

MINUTES

Meeting of: Group Audit Committee

Date & Time: 26 June 2018, 1.40pm

Place: Boroughmuir High School, 111 Viewforth, Edinburgh

Present: Graeme Watson (GW) (Chairman)
Ann Faulds (AF)
Fiona Mackenzie (FM)
Carolyn Dwyer (CD)

In attendance: Ian Russell (IR)
Peter Reekie (PR)
Viv Cockburn (VC)
Kerry Alexander (KA)
Tony Rose (TR)
Helen Berry (HB)
Liz Petrie (LP)

1 APOLOGIES

There were no apologies and no new declarations of interest.

2 MINUTE OF PREVIOUS MEETING

The minute of the meeting of the Committee of 29 January 2018 was reviewed and agreed as a correct record.

Matters arising:

Following up on the review of the Committee's terms of reference, GW advised that in consultation with the Chairman of the Board it had been decided that the membership of the Committee should continue to be all non-executive directors with the exception of the Chairman of the Board and that the Committee should meet three times in the year. Meetings would be held on the same day as Board meetings with the exception of the Committee meeting to consider the draft Annual Accounts and Financial Statements which should be scheduled two to three weeks in advance of the Board meeting where approval of the accounts would be sought.

3 ACTION TRACKER

The action tracker was reviewed and progress against actions noted.

VC outlined options for training for Audit Committee members covering audit committee effectiveness and finance for non financial directors and the Committee discussed library resources also available to support training. The Committee requested that the training

options and resources be incorporated in the induction for board directors and that VC circulate this to existing board members.

VC to circulate note on training to current board members and include in inductions for future directors.

The Committee noted that a policy for death in service arrangements had been drawn up and adopted.

4 REVIEW OF PROGRAMME OF INTERNAL CONTROLS TESTING

HB introduced the report outlining the proposed approach for the review of internal controls by the external auditors, Scott Moncrieff. It was noted that a full internal audit is not proposed and HB confirmed the organisational independence of the internal audit activity.

HB described the consultation and work undertaken in drawing up the proposals and the Committee noted the areas where reviews have taken place in recent years and those proposed for the next three year period.

The Committee noted that with the recent change in key personnel dealing with investments and the embedding of new processes in this area it is proposed that investment management be prioritised for review in the current year, 2018/19. It was further noted that following the introduction of GDPR in May 2018 it was proposed that the following year's review be on records management. Management reporting and Corporate Governance were provisionally proposed as areas to be considered for the 2020/21 audit and it was agreed that this could be reviewed over the next two years.

The Committee agreed the proposed areas for review in the next three years, noting that further consideration would be given to 2020/21 area for review.

The Committee discussed the range of functions subject to recent and future reviews and governance arrangements for areas not covered by the Scott Moncrieff internal audit reviews. The Committee noted that ICT security reviews are undertaken separately and do not fall within the remit given to Scott Moncrieff for the internal controls review.

The Committee noted that the internal control reviews plan excludes the majority of HR systems and agreed that the review of these should be considered by the Committee next year. The Committee was advised that assurance on the areas not included in the internal controls review is undertaken through different internal processes. PR proposed that clearer reporting to the Board on these areas take place.

HB highlighted the internal control reviews charter included in the report and this was noted by the Committee.

GW thanked HB for attending and presenting the paper and HB left the meeting.

5 REVIEW OF INTERNAL CONTROLS AND FINANCIAL PROCEDURES MANUAL

The Board noted the paper outlining proposed changes to the Internal Controls and Financial Procedures Manual together with the revised Manual.

VC advised that the updates fell into three categories:

- 1) Delegated authority levels
- 2) Financial procedures
- 3) Terminology such as job titles and updated references to external guidance

VC advised that the changes to the scheme of delegation are proposed to bring more resilience to the business and to contribute to the empowerment of Senior Associate Directors who operate at senior level in the business, leading programmes and workstreams, but to date have had limited signing authority. It was noted that under the proposed scheme expenditure and related contracts can be signed off by budget holders to any level within their approved budget.

The Committee discussed the impact of the increased delegation of authority. Visibility on consultancy expenditure across the business was discussed and it was agreed that PR review the management information held and reporting and include an overview of consultancy budget and spend in reporting to the Board. It was further agreed that termination of employment other than contractual or retirement should be taken to the Board.

VC advised that the changes to the financial procedures centred on investments and salaries and payroll reflecting the formalisation and updating of processes to track and review investment income and the introduction of the Cascade HR and payroll system.

The Committee agreed the changes to the Internal Controls and Financial Procedures Manual and agreed to recommend approval of the revised Scheme of Delegation to the Board, whilst emphasising the importance of PR maintaining visibility across the business on behalf of the Board.

6 2018/19 FINANCIAL STATEMENTS

a) Review of impact of impact of International Financial Reporting Standard 9 (IFRS9) on SFT's Accounting Policies

VC advised the Committee that changes to IFRS9 relating to financial instruments have been issued. While the changes are not applicable until the year ended 31 March 2019 the impact of the change will be disclosed in the notes to the Financial Statements for the year ended 31 March 2018.

VC summarised the areas of the accounts affected by the change and the impacts:

- Subordinated debt held in hub projects – VC advised that these may continue to be held at cost although a provision will need to be made for any expected credit loss.

- Working capital loans to hub projects – It was noted that no change in accounting treatment is proposed. VC advised that as the outstanding loans are due to be repaid in the short term any impact would be immaterial.
- Equity – VC advised that this principally applies to equity held in hub projects although nominal equity is also held in National Housing Trust LLPs. The change in the standard requires equity instruments to be held at fair value rather than cost. VC explained that as there is not a market value for the equity in hub projects, market value cannot be used to determine fair value in this instance. It was noted that fair value has been calculated by reference to the future cash flows to be generated by these investments which relate to dividend income receivable from each hub project usually towards the end of contract period. The Committee noted that the estimated fair value of the dividend income as at 31 March 2018, discounted at the 11% to represent the equity IRR is c£275k.
- Financial Transactions (FTs) funding – VC advised that to date FTs have been treated as an interest free loan and were this treatment to continue under the new standard fair value would have to be established. VC advised that Scottish Government has reviewed the treatment of FTs and these should now be treated as repayable grants. The Committee noted that this change would require reclassification within both SFT and SFTi accounts. The Committee agreed to recommend approval of the necessary changes in accounting policy relating to Financial Transactions funding as outlined in the report to the Board

VC outlined the possible future impact of the update to IFRS16 relating to lease accounting on the Company's Financial Statements. The revised standard requires the majority of leases to be capitalised rather than treated as operating leases. SFT only has one lease for its property which would be impacted by the new accounting standard. However, as the Company's current property lease expires in July 2020 the impact will not be material for the current year but consideration will require to be given to the accounting treatment of any new lease.

b) Financial Statements for year ended 31 March 2018: Business Review

The Committee noted and reviewed the draft text for the Financial Review and Results section of the SFT Financial Statements for the year ended 31 March 2018. The Committee was content with the drafting and Directors were asked to provide any further comment on the drafting to VC following the meeting.

7 REVIEW OF CORPORATE RISK REGISTER

The Committee noted and discussed the corporate risk register. It was noted that the format of the register had been revised to show the impact of mitigation measures being taken. VC advised that the register covers strategic and corporate risks with programme risks managed separately.

The Committee noted the critical corporate risk of cyber security which remains red after mitigation. The Committee was assured of ongoing vigilance and noted that security

testing will be taking place over the summer period. VC summarised emerging developments with the Company's ICT support supplier, Exsel, which is undergoing a corporate restructuring noting that to date service has not been affected. VC advised that discussions are ongoing and assessment of the service and relationship will be undertaken in the medium term.

It was noted that the budget management risk remains unchanged after mitigation activity. VC to review this risk.

It was confirmed that the Group Audit Committee would review risk on behalf of the Board.

VC to review budget management risk and corporate risk register to be scheduled for future reviews by Audit Committee.

8 REVIEW OF BENEFITS METHODOLOGY

The Committee noted the report summarising the approach and process adopted to determine the benefit of the Company's work in financial terms.

TR advised that the validation process for the benefit estimate of £139.3m for the year ended 31 March 2018 was well in hand and the validators report would be brought to the next Group Audit Committee meeting in September.

TR advised that the methodology has been used consistently through the current corporate planning period and highlighted four areas where there have been significant fluctuations in comparison to the previous year, namely:

- Economic Investment – a decrease primarily caused by delays in existing programmes pushing projected spend beyond the 10 year calculation period.
- Asset Management – an increase primarily due to higher capital receipts than anticipated.
- Early Years – this benefit stream is introduced for the first time this year.
- Housing – an increase from additional units provided under National Housing Trust Phase2B.

TR described the internal control process undertaken and the Committee noted the challenge and scrutiny provided by the benefits team, Leadership Team and CEO prior to the external validation process.

The Committee was advised that all effectiveness factors had been reviewed and, noting the benefit value attributed to Asset Management, it was highlighted that the effectiveness factor had been reduced in the previous year. The Committee asked that a listing of effectiveness factors be circulated.

Listing of effectiveness factors to be circulated.

The Committee noted that a report on evaluating non-financial benefits of the Company's work would be presented to the Board.

10 AOB

There was no further business.