Audit Committee

A meeting of Audit Committee was held on Monday, 28th September, 2009.

Present: Cllr Barry Woodhouse (Chairman); Cllr John Fletcher, Cllr Maurice Frankland, Cllr Maurice Perry and Cllr Mick Womphrey.

Officers: P Johnson, I Jones, P Saunders (R); P K Bell (LD).

Also in attendance: C Andrew (Audit Commission).

Apologies: Cllr Mrs Lynne Apedaile, Cllr Mrs Kath Nelson, Cllr Ross Patterson and Cllr Mrs Sylvia Walmsley.

A 28/09 Declarations of Interest

There were no interests declared.

A 29/09 Minutes

The minutes of the meeting held on Monday, 29th June 2009 were signed by the Chairman as a correct record.

A 30/09 Treasury Management Strategy 2009/10 – 2nd Quarter Update

Consideration was given to a report the issues surrounding Treasury Management, and the implementation of the Strategy at Stockton during 2009/10.

The report to this Committee in the first quarter outlined the principles of the Treasury Management Strategy, how these operated in practice and an update of the current position for Stockton. In this second quarter report there was a more depth look at the current issues surrounding security, liquidity and return on investment income and the priority order of these categories in placing investments.

The number one priority in placing an investment was the security of the organisation the money was being placed with. As mentioned in the last report the first reference point were the financial ratings lists from Fitch, Moodys, and Standard and Poors. The credibility of these agencies had however been questioned since the Icelandic crisis and it was important they were supplemented with additional information on the institutions. The second quarter had been rich in this category with five of the major banks releasing their last 12 months trading results. The two banks that did not require Government intervention, Barclays and HSBC, both announced substantial profits. These profits were generated from their investment banking operations rather than the retail side. Both banks had put the case that this showed the advantage of diversity in the banking business and that it showed some suggestions to split banks into pure investment only, or retail only, were flawed.

The three banks where the Government had injected substantial amounts of taxpayers money to ensure their continuance did not fare as well. RBS made a marginal profit but this was due in the main to an exceptional one off item in the accounts. Lloyds and Northern Rock both made substantial losses. For all three the discussions around their current status was about a medium term return to sustained profitable status not a short term one. In normal circumstances the viability of these banks continuing would undoubtedly be questioned. However, given the Government had already intervened to prevent their collapse, there was an acknowledged expectation they were going to be in the doldrums for some time to come, and they had been dubbed too big to fail, due to that impact on the economy it was highly unlikely that they would go out of existence. Despite this being the realistic assessment on these three banks Stockton had concentrated its investment placement for banks with Barclays, HSBC and the ethically based Co-operative Bank. The latter also making a profit in 2008, having seen a 40% increase in deposits during the recession (possibly due to the public expecting it to behave more responsibly because of its ethical stance) and recently winning the Best Financial Services Award from Which magazine.

With regard to Building Societies the most prominent news had been about the Chelsea Building Society. It made a loss in the first half of 2009. The society said this was due to fraudulent over-valuation of buy to let properties. Its Chief Executive said that it hoped to remain independent but would see how business goes for the next three months before deciding whether this was practical or whether they would seek a merger. In general a number of societies have been downgraded as the rating agencies had anticipated continuing substantial falls in house prices and escalating rates of repossessions. The latest data was that neither of these had been as bad as expected, indeed house prices had started to rise slightly, although there was doubt as to whether this would be sustained growth. It would seem therefore that the downgrades may have been too pessimistic but in acknowledgement of these Stockton had placements with fewer building societies in comparison to twelve months ago.

The second priority in the investment categories was liquidity. This was to ensure investments could be released at the appropriate time to fund the cashflow requirements of the Council's expenditure patterns. Stockton utilised the computer system Logotech to analyse and predict its cashflows to ensure that its investments were released at the right time so that it was not short of resource to fund expenditure. In addition with the concerns about security issues surrounding investment organisations, placements in general had tended to be for shorter periods than previously. Although this did contribute to security and liquidity requirements, the knock on effect was that it also contributed towards repressing yield returns on investments.

The final criteria to be assessed in making an investment decision was the rate of return the investment yields. This had gained considerable press coverage nationally as Council's face considerable shortfalls in 2009/10, compared to the returns they were getting previously before interest rates were so dramatically reduced. As mentioned previously in the report placing money with the more secure organisations and for a shorter period also reduced the return. The more secure organisations offered less for the investment due to their position of strength, and all organisations reduced their offers for shorter placement periods. Stockton did anticipate a reduction in investment income in setting its Medium Term Financial Plan for 2009/10. The plan was based on an average rate of return of 2% over the three years. Because Stockton Borough procured some placements prior to the dramatic fall and they had not yet matured, the averages for the early part of 2009/10 had been above target. Some recent placements had however been significantly below the target. At this present time these were not of sufficient volume to produce the belief we would miss the target in 2009/10, but this was something that would need close monitoring. The next two years were clearly a matter of speculation, but the Bank of England had produced some anticipated rates. For 2010/11 it expected the rates to start at 0.7% and rise to 2.2% by the year end. For 2011/12 it anticipated the range will be from 2.7% to 3.8%. If these predictions were correct, and Stockton Borough did make the necessary return in 2009/10, the average 2% across the three years should be achievable.

Finally as mentioned in the first quarter's report, although investments had grabbed the main share of attention due to the Icelandic crisis, the Risk and Returns publication advocates Councils examining its high interest debt at this time to evaluate whether this was worth redeeming. Again as mentioned in that report, Stockton had done this some two years ago and the remaining high interest debt had punitive premiums for redemption. The Council financial advisers Butlers constantly monitor the lower banded debt and there were times when some of this may attract a discount rather than a premium, due to prevailing market conditions and the decisions of the Public Works Loans Board in relation to those. It was possible therefore, that at some point the redemption of these offer sufficient counterbalance to offset some premium repayments. There then was the evaluation as to whether on this lower interest debt any future replacements would be at an advantageous level. Clearly in coming to a decision in this area, there were a number of variables to take into account in the relevant calculation and the timing of any such deals would be paramount. It was something that the Council would continue to review to see if at any point there were financial benefits for Stockton.

RESOLVED that the report be noted.

A 31/09 **Audit Commission Annual Governance Report 2008/09**

Members gave consideration to the Audit Commission's Annual Governance Report 2008/09.

The report summarised the findings from the 2008/09 audit. The report identified the key issues for the Committee to consider before the Audit Commission issued their opinion, conclusion and certificate.

The Committee noted the comment made at paragraph 4 of the report with regards to the financial statements submitted for audit being prepared to a good standard and well supported by comprehensive and accurate electronic working papers. The Committee requested that its appreciation of the work undertaken by Council officers, in this regard, be recorded.

RESOLVED that:-

1. The Audit Commission's Annual Governance Report be accepted and the Chairman be authorised to sign the representation letter on behalf of the Council.

2. The Committee notes the comment made in the Governance report, at

paragraph 4, and appreciates the work undertaken by Council officers in this regard.

A 32/09 **Re - approval of the Statement of Accounts 2008/09**

Consideration was given to a report on the Council's amended Statement of Accounts for 2008/09.

Members had approved the Statement of Accounts for 2008/09 at its meeting on 29 June 2009. Since that date one material item and a second item that was non-material but worthy of note have arisen and these had been incorporated within the amended statements that were attached to the report.

The items adjusted were:

• The value of the Council's Housing Stock – the current financial climate had seen houses prices fall significantly over the last 18 months. The housing stock was valued annually at 1st April, however the accounts presented include assets as at 31st March. In most years these amounts would not be significantly different from each other. Due to the current financial climate a reassessment of the valuation had been carried and this had led to a material reduction in value of £35 million. Of this sum, £8.4 million had been charged to the Income and Expenditure Account, while the remainder reversed previous additions to the Revaluation Reserve. The overall impact reduced the net worth of the Council to £357.2 million.

• The valuation of the Council's share of the Teesside Pension Fund was provided annually by actuaries appointed by the Pension Fund. The Council had been informed that the actuaries report contained an error that understated the interest charge and the actuarial gain by a sum of £6.052 million. This sum, while non-material, had been amended and charged to the Income and Expenditure Account.

• In each case the adjustments had no impact upon the previously reported level of General Fund or Housing Revenue Account balances. This was because the transactions were covered by special arrangements which prevented the amounts impacting upon the Council's budget requirement. Therefore the charges to the Income and Expenditure Account were reversed out through the Statement of Movement on General Fund Balance while the charges to the Revaluation Reserve are accounted for in the Statement of Total Recognised Gains and Losses.

Members requested that they be provided with detailed information on the cost of criminal damage to the Council.

RESOLVED that the amended Statement of Accounts for 2008/09 be approved.