



London Borough of Hammersmith & Fulham

# Audit and Pensions Committee Minutes

Thursday 8 December 2011

## PRESENT

**Committee members:** Councillors Michael Adam (Chairman), Nicholas Botterill, Marcus Ginn, Robert Iggulden, Michael Cartwright (Vice-Chairman) and PJ Murphy

**Apologies for Absence:** Eugenie White (Coopted Member)

**Trade Union Representative:** Sheela Selvajothy

**In Attendance:** Jon Hayes and Julian McGowan, Audit Commission  
Steve Russell and Caroline Ader, Ruffer, Helen Smith, Nikhill Agarwal and John Conroy P-Solve

**Officers:** Jane West, Director of Finance and Governance, Hitesh Jolapara, Deputy Director of Finance, Geoff Drake, Chief Internal Auditor, Dave McNamara, Assistant Director of Finance, Environment and Children's Services, Michael Sloniowski, Principal Consultant, Risk Management, Bob Pearce, Group Accountant - Technical and Owen Rees, Committee Coordinator

## 35. MINUTES OF THE PREVIOUS MEETING

### RESOLVED THAT

The minutes of the meeting held on 22 September 2011 be agreed as a true and correct record.

## 36. APOLOGIES FOR ABSENCE

There were apologies for absence from Eugenie White.

## 37. DECLARATIONS OF INTEREST

Councillor Cartwright and Councillor Murphy declared personal interests in items 38, 39, 40, 41, 42 and 43 as members of the London Borough of Hammersmith and Fulham Pension Fund.

### **38. PENSION FUND MANAGER PRESENTATION- RUFFER**

Steve Russell, Investment Director for Ruffer LLP, gave a presentation on Ruffer, their investment approach and their current thinking, with particular emphasis on alternative investments. He said that Ruffer were focused on absolute return investment only, and held a wide variety of assets, which were chosen with the aim, in the first instance, of protecting the capital under management. He said that making returns was extremely difficult, given the prevailing economic climate.

He said that, while a significant proportion of the funds under management at Ruffer were invested in equities, the fund was also investing heavily in index-linked gilts. This followed its expectation that, in the light of domestic and global debt levels, inflation could remain high in the medium term, with negative real interest rates. This would be accompanied by a period of deleveraging by banks, which would affect the viability of certain types of investment. He noted that the value of equities had risen highly in the period between 1980 and 2000, but had not always done so historically, particularly in periods of high inflation.

With regards to alternative investments, he noted the high correlation between equity returns and returns in some investments perceived as alternative. He also noted the dependency of some alternative assets on bank finance, instancing infrastructure and private equity. He described other alternatives that Ruffer was investing in, including illiquid assets, which could be a good match for pension funds provided they were identified and priced correctly. He said that there were five issues to bear in mind when choosing alternative investments- correlation to other assets, fee levels, the impact of the withdrawal of bank finance on the asset class, the liquidity of the assets acquired, and the risk of inflation, and/or Government intervention; he gave the action taken by the Swiss Government to lower the value of the Swiss Franc as an example of this.

The Chairman asked what Ruffer's position on commodities was. Mr Russell said that, given the possibility of a demand shock as a result of the break-up of the Euro, Ruffer was cautious about their purchase at the present, but believed that they might be more attractive in the medium term, once that risk had either diminished or come to pass.

Councillor Ginn asked what percentage of a portfolio should be held in alternative investments to protect against equities volatility. Mr Russell said that Ruffer had a 10 % net exposure to alternatives, which could still make money. He would suggest around 20% should be invested in alternatives. He said that he believed that active management was of high importance, as it allowed investors to benefit from decisions made by managers regarding when to sell and when to buy. He added that returns in alternatives were not necessarily giving drastically better returns, when fee levels were taken into account, however.

Councillor Iggulden asked what returns had been in the sector. Mr Russell said that this could be difficult to ascertain, though the illiquid assets purchased by Ruffer had been returning 5-7% in the 18 months since the strategy was adopted, with returns scheduled to improve over time. He said that forestry returns had also been good, but were, to a large degree, synthetic.

Councillor Iggulden asked about the purchase of art, wine, stamps, and guns as an investment. Mr Russell said that they could provide good returns and provided an excellent inflation hedge but realising the asset could be difficult. Given their illiquidity, he felt that they were a better investment for individuals than for institutional funds or managers.

The Chairman asked about property as an investment, given the presumption of more inflation. Mr Russell said that property was in general overvalued, with the risk of commercial rents falling in the light of economic conditions. Where there had been no boom in value, such as Germany and Japan, investment could be worthwhile, given the prevailing low rate of interest.

Councillor Botterill asked what the effect of demographics would be. Mr Russell said that he had seen no direct evidence of impact, and the long-term nature of change meant that investment would need to be made on very broad principles. He said that he did not believe that land and property would offer strong returns in the next decade, though there would be an end to any inflationary period.

Councillor Murphy asked whether the gap between the interest rate paid by banks and the rate at which they lent would not contain some of the inflationary effect of low rates. Mr Russell said that this was true, but that investors could not, given the need for banks to increase their assets rely on this, investors did not have access to the cheaper rates to borrow or the more expensive rates on their deposits.

## **RESOLVED THAT**

The presentation be noted.

### **39. PENSION VALUE AND INVESTMENT PERFORMANCE**

Helen Smith, P-Solve, presented the report, which set out the performance of the fund in the quarter to 30 September 2011. She said that the quarter had been turbulent and traumatic with the fund down by 5.6%. She said that, given the prevailing market conditions, it made sense to consider the fund's performance in relative terms, both in terms of its peers and in terms of the performance of its managers relative to the markets. On these measures, the fund had weathered the quarter well. She added that the following quarter would see Legal & General move to the new mandate and matching benchmark.

The Chairman said that he was concerned with the performance of Goldman Sachs. Ms Smith said that, following the change to the mandate suggested by Goldman Sachs, two good quarters had followed. The problems experienced in the quarter under discussion were typical of managers in their class and was considered acceptable but was under quarterly review.

Councillor Iggulden noted that the figures bore out that good managers could outperform the equities market as a whole. Ms Smith said that this was true, but that it was important not to assume future over-performance, in what could be an emotive market.

Regarding the current volatility, Bob Pearce, Group Accountant- Technical Services, said that the fund was now valued at the same level as before the quarter under discussion's losses.

Councillor Iggulden stressed the importance of considering both capital and income growth in assessing the value of equities as an asset class. Ms Smith said that total return was considered, and that there were legitimate investment cases to be made for equities, though it was important to take a holistic view of their place within the whole fund.

#### **RESOLVED THAT**

The report be noted.

#### **40. PENSION FUND INVESTMENT STRATEGY**

Bob Pearce, Group Accountant- Technical Services, introduced the report, which sought to amend the fund's liability benchmark in line with the last actuarial valuation (backdated to 1<sup>st</sup> April 2011 to match the alteration in the contribution rate). He said that a further report on possible alternative investments for the fund, including the possibility of amending the allocation between mandates, would be submitted to the Committee's next meeting.

#### **RESOLVED THAT**

With effect from 1<sup>st</sup> April 2011, the new Liability Benchmark Portfolio (LBP), with an out-performance target of 2.2%, be agreed.

#### **41. CONSULTATION ON PROPOSED INCREASES TO EMPLOYEE CONTRIBUTION RATES AND CHANGES TO SCHEME ACCRUAL RATES FOR THE LGPS**

Jane West, Director of Corporate Finance and Governance, introduced the report, which presented a draft consultation on proposed changes to employee contribution rates.

Councillor Cartwright noted the emphasis placed on potential loss of members, which was an objection put forward by the trade unions. He asked whether officers expected members to exit the scheme.

Ms West said that the combination of rises, inflation and a pay freeze meant that she believed the risk had been underplayed in the Government analysis. In response to a question from Councillor Murphy, she confirmed that 66% of staff employed by the Council were at the top of their pay grade, meaning that the pay-freeze would affect them.

Councillor Iggulden suggested that withdrawals from the fund would be, at worst, neutral in the effect. Ms West said that withdrawals might reduce the demands on the fund in the long-term, but would also reduce cash flow into the fund; this might require a change in structure of the fund, with associated risk.

In response to a question from Councillor Ginn regarding the importance of cash flow, Ms West said that income had always exceeded expenditure, with the deficit the product of current gilt yields. Bob Pearce, Group Accountant - Technical, said that a recent survey of Local Authority Pension Funds had shown that employer contributions for April to September 2011 had fallen 2.2 percent compared to the same period last year, with the employee contributions down 5.5 percent. Councillor Murphy asked whether this was attributable to a reduction in staff numbers, rather than staff withdrawing from the scheme. Ms West said that officers would provide the Committee with figures on opt-outs in the last 6 months.

#### **RESOLVED THAT**

- (i) The consultation response be agreed for submission, and;
- (ii) Officers provide the Committee with figures on the level of opt-outs by staff in the previous 6 months.

#### **42. TRI-BOROUGH TREASURY AND PENSION SERVICE**

Hitesh Jolapara, Deputy Director of Finance, gave the Committee a short verbal briefing on the move to a Tri-Borough Pensions and Treasury Service. Bob Pearce also updated the Committee on staff changes at P-Solve.

#### **43. ANNUAL AUDIT LETTER**

Jon Hayes, District Auditor, introduced the auditor's annual letter to the Council, and drew the Committee's attention to the section on challenges and to the section outlining the schedule of fees. He said that the fees were set following a sector-wide consultation.

Councillor Cartwright asked about the fee set for the Wormwood Scrubs Charitable Trust audit, and asked whether this could be carried out as a Small Body audit. Mr Hayes said that as the organisation was a charity and the Council was a corporate trustee, the approach taken was common. In response to further questions from the Committee, he said that the Audit Commission's position as auditor to the Council meant that they were better equipped to audit the Trust than another auditor would be, and that while the trust could be incorporated into the Council's main accounts, neither the Council nor the auditor thought this sensible.

#### **RESOLVED THAT**

The report be noted.

#### **44. WORMWOOD SCRUBS ANNUAL GOVERNANCE REPORT 2010-11**

Hitesh Jolapara, Deputy Director of Finance, introduced the report, which contained the audited accounts of the Wormwood Scrubs Charitable Trust, and the annual governance report compiled by the auditor.

Dave McNamara, Assistant Director of Finance, clarified that the Council had begun to make a contribution to the trust to ensure that it could meet the costs of the upkeep of Wormwood Scrubs. He said that the accounts had netted contributions to and from the Council against each other.

The Chairman asked about the possibility of a development on the car park. Dave McNamara said that the area was metropolitan open land, but that the service could provide a briefing on the practicality of any change to the area. He said that the service would also be able to give an explanation of the circumstances under which the Trust made a contribution to the Linford Christie Stadium.

In response to a question from Councillor Murphy, he said that the risk of the artillery wall further deteriorating was minimal.

#### **RESOLVED THAT**

- (i) The annual governance report be agreed, and;
- (ii) That the 2010/11 audited statement of accounts and Trustee's report be approved, and
- (iii) That the 2011/12 contribution to the running costs of Linford Christie stadium, up to a maximum of £115,500 be approved.

#### **45. AUDIT COMMISSION RECOMMENDATIONS UPDATES & ANNUAL GOVERNANCE STATEMENT 2011 ACTION PLAN**

Geoff Drake, Chief Internal Auditor, introduced the report, which showed no outstanding Audit Commission recommendations, and one outstanding Annual Governance Statement action, which was not scheduled to complete for some time.

#### **RESOLVED THAT**

The report be noted.

#### **46. TREASURY MANAGEMENT UPDATE FOR THE FIRST SIX MONTHS OF 2011-12**

The Chairman asked what had enabled the reduction in general fund debt. Hitesh Jolapara, Deputy Director of Finance, said that it had been capital receipts: he agreed to supply the Committee with a breakdown of what the receipts related to.

Councillor Ginn asked about the reforms affecting the Housing Revenue Account (HRA). Mr Jolapara said that the Council's HRA debt was estimated to be £186 million following the alteration of the subsidy arrangements. The Housing and Regeneration department were drawing up a 30-year business plan in response to the changes, while CIPFA guidance was that debt should be continue to be pooled separately.

## **RESOLVED THAT**

The report be noted

### **47. COMBINED RISK MANAGEMENT HIGHLIGHT REPORT**

Michael Sloniowski, Principal Consultant- Risk Management, introduced the report, which set out risk management activity in the period since the last meeting. He said that there had been intensive work on the integration of risk management as part of the Tri-Borough programme. He said that work also included work on the Fraud Risk Register, the adoption of a new Local Governance Code, and assessing the implications of the employee code of conduct in light of the Bribery Act.

Councillor Cartwright asked about the impact of the Bribery Act, in light of the recent publicity surrounding the Post Office. Mr Sloniowski said that the employee Code of Conduct was compliant with the Act. With regards to the position of contractors, John Hayes, District Auditor, said that the act required authorities to have assurances that contractors were compliant, and that issues could arise in areas such as trade waste collection. Dave McNamara, Assistant Director of Finance- Environment and Children's Services, said that the Serco contract did include a clause forbidding contractors from accepting tips.

## **RESOLVED THAT**

The report be noted.

### **48. ST MARY'S PRIMARY SCHOOL AUDIT**

Dave McNamara, Assistant Director of Finance- Environment and Children's Services, introduced the report, which set out, further to the nil assurance audit issued on St Mary's Primary School, the progress of the subsequent investigation, and the measures taken by the Council following the audit. He said that, of the schools audited that year, only St Mary's had failed to meet the required financial standard, and would be audited again in 2012. He said that additional measures had been put in place, including a quarterly review of schools by officers to identify those that might require an audit and an additional audit when schools when through a management change; with the agreement of the Chair of Governors at Holy Cross Primary School, this had included an audit of voluntary funds. The Schools Management Service made its report directly to the Governors.

Councillor Iggulden asked where responsibility lay for voluntary funds. Mr McNamara said that the responsibility for grant and diocesan funds was clear, but the responsibility for voluntary funds lay with the school. As such, the discovery of the issues at St Mary's Primary School by the Council, given their isolation from grant funds, were coincidental, and the nature of the problem was unusual. Recent amendments to the law had made it easier for local authorities to report concerns regarding voluntary funds, and the Council urged schools not to keep a separate bank account for voluntary funds, however.

## **RESOLVED THAT**

- (i) The report be noted, and;
- (ii) The follow up audit scheduled for 2012 be noted.

**49. PARKING PAY AND DISPLAY DEPARTMENTAL RESPONSE**

Dave McNamara, Assistant Director of Finance- Environment and Children's Services, introduced the report, which set out a response to the recent audit of Parking Pay and Display. He said that the service did not have any concerns about the contractor, Royal Borough of Kensington and Chelsea, or their management of concerns about individual operators. He noted that there had been issues about evidencing the controls that RBKC had in place for the audit, but that these controls were in force.

With regards to the issues identified with reconciliations, he said that the service felt that the audit overstated the issue. He said that the machines involved were often older ones, and had failed to sync immediately with the database, though this evened out over time and represented an improvement over a spot reconciliation process. He added that the problems with foreign coins were endemic to the method of collection.

Councillor Murphy asked if, in the light of problems with reconciliation, the Council had sufficient assurance that the amount collected was correct. Mr McNamara said that the Council was able to see where there had been consistent undercollection and acted accordingly. However, given the level of variation in relation to the level of income, when measured against the cost of replacing the machines to remove the problem, it was considered it as an operational risk.

**RESOLVED THAT**

The report be noted

**50. CORPORATE ANTI FRAUD SERVICE REPORT 1 APRIL TO 30 SEPTEMBER 2011**

Geoff Drake, Chief Internal Auditor, introduced the report, which set out the work undertaken by the Corporate Anti-Fraud Service (CAFS) in the first 6 months of the 2011-12 financial year. He said that 76 sanctions had been issued against a target of 60, with £235,000 recovered in real financial terms, and £3.6 million when including property, using the Audit Commission's valuation scale. These figures excluded £94,000 recovered and paid out to partners.

He said that the focus of the service had been shifted at the start of the year, with a focus on recovery of tenancy properties. He said that joint working had taken place with the Housing and Regeneration department to tackle tenancy fraud, and with the Police to investigate criminal activity. The service also now has 3 financial investigators, who work to identify assets which could be targeted for confiscation.



He drew the Committee to the collection of press releases and press coverage at the back of the report, and said that the service would feature in an upcoming episode of Saints and Scroungers.

The Chairman asked whether it was felt that sentences imposed by the courts were strong enough. Mr Drake said that officers felt not, but that the level of financial penalties imposed was more of an issue. Councillor Cartwright noted that sentences were given in line with guidelines issued by the Government.

The Chairman asked about the efforts made on recovery. Mr Drake said that the Council's Debt Management team were involved from an early stage in the interview process. He said that this was part of the unit's orientation towards income generation.

Councillor Iggulden asked whether the services provided to other Councils were on a commercial basis. Mr Drake said that the chief service provided was through the Council's financial investigators, and that a service level agreement was being developed.

Councillor Cartwright asked about the work undertaken on tenancy fraud, given the high value of the assets, and asked how CAFS interacted with the Housing service. Mr Drake said that CAFS received referrals from Housing, and had done educational work with the service. Work was now underway to use data mining to identify potential fraud cases; this involved checking other databases maintained by the Council and external databases, such as Experian.

In response to a question from Sheela Selvajothy, Trade Union Representative, Mr Drake said that any employee, and their trade union if they were a member, would not be informed of an investigation until disciplinary charges were brought: this was both to protect the integrity of the investigation and to protect the reputation of the employee, lest the investigation exonerate them.

#### **RESOLVED THAT**

The report be noted.

#### **51. INTERNAL AUDIT QUARTERLY REPORT FOR THE PERIOD 1 APRIL TO 30 SEPTEMBER 2011**

Geoff Drake, Chief Internal Auditor, introduced the report, which set out internal audit activity undertaken in the quarter to 30 September 2011. He said that, at the time of the Committee, there were 5 outstanding reports, 20 outstanding recommendations, and 9 outstanding recommendations over 6 months past their due date. The audit plan was being delivered broadly to target.

#### **RESOLVED THAT**

The report be noted.

#### **52. 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 and 3 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.

**53. EXEMPT MINUTES OF THE MEETING ON 22 SEPTEMBER 2011**

**RESOLVED THAT**

The exempt minutes of the meeting held on 22 September 2011 be agreed as a true and correct record.

Meeting started: 7.00 pm  
Meeting ended: 10.00 pm

Chairman .....

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