

The Accounts Commission for Scotland

Agenda

Meeting on Thursday 16 January 2014
in the offices of Audit Scotland, 18 George Street, Edinburgh

The meeting will begin at 10:00 am

1. **Apologies for absence.**
2. **Declarations of interest.**
3. **Decisions on taking business in private:** The Commission will consider whether to take items 7 to 10 in private.
4. **Minutes of meeting of 12 December 2013.**
5. **Update report by the Controller of Audit:** The Commission will consider a report from the Controller of Audit on significant recent activity in relation to the audit of local government.
6. **Parliamentary Commission on Banking Standards:** The Commission will consider a report by the Director of Audit Services.

The following items are proposed to be considered in private:

7. **Report of the Mid Staffordshire NHS Foundation Trust Public Inquiry (Francis Report):** The Commission will consider a report by the Controller of Audit.
8. **Developing a place and partnership-based joint scrutiny planning process: future developments:** The Commission will consider a report by the Controller of Audit
9. **Community Empowerment and Renewal Bill: draft response:** The Commission will consider a report by the Controller of Audit.
10. **Commission business matters:** The Chair will report on matters of interest.

ACCOUNTS COMMISSION

MEETING 16 JANUARY 2014

MINUTES OF PREVIOUS MEETING

Minutes of the meeting of the Accounts Commission
held in the offices of Audit Scotland at
18 George Street, Edinburgh, on
Thursday, 12 December 2013, at 10.00am

PRESENT: Douglas Sinclair (Chair)
Michael Ash
Alan Campbell
Colin Duncan
Christine May
Bill McQueen
Linda Pollock
Colin Peebles
Graham Sharp
Pauline Weetman

IN ATTENDANCE: Fraser McKinlay, Controller of Audit
Paul Reilly, Secretary and Business Manager
Elaine Boyd, Senior Audit Manager, Audit Services [Items 10 and 13]
Russell Frith, Assistant Auditor General [Item 16]
Dave McConnell, Assistant Director, Audit Services [Items 10 and 13]
Kathrine Sibbald, Portfolio Manager, Performance Audit and Best
Value (PABV) [Item 14]
Gordon Smail, Senior Manager, PABV [Items 9, 10, 12 and 13]
Shelagh Stewart, Project Manager, PABV [Item 14]
Martin Walker, Assistant Director, PABV [Items 9 and 12]
Tommy Yule, Project Manager, PABV [Items 9 and 12]

<u>Item No</u>	<u>Subject</u>
1.	Apologies for absence
2.	Declarations of interest
3.	Decisions on taking business in private
4.	Minutes of meeting of 14 November 2013
5.	Minutes of meeting of Financial Audit and Assurance Committee of 28 November 2013
6.	Minutes of meeting of Performance Audit Committee of 28 November 2013
7.	Chair's introduction
8.	Update report by the Controller of Audit
9.	Statutory report – Caithness Heat and Power
10.	Statutory report: East Dunbartonshire Council
11.	Any other business
12.	Statutory report – follow-up – Caithness Heat and Power
13.	Statutory report: East Dunbartonshire Council
14.	Statutory performance information: 2013 Direction
15.	COSLA Commission on Strengthening Local Democracy: draft submission
16.	Formal authority for Audit Scotland staff to make VAT claims

1. Apologies for absence

Apologies for absence were received from Sandy Cumming.

2. Declarations of interest

The following declarations of interest were made:

- Christine May, in items 10 and 13, as an adviser to opencast mining companies.
- Graham Sharp, in items 10 and 13, as a resident of East Dunbartonshire.

3. Decisions on taking business in private

It was agreed that items 13 to 16 should be taken in private as they contained draft reports and confidential issues.

4. Minutes of meeting of 14 November 2013

The minutes of the meeting of 14 November 2013 were submitted and approved.

Arising therefrom, advice from the Controller of Audit was noted that a meeting of local area network leads would take place on 13 December 2013.

5. Minutes of the meeting of the Financial Audit and Assurance Committee of 28 November 2013

The minutes of the meeting of the Financial Audit and Assurance Committee of 28 November 2013 were submitted and approved.

Arising therefrom, it was agreed that the Controller of Audit work with the Chair of the Committee to ensure reporting in early course to the Commission on proposals for the publishing of information on the 2012/13 Local Government Pension Scheme annual audit.

6. Minutes of the meeting of the Performance Audit Committee of 28 November 2013

The minutes of the meeting of the Performance Audit Committee of 28 November 2013 were submitted and approved.

7. Chair's introduction

The Chair:

- Welcomed Pauline Weetman to her first meeting of the Commission.
- Advised that he would correspond with Commission members on proposed make-up of the Commission committees in the light of recent changes to the membership of the Commission.
- Reported that:
 - On 5 December, the regular Accounts Commission meeting with strategic scrutiny bodies was postponed due to the bad weather.

- On 10 December, he attended an event hosted by the First Minister and Cabinet colleagues at which they answered questions on the independence White Paper from representatives of Scottish public life.
- On 11 December, he met Stephen Gallagher, Deputy Director of Local Government and Communities in the Scottish Government.
- Also on 11 December, he met Ronnie Cleland, Chair of the Audit Scotland Board.
- Also on 11 December, he attended a meeting of the National Community Planning Group, at which was discussed: implementation of the Agreement on Joint Working on Community Planning and Resourcing; and co-production and community engagement with the third sector.

8. Update report by the Controller of Audit

The Commission considered a report by the Controller of Audit providing an update on significant recent activity in relation to the audit of local government.

During discussion the Commission:

- In relation to paragraph 8 of the report, noted advice from the Chair about the possible implications of the Procurement Reform (Scotland) Bill for arms' length external organisations.
- Further in this regard agreed that the Bill be made available to members.
- In relation to paragraph 10, agreed that further thought be given to strategic engagement with the Improvement Service in relation to initiatives such as publications.
- In relation to paragraph 14, agreed that the Audit Commission reports *Protecting the public purse 2013: fighting fraud against local government* and *Tough times 2013: Councils' responses to financial challenges from 2010/11 to 2013/14* be placed on the Commission members' portal.

Actions: Secretary and Business Manager

Thereafter the Commission agreed to note the report.

9. Statutory Report – Caithness Heat and Power

The Commission considered a report by the Secretary and Business Manager introducing the Controller of Audit's statutory report on The Highland Council: Caithness Heat and Power and seeking direction on how to proceed.

Following consideration, the Commission agreed to note the report and to consider in private how to proceed.

10. Statutory report: East Dunbartonshire Council

The Commission considered a report by the Secretary and Business Manager introducing the Controller of Audit's statutory report on East Dunbartonshire Council and seeking direction on how to proceed.

Following consideration, the Commission agreed to note the report and to consider in private how to proceed.

11. Any other business

The Chair asked that his appreciation be recorded on behalf of the Commission of the work of Audit Scotland in supporting the Commission during 2013.

12. Statutory report – follow-up – Caithness Heat and Power [in private]

The Commission agreed that this item be held in private to allow it to consider how to proceed in relation to a report by the Controller of Audit.

Following discussion, the Commission agreed to make findings to be contained in a report and published in early course.

Action: Secretary and Business Manager

13. Statutory report: East Dunbartonshire Council [in private]

The Commission agreed that this item be held in private to allow it to consider a draft performance audit programme.

Following discussion, the Commission agreed:

- to direct the Controller of Audit to undertake further investigations
- that these be in the form of further Best Value audit work

Action: Controller of Audit

- to invite the Council to a meeting with the Commission to discuss the reasons behind its decision.

Action: Secretary and Business Manager

14. Statutory performance information: 2013 Direction [in private]

The Commission considered a report by the Controller of Audit seeking approval of the draft 2013 Direction in relation to statutory performance information; reporting publication of 2012/13 statutory performance indicator data; and providing an update on the progress of the Scottish Local Government Benchmarking Framework.

Following discussion the Commission:

- approved the draft 2013 Direction
- noted the outline of the 2012/13 statutory performance indicator data
- noted the progress of the Scottish Local Government Benchmarking Framework.

Action: Controller of Audit

15. COSLA Commission on Strengthening Local Democracy: draft submission [in private]

The Commission agreed that this item be held in private to allow it to consider a draft response to a consultation.

The Commission considered a report by the Secretary and Business Manager proposing a draft response of the Accounts Commission to COSLA's Commission on Strengthening Local Democracy.

Following discussion, the Commission agreed to write to COSLA to advise that it does not see a need to respond directly to its initiative.

Action: Secretary and Business Manager

16. Formal authority for Audit Scotland staff to make VAT claims [in private]

The Commission considered a report by the Assistant Auditor General seeking formal authority for Audit Scotland staff to make VAT input tax recovery claims for the Commission.

Following discussion the Commission agreed to grant authority for members of staff of Audit Scotland to make and sign VAT refund claims for the Commission and to otherwise correspond with HMRC on its behalf.

The following papers are enclosed for this meeting:

Agenda Item	Paper number
Agenda Item 4: Minutes of meeting of the Commission of 12 December 2013	AC.2014.1.1
Agenda Item 5: Report by Controller of Audit	AC.2014.1.2
Agenda Item 6: Report by Director of Audit Services	AC.2014.1.3
Agenda Item 7: Report by Controller of Audit	AC.2014.1.4
Agenda Item 8: Report by Controller of Audit	AC.2014.1.5
Agenda Item 9: Report by Controller of Audit	AC.2014.1.6

ACCOUNTS COMMISSION

MEETING 16 JANUARY 2014

REPORT BY CONTROLLER OF AUDIT

UPDATE REPORT

Introduction

1. The purpose of this report is to provide a regular update to the Commission on significant recent activity in relation to the audit of local government.
2. It is intended to complement the intelligence reports to the Financial Audit and Assurance Committee, which provide a more detailed update on issues arising in local government.
3. The most recent such report was at the Committee meeting of 28 November.

Local government issues

Scottish Parliament/ Scottish Government/ CoSLA/Improvement Service

4. On 4 December *Local Government and Regeneration Committee* took evidence on the work of the Commission on Strengthening Local Democracy in Scotland from Councillor David O'Neill (Chair of the Commission) Councillor Rhondda Geekie, Councillor Drew Hendry, Louise MacDonald and Geoff Mawdsley (members of the Commission) and Adam Stewart (Secretary to the Commission). The Committee also took evidence on the annual report of the Commissioner for Ethical Standards in Public Life in Scotland from Mr Stuart Allan, Public Standards Commissioner for Scotland, and Helen Hayne, Investigations Manager, Commission for Ethical Standards in Public Life in Scotland. The official report of the meeting is available here:
<http://www.scottish.parliament.uk/parliamentarybusiness/28862.aspx?r=8685&mode=pdf>
5. On 11 December the Committee took evidence on the Scottish Public Services Ombudsman ("SPSO") 2012 Annual Report from; Jim Martin, Scottish Public Services Ombudsman, Niki Maclean, Director, Emma Gray, Head of Policy and External Communications, and Paul McFadden, Head of Complaints Standards, Scottish Public Services Ombudsman. The official report of the meeting is available here:
<http://www.scottish.parliament.uk/parliamentarybusiness/28862.aspx?r=8710&mode=pdf>
6. Earlier this month the *Commission on Strengthening Local Democracy in Scotland* reported on the outcome of a survey conducted on its behalf by Ipsos MORI. The results were based on a survey of 1,006 respondents (adults aged 16+) conducted by telephone between 29 November and 5 December 2013.
7. The findings of the survey indicate that:
 - 82% of the respondents would like more say in how local services are provided in their area
 - 35% feel part of how decisions affecting their community are made

- 71% feel that local services should be delivered in ways that meet local need (compared to 27% who feel that local services should be delivered in the same way for of Scotland's communities)
 - 31% consider that it easy to see how taxes are used to provide local services (compared to 63% who do not)
 - 65% would be willing to pay more council tax if they were certain that money raised was spent on local services
8. The survey results are available here: <http://www.localdemocracy.info/wp-content/uploads/2014/01/Commission-MORI-Poll.pdf>
9. In December the Scottish Parliament approved the appointment of Mr Bill Thomson as Commissioner for Ethical Standards in Public Life in Scotland from 1 April 2014. Mr Thomson has 25 years' experience in senior posts in the Scottish public sector, in local government law and administration and since 1999 in the Scottish Parliament, where he is currently an Assistant Chief Executive.

Current activity in local government

10. In December Edinburgh City councillor Alex Lunn left the Labour group to join the SNP group The move means that the SNP now has 18 members on the council, compared to Labour, which has 20.
11. The New Year's honours list included OBEs awarded to Councillor Eileen McCartin, Renfrewshire Council for political service and Councillor James Walker, West Lothian Council for services to the community in Bathgate, West Lothian.

Other Agencies

12. On 12 December the *Audit Commission* published its annual report on the stewardship of taxpayers' money by local public bodies. 'Auditing the Accounts 2012/13' found that in 2012/13, the quality and timeliness of financial reporting was consistently strong for most groups compared to last year, while councils and small bodies had improved further still. The key messages include:
- Almost all bodies received an audit opinion by 30 September 2013
 - Responsible financial officers (RFOs) met their requirement to sign and certify the accounts by 30 June 2013 at almost all principal bodies.
 - The overwhelming majority of audited bodies received an unqualified audit opinion on their accounts.
 - Bodies maintained the timeliness of the information provided to inform Whole of Government Accounts (WGA).
 - Principal bodies have put in place proper arrangements for securing value for money (VFM).
 - Bodies have shown financial resilience but must continue adapting as they face further financial management and reporting challenges in 2013/14.
13. The report is available here: <http://www.audit-commission.gov.uk/wp-content/uploads/2012/12/Auditing-the-Accounts-LG-2012-13.pdf>

14. On 19 December *the National Audit Office* published a report on 'Optimism bias in public sector projects'. The report uses the NAO's back catalogue to illustrate the consequences of over optimism. In doing so, the report identifies some contributory factors – such as project complexity and an organisation's culture of challenge. The report is available here: <http://www.nao.org.uk/report/optimism-bias-paper/>

Conclusion

15. The Commission is invited to consider and note this report.

Fraser McKinlay
Controller of Audit
8 January 2014

ACCOUNTS COMMISSION

16 JANUARY 2014

REPORT BY DIRECTOR OF AUDIT SERVICES

PARLIAMENTARY COMMISSION ON BANKING STANDARDS

1. Purpose of report

This report provides the Accounts Commission with a summary of key messages from the *Parliamentary Commission on Banking Standards – ‘An accident waiting to happen’: the failure of HBOS*, and advises the Accounts Commission of issues and associated actions being taken forward by Audit Scotland.

2. Background

The Parliamentary Commission on Banking Standards (the ‘Commission’) was appointed by both Houses in Parliament to consider and report on professional standards and culture of the UK banking sector, including lessons to be learned about corporate governance, transparency and conflicts of interest. The Commission was invited to consider the implications for regulation and Government policy and to make recommendations for legislative and other action.

The title of the Commission’s report is taken from a quote from the Halifax Bank of Scotland (HBOS) Group Finance Director to the Board in January 2004 that, in the view of the Financial Services Authority (FSA): *the group’s growth had outpaced the ability to control risks. The Group’s strong growth, which was markedly different than the position of the peer group, may have given rise to ‘an accident waiting to happen’*. However neither HBOS nor the FSA followed through on the implications of that characterisation.

Since 2007 HBOS shareholders have lost 96% of its peak value, and what remains is as a result of support from the UK government, £20bn, and Lloyds TSB, £20bn. In March 2012 the FSA found HBOS guilty of very serious misconduct and issued a public censure to that effect. The Commission decided to examine the HBOS experience as a case study in banking failure.

Audit Scotland has considered the implications of the report for its work, including consideration by the Board at its last meeting on 21 November. The Chair of the Accounts Commission at that time, John Baillie, asked that a report in this regard be presented to the Accounts Commission.

3. Audit Scotland’s consideration

Audit Scotland’s Leadership Group – consisting of the management team and Assistant Directors - discussed the report on 20 August 2013 to determine what actions Audit Scotland may take going forward.

At a high level the failings were summarised as follows:

- An ambitious strategy was followed without due cognisance of the associated risk

- Due to management failure there was enormous loss of value
- There was ineffectual risk management at a strategic level
- The regulator was not taken seriously, and the regulator itself was inconsistent
- The board lacked all of the competencies necessary
- The organisation's response to the crisis was wholly inadequate.

There was also recognition of the inter-related nature of this discussion with that of the Francis Report on Mid-Staffordshire NHS Trust.

The result of the discussion of 20 August is summarised in Appendix 1.

4. Next steps

Three different responses have been identified for the types of weakness described: a number of points are already covered by planned audit work of two of Audit Scotland's business groups (Audit Services Group and Performance Audit and Best Value Group); certain points will be addressed by reinforcing the need for more effective application of certain audit processes; and other points will be taken forward for consideration as part of the 2013/14 planning process of the two business groups.

Since Audit Scotland's discussion, the Final Report of the Parliamentary Commission on Banking Standards has been published: 'Changing Banking for Good', in which recommendations have been made to improve standards across the banking industry. We await to see the ramifications for good governance in the public sector.

The discussions in Audit Scotland have raised everyone's awareness of the role we all must play to actively encourage good governance in public bodies, to ensure a focus on the long term financial health of public bodies, and, in so doing, contribute to the renewed corporate objective of making a positive impact on the public bodies we audit.

5. Conclusion

The Accounts Commission is invited to note the discussions held and actions taken and proposed in consideration of the April 2013 report *Parliamentary Commission on Banking Standards – 'An accident waiting to happen': The failure of HBOS*.

Fiona Kordiak
Director Audit Services
7 January 2014

APPENDIX 1

Chapter heading in report	The issue for us	Actions underway <i>(Proposed actions in italics)</i>
<p>Chapter 2 – The ‘new force in banking’: HBOS sustained significant business growth, expanding its lending significantly faster than its deposits. Due to this imbalance the bank was increasingly dependent on wholesale funding. The Commission concluded that ‘the strategy set by the Board sowed the seeds of its destruction...involved accepting more risk...This culture was brash... all the more corrosive when coupled with a lack of corporate self-knowledge at the top of the organisation’.</p>	<p>Are there overly ambitious organisations, in respect of financial risk taking?</p> <p>Are certain strategies out of balance – eg substantial capital investment plans without: commensurate forward looking revenue plans; commensurate services redesign/service transfer plans; or plans which in turn encourage reckless borrowing?</p> <p>Are there any unhealthy cultures that we need to talk about? Are there dominant chief executives/leaders/administrations where there is insufficient challenge to counter balance them?</p> <p>Do our bodies demonstrate sound corporate self-awareness?</p>	<p>Major capital projects have been identified as a risk. Performance Audit and Best Value Group (PABV) have issued a number of reports on this topic in the recent past and there is regular reporting from local auditors to PABV of the most significant capital projects.</p> <p>Overview reports make more use of financial ratios to demonstrate long term liabilities (eg borrowings, PFI commitments)</p> <p>PABV scoping an audit of Treasury management.</p> <p><i>Local auditors have the opportunity to meet Audit Committees in private. May be opportune to make more of those meetings to delve more deeply into corporate culture.</i></p> <p><i>Traditionally financial planning excludes balance sheet position (largely due to different financial target eg General Fund (LG), cash drawdown (CG)); time to review and comment.</i></p>

Chapter heading in report	The issue for us	Actions underway <i>(Proposed actions in italics)</i>
<p>Chapter 3 – The avenues to impairment: the corporate loan book was dominated by property based investment, and after 2005, in the pursuit of market expansion the bank sought out ‘sub-investment grade’ business. The Commission estimates that the aggregate customer loan impairments from 2008-11 totalled some £25bn. There was an ambitious international growth strategy which resulted in impairment of £14.5bn and the Commission refers to an ‘almost wilful blindness to the weaknesses of the portfolio’. The Treasury division switched from maintaining liquidity conservatively in government bonds and bank certificates of deposit to new products such as credit derivatives, intended to generate superior returns. However there was greater inherent risk in such products. As the financial crisis developed losses in this division amounted to £7.2bn between 2008 and 2011. The Commission concludes that losses of this magnitude, across three divisions, suggests ‘a systemic management failure across the organisation’.</p>	<p>What are the key assets in the balance sheets of public bodies: Property, plant & equipment Social housing Forestry Heritage assets Investment property Investments Student loans Debtors Cash & cash equivalents What risk/sensitivity analysis do our bodies undertake to determine if there is a risk of them being over-valued? Are they anticipating impairment when construction projects become operational assets?</p> <p>Does the protracted economic recession have an impact on asset values (eg recoverability of LT/debtors, valuation of social housing)?</p> <p>Are assets generating the return intended?</p> <p>How will Welfare Reform impact on recovery of debtors and value of social housing?</p> <p>Reserves are building up – are they held in low risk deposits?</p> <p>Is there over dependence on too few independent financial advisors to LG?</p> <p>Is the s95 officer and the SMT asking these questions of themselves?</p> <p>If an RSL were to go into administration would the council have to step in for the provision of social housing?</p>	<p>Standard audit procedures to annually review valuation of assets, including impairment when an asset becomes operational.</p> <p><i>Local auditors and Audit Strategy gathering and sharing intelligence on the impact of Welfare Reform as and when certain stages are implemented.</i></p> <p>Considered as part of the audit work on cash and cash equivalents, and investments.</p> <p><i>To explore.</i></p> <p><i>To explore.</i></p> <p><i>To explore.</i></p>

Chapter heading in report	The issue for us	Actions underway <i>(Proposed actions in italics)</i>
<p>Chapter 4 – A failure of internal control: The Commission reports that ‘the risk function in HBOS was a cardinal area of weakness in the bank. The status of the Group risk functions was low relative to the operating divisions. Successive Group Risk Directors were fatally weakened in carrying out their duties by their lack of expertise and experience in carrying out a risk function, by the fact that the centre of gravity lay with the divisions themselves...and by the knowledge that their hopes for career progression lay elsewhere in the bank. The degradation of the risk function was an important factor in explaining why the high risk activities of the ...Divisions were not properly analysed or checked at the highest levels within the bank...weaknesses of group risk in HBOS were a matter of design, not accident.’</p>	<p>Does the risk function have sufficient leadership and profile in bodies (in respect of financial risk)?</p> <p>Is there sufficient knowledge of the business held by the individuals tasked with assessing operational risk?</p> <p>Is there a high turnover in those that lead on risk?</p> <p>Is there sufficient risk management at the low operational levels but a lack of risk awareness for fundamental and strategic matters, eg impact of government policy/imposed mergers/etc.</p> <p>And how effectively do processes embrace groups ALEOs?</p> <p>Are reports on internal control reaching those individuals and committees that need to know?</p>	<p><i>Local auditors routinely consider but ought to address more robustly.</i></p> <p><i>Competency of leadership not routinely evaluated, except where there is a BV audit. To be discussed further.</i></p> <p><i>Local auditors routinely consider but ought to address more robustly.</i></p> <p><i>Currently being explored following Accounts Commission meeting of 17 October 2013..</i></p> <p><i>Local auditors routinely consider but ought to address more robustly.</i></p>

Chapter heading in report	The issue for us	Actions underway <i>(Proposed actions in italics)</i>
<p>Chapter 5 – A failure of regulation: The FSA reported as early as 2002 serious concerns that the group’s control functions were not keeping pace with growth, that the group risk function was insufficiently embedded in the business and that the bank was over-reliant on wholesale funding. The Audit Committee rejected the findings of the FSA. In 2003 the FSA expressed concern that HBOS had not properly addressed the findings of the 2002 review. Reviews were commissioned from KPMG and PwC, which had recommendations to make, but largely provided assurance. Consequently regulatory pressure for improvement diminished. FSA’s focus changed from 2004 onwards with less emphasis on liquidity and the quality of loans and more emphasis on systems and controls. The Commission observes that the most senior levels of the FSA, MD and Directors, had very little direct contact with the firm. FSA has said of itself that due to a good relationship with HBOS it placed reliance on the senior management team to deliver actions in accordance with the risk mitigation programme. The Commission believes that the FSA regulation of HBOS to be ‘thoroughly inadequate...with a regulatory approach ... with a focus on box ticking which detracted from consideration of fundamental issues...and that the FSA’s own approach encouraged the Board of HBOS to...treat the regulator as a source of interference to be pushed back.’</p>	<p>Do we follow up on what we report robustly, to ensure addressed?</p> <p>What do we do when management do not accept our findings?</p> <p>Are our senior staff sufficiently engaged with the bodies? Are we overly-supportive of bodies?</p> <p>Have we got the balance right between systems and substance of transactions?</p> <p>Would an external assessor find our audit process robust?</p>	<p>Local auditors routinely follow up recommendations from prior year reports, and report to the client.</p> <p>Recommendations from national reports are not 100% followed up: certain reports are selected for follow up by Audit Services Group (ASG) or PABV. However selection <i>is</i> based on a risk assessment (of the topic and previous findings).</p> <p>Appointed auditors are routinely engaged with individual bodies; senior PABV staff are routinely in contact with national representative groups.</p> <p>The nature of public sector audit work requires us to report on the ‘legality’ or ‘regularity’ of transactions. Consequently we do cover the substance of transactions.</p> <p>ASG has been subject to review by ICAS and ICAS return for part two of their review in January 2014; the first report having been satisfactory.</p>

Chapter heading in report	The issue for us	Actions underway <i>(Proposed actions in italics)</i>
<p>Chapter 6 – ‘The best board I ever sat on’: HBOS executives and non-executives considered the board to be strong and effective, that it demonstrated considerable relevant experience, and that the individuals were of high intellect and integrity. This is reflected in the risk assessments on corporate governance. The Commission concludes, however, that there was insufficient banking expertise among HBOS’s top management, that the board lacked the necessary banking experience among its non-executives and that the board ‘represents a model of self-delusion, of triumph of process over purpose’.</p>	<p>Do the boards demonstrate the right mix of expertise, wisdom and challenge? Do we report where we observe this not to be the case?</p> <p>If they are doing self-assessments, when do they get external input?</p> <p>How rigorous is the review of performance of board members?</p>	<p><i>Competency of leadership not routinely evaluated, except where there is a BV audit. To be discussed further.</i></p>

Chapter heading in report	The issue for us	Actions underway <i>(Proposed actions in italics)</i>
<p>Chapter 7 – Downfall: In 2006 the head of Treasury Division advised the Executive Committee that the wholesale funding need of the bank, the highest of any UK bank, was untenable and unsustainable. HBOS took steps to mitigate its reliance but it had to be cautious about what messages it was sending to the market. The day Northern Rock was granted emergency assistance HBOS set up a Contingency Planning Group. The Board felt it was coping well with the financial crisis, the HBOS chairman writing to the FSA chairman in November 2007: ‘without wishing to be complacent or hubristic, management has done a superb job...we sense a continual paranoia with the FSA about the ‘about the ladder of vulnerability and HBOS’’. In autumn 2008 the bank was faced with the closure of wholesale markets which meant it could not raise the necessary financing to meet its outflows. Management had no contingency plan for the severity of the financial crisis it faced. The Commission concludes that ‘the HBOS failure was fundamentally one of solvency’. This was as a result of very large asset impairments, £50bn between 2008 and 2011, or 10% of its customer loan book, double that of any other UK domestic banking group. The Commission considers that the crisis in the financial markets was merely a catalyst in exposing the ‘reckless lending policies’ pursued by HBOS.</p>	<p>Is the Board listening to internal concerns, and then doing something about it?</p> <p>On borrowing, can LG find replacement loans when necessary, and across the border? Would there ever be a risk of not being able to replace them?</p> <p>Have cashflow projections fully taken account of repayment of capital as well as interest?</p> <p>Would there ever be a problem of solvency for our bodies?</p> <p>Is the mix of IFRS and Code/GF adjustments obscuring the repayment of borrowings?</p>	<p><i>Local auditors have the opportunity to meet Audit Committees in private. May be opportune to make more of those meetings to delve more deeply into corporate culture.</i></p> <p>PABV scoping an audit of Treasury management.</p> <p><i>To consider as part of the ‘expectations of audit’ review.</i></p>