.

Coopted Member: Eugenie White

P-SOLVE: John Conroy

Audit Commission: Julian McGowan

Trade Union Representative: Sheela Selvajothy

Officers: Jane West, Executive Director of Finance and Corporate Governance, Hitesh Jolapara, Bi-Borough Director for Finance, Jonathan Hunt, Tri-Borough Director of Treasury and Pensions, Mark Jones, Bi-Borough Director for Finance, ELRS and TTS, Debbie Morris, Bi-borough Director for Human Resources, Christopher Harris, Head of Corporate Accountancy and Capital, Bob Pearce, Pension Fund Accountant, Geoff Drake, Chief Internal Auditor, Michael Sloniowski, Principal Consultant- Risk Management, George Lepine, HR Consultant, and Owen Rees, Committee Coordinator

19. MINUTES OF THE PREVIOUS MEETING

Jonathan Hunt, Tri-Borough Director of Treasury and Pensions, updated on actions from the last Committee. He said that information on fees was contained elsewhere on the agenda and had been forwarded to members in August. He said that the minutes of the meeting that had issued a mandate to Majedie's Tortoise Fund made clear that it was a long/short fund, and made no reference to emerging markets, though the mandate for MFS had been varied to give more exposure to emerging markets equities.

RESOLVED THAT

(i) The minutes of the meeting on the 28th June 2012 be agreed as a true and correct record, and that;

(ii) The outstanding actions be noted.

20. APOLOGIES FOR ABSENCE

There were apologies from Councillors Cartwright and Iggulden.

21. DECLARATIONS OF INTEREST

Councillor Murphy declared an other interest as a member of the Pension Fund in items 23, 24, 26 and 35.

22. REVISED TERMS OF REFERENCE

The Chairman noted that the appointment of the Vice-Chairman had been deferred from the previous meeting, and in line with the nomination made by the Opposition Whip, proposed that Councillor Murphy be appointed as Vice Chairman.

RESOLVED THAT

(i) The revised Terms of Reference be noted, and that;
(ii) Councillor Murphy be appointed as Vice-Chairman for the 2011-12 Municipal Year.

23. LEGAL AND GENERAL PRESENTATION

Jonathan Hunt, Tri-Borough Director of Treasury and Pensions, said that, in light of the full agenda, it had bene decided to defer the presentation by Legal and General to a future meeting.

24. PENSION VALUE AND INVESTMENT PERFORMANCE

John Conroy, P-Solve, introduced the quarterly report to the 30th June 2012, and set out the market conditions that had served as the background to that performance. He said that global markets were experiencing a period of unprecedented instability, in which attitudes to risk meant that assets were bought and sold at prices that did not necessarily relate to their underlying value. He said that this was particularly the case with US, German and UK index linked gilts, the last of which had a considerable impact on the fund.

He said that risk aversion had caused yields on index-linked gilts to fall to their lowest ever level. He said that a number of factors and uncertainties were contributing to this environment, including the problems in the Eurozone, the fiscal cliff faced by the United States and the possibility of a “hard landing” for the Chinese economy. He said that this had resulted in money flowing into UK gilts in search of a safe haven, even if the underlying position of the UK economy and government finances did not necessarily warrant this.

He said that, in the quarter year under review, the fund had underperformed the liability benchmark, though this underperformance should be set against the performance of the Legal and General benchmark, which illustrated the high rise in gilt prices. He then set out the performance of individual managers, outlining the chief factors affecting their performance.

Councillor Murphy asked how Majedie has performed against the FTSE All Share. Mr Conroy said that this could be seen by subtracting 2% from their performance. He said that this showed a clear underperformance in the most recent period, but that there had been out performance on a 1 and 2 year rolling basis.

Councillor Ivimy asked about the fund's lack of exposure to non-index linked government bonds. Mr Conroy said that funds in general did not hold a high quantity of that type of asset, and that there was uncertainty around the asset class, given the high prices for gilts.

Councillor Ivimy asked why, given that its intended purpose and ability to short stocks, the Tortoise Fund had not contributed stronger performance during the turbulent period. Mr Conroy said that Majedie would argue that this was a result of stock specific return, that shorts could fail, and that pricing of shares was showing extremes of valuation which might caused managers to purchase shares rather than sell. Bob Pearce, Pension Fund Accountant, said that the Tortoise Fund was home to around of 8% of the Council's investment with Majedie, so short positions taken would be relatively small.

Mr Pearce said that, with regards to the performance of the Fund as a whole, it had been in the 6th percentile of local authority funds in the previous financial year, with those funds that had outperformed it being closed funds, invested entirely in index-linked gilts. He noted the extreme fluctuation in markets, which had seen the fund's value rise to £650 million in the present quarter before falling back to £639 million at the date of the meeting.

Councillor Murphy asked, in light of the unusual and unprecedented market conditions, how well the fund's managers were able to cope, particularly if such conditions were to become normal. Mr Conroy said that there were both strategic and tactical considerations. He said that he was confident that the Fund had the right strategic position and that its assets were allocated appropriately. However, he said that there was the possibility that interest rates could remain as low as they were at present for the medium to long term, as had happened in Japan, and this would affect what position was taken on holding equities. He also drew attention to the debate around the inflation measurement. He said that any changes in the strategy, however, moving excess returns from the Matching Fund, would raise the issue of what was a more appropriate asset class for those funds to be used on, given the function of the matching fund. In response to a question from the Chairman, he said that the current market position meant that options would be extremely expensive, due to the difficulty of finding a counterparty. He said that it was his view, and that of officers, that the next valuation would be the appropriate time to review strategy and those charged with implementing it.

Mr Pearce said that, to give comparison, the fund had returned 8.2% for the financial year 2011/2012 which compared very favourably with other London Local Authorities whose returns ranged from 8.2% to 2.6%, with Majedie returning 6.5% against an average of 2.2% for managers in their class, placing them in the 5th percentile, while MFS returned 7.2% against 2.1% for managers in their class, placing them in the 1st percentile. He said that both Ruffer and Barings also outperformed the average fund return, at 4.8 and 4.7% respectively. Mr Conroy

said that, notwithstanding any future changes to the structure of the fund, P-Solve were satisfied with the performance of the Dynamic Asset Allocation mandates.

Mr Conroy concluded by saying that two managers from Majedie's ex-UK equities team had departed, with the funds they managed to be wound up. He did not believe that this would have a direct impact on the management of the Council's funds.

RESOLVED THAT

(i) The report be noted.

(ii) That the Committee record a vote of thanks to Bob Pearce for the advice and expertise he had given during his service with the Council, and wish him luck for his retirement.

25. TREASURY MANAGEMENT 2011-12 OUTTURN

Jonathan Hunt, Tri-Borough Director of Treasury and Pensions, introduced the report which set out the Treasury Management Outturn for the previous financial year. He set out the profile of the Council's debt, and its underlying borrowing need (Capital Financing Requirement). He also explained the structure of the Council's debt, including maturity dates.

The Chairman asked why the Council had held so much cash. Mr. Hunt explained that this was an issue of timing.

Councillor Murphy asked about the Council's loan to Birmingham City Council. Mr Hunt said that Birmingham was rated AAA, and that inter-authority lending was not uncommon, particularly given the poor rates of return available from other sources. In response to follow-up questions about Council's credit ratings, he said that a number of Councils currently possessed credit ratings, generally of AA+ or above. He said that this had occurred largely as those Councils had sought to borrow directly in the money markets, due to the high rates asked by the Public Works Loan Board (PWLB). The PWLB had subsequently lowered rates, meaning that the planned borrowing did not take place. Mr. Hunt said that given the costs involved, gaining a rating was only necessary if the Council planned to directly issue debt.

RESOLVED THAT

The report be noted.

26. LONDON BOROUGH OF HAMMERSMITH AND FULHAM STATEMENT OF ACCOUNTS, INCLUDING PENSION FUND FOR 2011/12

Hitesh Jolapara, Bi-Borough Director for Finance, introduced the report, which set out the accounts for the 2011-12 year. He said that the accounts had been given a clean bill of health by the auditor, with no issues found on the Pension Fund accounts. He drew attention to some of the major changes that had taken effect

during the year, including the inclusion of heritage assets and the repayment of £197 million of Housing Revenue Account debt.

Julian McGowan, Audit Manager, Audit Commission, said that the Auditor would be able to issue an unqualified opinion with no outstanding objections. He said that the process of the audit had gone very well with the accounts presented in good time and queries responded to quickly. He said that the accounts could be approved and that the recommendations made in the audit had received a positive response.

Eugenie White asked about the difference between the accounts as stated on page55 and on page 81. Christopher Harris, Head of Corporate Accountancy and Capital, said that the table on page 81 showed the balance sheet under International Financial Reporting Standards (IFRS). He said that this meant that impairments that were shown as due in their entirety, the Council's Pension Fund debt for instance.

Councillor Murphy asked, given the financial risks identified, whether the reserves were high enough. Jane West, Executive Director of Finance and Corporate Governance, said that it was her view that balances would need to be added to rather than reduced, but that they were already considerably higher than when she took the post.

Councillor Ginn asked Mr McGowan how the Council's performance compared to other boroughs. Mr McGowan said that it had been an easier process than the previous year had been, due to IRFS being better established. He said that, in his experience, the Council was among the top 10 percent in London for responsiveness and the quantity of adjustments required.

Councillor Murphy asked about the disposal of finance leases. Mr Harris explained that one related to the freehold for the Novotel in King Street, which had been sold during the year. He said that the other one related to the Metro building nearby, which while listed for disposal, was the subject of a complex legal position, making negotiation necessary and a timetable for that disposal uncertain. Officers agreed to send the Committee a briefing on the position of the site.

Councillor Murphy asked why, given the pay freeze for staff employed by the Council, senior staff had continued to receive pay rises. Ms West said that the rises had been contractual, and related to performance related pay; she said that all staff entitled to a contractual increase had received one, but that 92% were already at the top of their pay band. She confirmed that bonuses paid were pensionable.

The Chairman asked whether there was a breakdown of the £26 million in savings. Ms West said that the pay scales for senior officers and the breakdown of savings had been reported to full Council, and officers would circulate details.

The Chairman said that the degree of overspend was noteworthy, and wondered if it reflected issues with budgeting. Mr Jolapara said that managers, given the overall environment, had incentive to make savings early, and that there was no

culture of spending to budget within the organisation. Councillor Ginn said that, if business objectives were met, underspend had to be considered a success.

Eugenie White asked about the issues with short term debtors identified in the auditor's report. Mr Harris said that there could be good reason for debts to remain on the Council's books, past the point at which they would normally be written off, giving the example of charges on property. He said that the report had identified that the Council needed to improve its record keeping however.

RESOLVED THAT

(i) That the content of the Auditor's Annual Governance Reports, which state that the accounts will receive an unqualified opinion, are free from material misstatements, that the Council has an adequate internal control environment and has made proper arrangements to secure economy, efficiency and effectiveness in the use of resources, be noted, and;

(ii) That the Council's response to the Annual Governance Reports (AGR) be noted, and;

(iii) That the management representation letter (as included with the AGR) be approved, and;

(iv) That the Statement of Accounts for 2011/12 be approved.

27. 2011/12 WORMWOOD SCRUBS CHARITABLE TRUST ACCOUNTS

Hitesh Jolapara, Bi-Borough Director For Finance, introduced the report, which set out the accounts, trustees' report and auditor's report for the Wormwood Scrubs Charitable Trust for 2011/12. He said that the audit had given the accounts a clean bill of health, not identifying any material issues.

Councillor Ivimy said that running the Trust running a deficit had been unfortunate. Mark Jones, Bi-Borough Director for Finance, ELRS and TTS, said that this represented investments made in the Linford Christie Stadium with a view to increasing income from the site. He said that there had also been a fall in pay and display income, a fall which had been in line with sites elsewhere.

In response to a question from Eugenie White, Mr Jones said that he did not know the source of the reserves, though it was likely to be a result of surpluses maintained over a long period. In response to further questions, he said that he did not believe that the car park area needed resurfacing at present, and that he would check and report back to the Committee on the duration of the Quadrant contract.

RESOLVED THAT

(i) The Wormwood Scrubs Charitable Trust's 2011/12 audited statement of accounts and Trustee's report be approved, and that;

(ii) The content of the Auditor's Annual Governance Report (AGR) stating that the accounts will receive an unqualified opinion be noted, and that;

(iii) The management representation letter (as included with the AGR) be approved, and that;

(iv) The 2012/13 contribution to the running costs of Linford Christie stadium up to a maximum of £115,500 be approved.

28. ANNUAL GOVERNANCE STATEMENT 2012

Geoff Drake, Chief Internal Auditor, presented the Annual Governance Statement. He said that it identified 5 extant control weaknesses, the remainder were included to close those identified last year that have been resolved. It was also explained that at future meetings of the Committee reports will be provided identifying the action plans to address these outstanding weaknesses plus External Audit recommendations from their Annual Governance Report, and progress made in miiplemnteting these plans..

Eugenie White asked whether the Statement included measures to combat fraud in schools. Mr Drake said that the alleged fraud had taken place in relation to voluntary funds, and as such had not been a control weakness for the Council. Work to promote awareness was undertaken as part of school audits.

With regards to gas safety certification, Mr Drake said that he would report to Committee members the wider risks and how they are being overseen, but that with regards to the allegations discussed at the last meeting, the Council had been convicted and fined £105,000, which was at the lower end of the available penalties.

RESOLVED THAT

That the Annual Governance Statement for 2012 be noted.

29. VOLUNTARY DISCLOSURE TO HMRC

George Lepine, HR Consultant, presented the report which set out the voluntary disclosure made to HMRC by the Council with regards to a group of workers whose employment status had been incorrectly judged. He said that following discussion with HMRC since the report was written, the figures for possible liability should be amended. He said that HMRC assessed the liability at £471,000, though this would be off-set against tax paid by the individuals affected; he said that this might mean a reduction of 50% or more in that element due on the basis that tax had been paid. In addition, the Council was likely to be charged an interest payment, and a penalty charge, although LBHF was negotiating with HMRC with a view to suspending the charge subject to the outcome of a further audit. He said that the worst case scenarios would see the Council paying £640,000 while the best case would see the Council paying £350,000.

Councillor Ivimy asked if the individuals involved had been notified. Mr Lepine said that HMRC did not allow the Council to contact the individuals on this matter.

Councillor Murphy noted that a penalty for "careless error" was likely. He asked what other penalties could have been charged. Mr Lepine said that there were four categories: error, careless error, where it was judged that reasonable care had not been taken to get things right , deliberate error, where the underpayment was knowingly committed, and deliberate and concealed error, where the underpayment was deliberate and there had been subsequent attempts to conceal the underpayment from HMRC.

Councillor Murphy asked when members had been informed of the decision to write to HMRC in February, stating that the Council was considering a voluntary disclosure. Jane West, Executive Director of Finance and Corporate Governance, said that she may have informed the Leader but would need to confirm this. She said that the possible need to make such a disclosure had been set out in the report agreed by Cabinet in January 2012 for a review of cases in which people might have been incorrectly dealt with as self employed for tax purposes and the provision of tax advice. She would give details of what steps were taken to inform Councillors once the decision to make a disclosure was made.

RESOLVED THAT

The report be noted.

30. COMBINED RISK MANAGEMENT HIGHLIGHT REPORT

Michael Sloniowski, Principal Consultant- Risk Management, introduced the report, which set out risk management activity undertaken in the previous period. He drew attention to the stress on the public sector as a whole as set out in 2.2, and for organisations generally, as the dependencies on IT increased. He drew attention to the work done by CIPFA on financial risks, by PWC on fraud risk and to the changes made to the Council's risk register in the period.

Councillor Ginn asked what the largest area of risk for the Council was. Mr Sloniowski said that the unprecedented pace and scale of change was the largest source of risk, particularly in ensuring that process kept pace with organisational change.

The Chairman asked about the risk of cyber attack. Mr Sloniowski said that he understood the increased risk to be due to the seriousness of any disruption increasing, but that he would check with the Bridge Partnership how the Council was protected.

Councillor Murphy asked about the risks of a child protection incident, and the risks of embedding cultural change in that area of work. Mr Sloniowski said that it was a closely monitored area, and that it was an area with a wide range of risks. Jane West, Executive Director of Finance and Corporate Governance, said that the Council did work to improve productivity in the service.

Eugenie White noted that the prevalence of social media meant that any incident had the potential to escalate in terms of media attention, and suggested that this was not fully reflected in the risk register. Councillor Murphy asked whether the Council had access to a crisis management service, in the event of an incident with media attention similar to the then current story in East Sussex. Mr Sloniowski said that he would check with the relevant director.

RESOLVED THAT

The report be noted.

31. INTERNAL AUDIT QUARTERLY REPORT

Geoff Drake, Chief Internal Auditor, introduced the report, which set out Internal Audit performance in the previous period. He said that of 16 reports and 3 management letters issued in the period, 5 limited assurance reports had been issued, one of which formed a separate report on the agenda. He said that all recommendations from the other reports had been reported as implemented. He also identified that 5 reports and 2 recommendations remained outstanding beyond their due dates, a worsening of the position since the last two Committee meetings had none past their due dates which shows the quality of delivery of the Audit Manager who had recently left. It was further reported that the draft internal audit plans for the 20013/14 year have started to be developed in preparation for reporting to the Committee in February 2013.

RESOLVED THAT

That the report be noted.

32. FINAL INTERNAL AUDIT REPORT FOR NATIONAL NON-DOMESTIC RATES (NNDR)

RESOLVED THAT

The report be noted.

33. EXCLUSION OF THE PUBLIC AND PRESS

RESOLVED THAT

Under Section 100A (4) of the Local Government Act 1972, that the public and press be excluded from the meeting during the consideration of the following items of business, on the grounds that they contain the likely disclosure of exempt information, as defined in paragraphs 1, 3 and 7 of Schedule 12A of the said Act, and that the public interest in maintaining the exemption currently outweighs the public interest in disclosing the information.

34. EXEMPT MINUTES OF THE MEETING HELD ON 28TH JUNE 2012

RESOLVED THAT

The exempt minutes of the meeting held on the 28th June 2012 be agreed as a trued and correct record.

35. FUND MANAGEMENT FEES

RESOLVED THAT

The report be noted.

36. FINAL INTERNAL AUDIT REPORT FOR NATIONAL NON-DOMESTIC RATES (NNDR)- EXEMPT ASPECTS

RESOLVED THAT

The report be noted.

Meeting started: 7.00 pm
Meeting ended: 9.35 pm

Chairman .....

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