AUDIT COMMITTEE

Minutes of a meeting of the Audit Committee, held in the Council Chamber, the old Town Hall, Letchworth, on Tuesday 9 October 2018.

PRESENT

Jeremy Newman (Chair)
David Chalk (standing in for Lynne Ceeney)
Vernon McClure

IN ATTENDANCE

Kit Davies (Chief Executive)
Daniel Harris (RSM)
Paul Harte (Finance Director)
David Hitchen (Corporate Services Director)
Robert Dale (Company Secretary)

WELCOME

- A new member, Danny Malyon, had been appointed to the Board and agreed to join the Audit Committee. He was not able to attend this meeting. Danny is Head of Facilities Management (FM) for Sainsburys, and a Director of Arcus Holdings Ltd, which provides FM services to a range of customers.

ITEM 1a: APOLOGIES FOR ABSENCE

- Lynne Ceeney, Danny Malyon, Kelly Dunn (KPMG) and Laura Kneebone (KPMG).

ITEM 1B: DECLARATIONS OF INTEREST

- David Chalk declared his interest as an employee of the Lloyds Banking Group, who were the Group's lenders.

ITEM 1C: MINUTES OF THE PREVIOUS MEETING

- Minutes of the meeting held on 14 May 2018 were signed as an accurate record of proceedings.

ITEM 1D: MATTERS ARISING

- Actions had been progressed as follows:
  - Circulate the report from this audit [of Hart L&D] by Friday 29 June, or provide a written explanation of any reason for delay by that date, and circulate by Friday 13 July. **Action complete**. The report was circulated at the end of June and is also included on this agenda (Item 3).
  - Take further advice from RSM on VAT declarations and report to the Chair. **Action under way**. A draft report had been provided by RSM but Paul Harte had not been satisfied with the quality and had asked for further work to be done. Governors asked:

Question: *What was holding up the report?* There had been delays at RSM and feedback on content had been given by HLG.

Question: *How were VAT returns now being made and was RSM satisfied that the approach did not create a risk of VAT being underpaid?* Returns were being made on the new basis. This approach had been discussed with the associate director from RSM and the split of business/non business on declarations had been agreed. A formal confirmation of their views had not yet been received.

Question: *What was the position in respect of the further claim for the return of overpaid VAT?* HMRC had asked some more questions and the Finance team was working with RSM on the response.

Question: *Were delays caused by Group staff?* The HMRC queries had only been received within the last two weeks.

Governors asked RSM to provide written advice about how the Group's VAT returns should be made and on the prospect of receiving the outstanding claim (c£0.8m). RSM noted that HMRC had not challenged the principles of the claim.

Action: Prepare and circulate a report to advise the Committee (a) that the methodology for submitting Group VAT returns was justified and unlikely to lead to underpayment on an ongoing basis; and (b) on the likelihood of and timing for securing the balance of the outstanding VAT reclaim.

- Amend proposed Board meeting schedule and propose at next Board meeting. **Action complete**. The Board meeting was postponed by one week to Monday 10 December, and the Audit Committee subsequently postponed to Monday 3 December at the Chair's request.
- Draft outline scopes for each audit area and share with the Committee. **Action complete**. Audit scopes were shared with the Chair in August and his feedback incorporated. See also Item 5.
- Draft paper on GDPR compliance identifying what work was outstanding and setting out a path to completion, with a summary report to the Board in June. **Action complete**. A paper was shared with the Board in June.
- Consider arranging an extra Audit Committee meeting at the end of September/start of October 2018. **Action complete**. This was arranged.
- Issue Outlook appointments to members, including an extra meeting in early October 2018. **Action complete**. Appointments were circulated.

ITEM 2: FE COMMISSIONER'S VISIT

- The Group has received an 'inadequate' rating for its financial health because of a poor trading year, and change in lenders' attitudes towards the FE sector and a weak financial position dating back some years. It had sought Exceptional Financial Support (EFS) from the Education and Skills Funding Agency (it was one of a number of FE colleges to have done so this year). A separate application to the Transaction Unit for Restructure Funds (RF) had been made.
- This was a trigger for intervention from the FE Commissioner, whose team had visited in September and who would publish a summary report in December.
- It had been a very tough visit, with vigorous and robust challenge, to which staff and governors had responded openly. The team had recognised that the Group delivered good student experience and outcomes. It was not intending to recommend replacing executive or non-executive leadership, which it had done in other cases; there would be some recommendations affecting governance:

- The Group would be placed in 'administered' status. This meant that an observer from the ESFA would join the Board. This would help assure the Agency that governors were providing sufficient direction and challenge.
- Monthly 'case conferences' would involve the CEO, bank and Agency representatives, with a governor present to ensure the Board was given the full picture. The Board would also receive monthly management accounts, giving more frequent and detailed information about the performance of the business. This would also be supported by a new Finance Committee.
- BDO was undertaking due diligence on the 2018/19 business plan, which was expected to inform discussions with the bank and the Agency.
- The risk register would be enhanced to give a more detailed and specific description of risks and mitigations, analysed by income/funding stream.
- The Group Finance Director would be a 'senior post-holder', reporting direct to the Board via the Chair, and could only be dismissed by the Board.
- The Board's risk appetite was seen as too high (based on its willingness historically to undertake 'non-core' activity) and should be reduced. This would be linked to a recommendation to give up activities seen as distracting – such as Hertvec, the gym and possibly the Hart Schools Trust.

- Governors asked:

Question: *How was student recruitment so far?* Numbers were up on business plan targets for 16-18 study programmes and apprenticeship recruitment was ahead of plan. Recruitment to HE programmes was down, mainly because the University of Hertfordshire (part of the HE consortium to which the Group belonged) had unilaterally and without consultation reduced its entrance requirements, meaning that students that might have joined a Foundation Degree programme at the college and affiliated to the university, went to the university instead. Action was being taken to reduce costs to offset as much of the anticipated loss as possible.

Question: *What could be challenged in the summary report?* We could check for factual accuracy. There were some sensitive points needing careful handling.

Question: *Did the FE Commissioner expect the Risk Register to be much bigger and more detailed?* Suitable models of best practice were being sought, balancing the need for comprehensive coverage with ensuring members could use the reports effectively. Where risk register discussions were on agendas should be reviewed.

- There would be a full discussion at the forthcoming Board meeting.

ITEM 3: INTERNAL AUDIT REPORTS

- Three reports had been circulated to the Committee:

Hart L&D Whistleblowing

- This had reviewed investigatory work carried out by Group staff into allegations made by a whistleblower in October 2017. The report had considered the work carried out to review all of the relevant Hart L&D records and had confirmed that:
    - the derecognition of future income which had been necessary in the 2016/17 financial statements had been correctly calculated;

  - the process undertaken to check learner data for errors and misstatements had been thorough and that no additional problems had been identified;
  - there was no evidence of other staff being involved in the malpractice.
- Members were satisfied that the decision for staff to carry out a 100% review of affected learner records had been the right one. They asked RSM:

Question: *Should this malpractice have been picked up without the intervention of a whistleblower? And if so, how?* RSM could offer no opinion on *how* such malpractice could have been picked up as that was not within the scope of their report.

Question: *Had the Group unduly limited the scope of IA service reporting?* RSM agreed that the scope could be broader, although this was, at least, a function of cost.

Question: *How could the Group receive assurance that its framework of control was appropriate, and that its approach to recruiting staff and the prevailing culture was one of integrity?* The IA service could not advise on the best approach to detecting fraud and sample audits could only give reasonable and not 100% assurance. RSM could offer a 'fraud health check' which would undertake assessment of such risks on a wider basis.

Question: *What more could be done to limit the risk of malpractice and had controls been improved following this investigation?* On reflection, an audit of learner numbers could be considered for inclusion within the yearly audit schedule.

Key Financial Controls

- The report identified instances of continuing poor practice eg not completing Purchase Orders before Invoices had been received. This made it difficult to be certain about financial commitments. Reminders to staff not following the correct approach had been issued; members suggested that firmer disciplinary action be implemented so that staff understood the seriousness of the issue.

Action: Remind staff about the importance of financial controls and apply disciplinary sanctions for future non-compliance.

Sub-contracting

- This report had also identified instances of poor compliance with due process. Action needed to be taken to address this.

Action: Compile and circulate tracker listing IA recommendations from past IA reports and actions take to implement them. Where actions had not been completed, or where process failures were still happening, consider inviting the relevant member of staff to the Audit Committee to explain why.

ITEM 4: INTERNAL AUDITORS ANNUAL REPORT 2017/18

- The progress report identified the number of high (0), Medium (5) and Low (14) priority recommendations made in 2017/18 and indicated that an unqualified Internal Audit opinion would be issued as part of the year-end process. One report (on VAT) was being finalised, and RSM was also completing work to follow up on the adequacy of management responses to its recommendations.

ITEM 5: INTERNAL AUDIT PLAN 2018/19

- The plan circulated had been based on discussions with the Finance team and advice from the Audit Committee at the previous meeting. Present circumstances meant that the plan needed substantial review. If an internal audit service was to provide meaningful assurance, rather than simply being an exercise to 'tick a box,' it might need to devote more resources to considering fewer but more significant areas.
- Governors were concerned that there had been an active Internal Audit (IA) process in operation over the past three years, but several failures had occurred that had not been picked up by this. How could IA become more effective at providing real assurance? Perhaps it had not been looking in the right places?
- **Governors agreed** that:
  - Internal Audit reports from the last three years should be reviewed by Group staff and a tracker produced for the Committee showing the recommendations made and the actions taken to address them;
  - The scope of the Internal Audit service for 2018/19 should be reviewed based on the enhanced Risk Register;
  - A small number of key risk areas should be identified and IA resources focussed on them, with any mandatory reports additional to this. Reports should consider areas of high risk, where high levels of mitigation were identified – as failure of mitigation in such cases would have serious consequences – and areas where poor mitigation was identified.

Action: Seek an improved model/template for the Risk Register and refresh to provide a better analysis of current risks.

Action: Prepare a new IA Plan for 2018/19 based on the new Risk Register.

ITEM 6: YEAR-END ARRANGEMENTS – UPDATE

- Work was on schedule with the first draft to be circulated to the Committee by the end of the month. There would be an update meeting with the Audit partner next week, the outcome of which Paul Harte would share with members.
- The Chair expressed disappointment that no one from KPMG had attended this meeting, or contacted him to provide an update on their work.

Action: Inform KPMG auditors that if unable to attend a meeting, it would be helpful to contact the Chair as well as the Clerk so that relevant updates can be communicated.

ITEM 7: CORPORATE RISK REGISTER

- Governors reviewed the risk register and advised that the risk relating to VAT declarations remain open until written confirmation is received from RSM that the methodology for making VAT Returns was considered appropriate. They also suggested that the risk associated with reputational damage from negative cash-flow be rewritten to reflect the possible impact on student recruitment and relationships with stakeholders and others.
- Lloyds was updating documentation for existing loan and overdraft arrangements with the Group, including redrafting covenants. It had been unwilling to reduce the

legal charges for this process, so there would be extra costs borne by the Group, plus our own legal costs.

- Discussions with the bank and the funding agency had taken place; the bank seemed willing to be flexible over the overdraft limit on a short-term basis.

Question: *What new covenant terms would be applied?* This was not clear; work being done by BDO to check the robustness of our business plans would inform this.

Action: Clarify prospective covenant terms with Lloyds.

Action: Include on risk register additional risks/critical dependencies: (a) that Lloyds withdraws loan support before either Exceptional Financial Support (EFS) or Restructure Fund (RF) monies were made available; (b) that the Transaction Unit refuses to award RF funding; (c) that the ESFA fails to provide all of the EFS requested.

ITEM 8: FRAUD AND WHISTLEBLOWING

- No instances of fraud had been reported since the previous meeting.
- The paper circulated had summarised the outcomes from the two Whistleblowing cases open at the time of the last meeting. One had also been the subject of the Internal Audit report considered at Item 3. The other had been correctly classified as a Grievance and handled accordingly. **Members agreed** that these two cases could be closed.
- No new cases had come to light since the previous meeting.

ITEM 9: GIFTS AND HOSPITALITY REGISTER

- One declaration had been made since the last meeting. This related to three tickets for a football match at Wembley Stadium, the value of which was c£150. The gift had been offered by Highfield Assessment in appreciation of a positive working relationship. Future reports would include the reason for the gift.

Action: Report on stated reason for gift or hospitality in future papers.

ITEM 10: CLOSED SESSION

- **Members decided** that a closed session was not required.

ITEM 11: ANY OTHER BUSINESS

- None.

ITEM 12: DATE OF NEXT MEETING

- Members agreed to align the start time for the Audit Committee with that for other Committees, so meetings would start at 18.30 in future.

Action: Amend diary appointments to show a later start time.

- Monday 3 December 2018, starting at 18.30, at the old Town Hall, Letchworth.

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Signed as an accurate record Chair Date

ACTION LOG

Meeting	Minute Reference	Summary of Action	Who	When
14/05/18	2.	Take further advice from RSM on VAT declarations and report to the Chair.	Paul Harte	29/06/18
09/10/18	3.	Remind staff about the importance of financial controls and apply disciplinary sanctions for future non-compliance.	Kit Davies	26/10/18
09/10/18	3.	Compile and circulate tracker listing IA recommendations from past IA reports and actions take to implement them. Where actions had not been completed, or process failures were still happening, summon the accountable staff member to the Audit Committee to explain why.	Kit Davies	09/11/18
09/10/18	5.	Seek an improved model/template for the Risk Register and refresh to give a better analysis of current risks.	Dave Hitchen	26/10/18
09/10/18	5.	Prepare an IA Plan for 2018/19 based on the new Risk Register.	Paul Harte/Daniel Harris	14/12/18
09/10/18	6.	Inform KPMG auditors that if unable to attend a meeting, they should contact the Chair as well as the Clerk so that relevant updates can be communicated.	Robert Dale	12/10/18
09/10/18	7.	Clarify prospective covenant terms with Lloyds.	Paul Harte	09/11/18
09/10/18	7.	Include on risk register new risks/critical dependencies: (a) that Lloyds withdraws loan support before either Exceptional Financial Support (EFS) or Restructure Fund (RF) monies become available; (b) that the Transaction Unit refuses to award RF funding; (c) that the ESF fails to provide all of the EFS requested.	Dave Hitchen	26/10/18
09/10/18	10.	Report on stated reason for gift or hospitality in future papers.	Robert Dale	15/11/18
09/10/18	12.	Amend diary appointments to show a later start time.	Robert Dale	31/10/18