

AUDIT COMMITTEE

Minutes of the Meeting of the Audit Committee (the Committee) held at British Waterways' London Office, Sheldon Square, Paddington on Wednesday 8 June 2011 at 10.00 a.m.

PRESENT:

Mr N Hugill (Chairman), Mr J Bridgeman, Mr P Sarwal

APOLOGIES:

Mr R Green

IN ATTENDANCE:

Mr T Hales, Mr N Johnson, Mr P Ridal, Mr J Stirling, Mr K Labbett, (all from BW), Mr S Maslin, Mr T Lincoln, Ms C Reid (all from Grant Thornton) and Mr M Devin (from Prism Cosec, minutes)

11/A10 MINUTES OF THE PREVIOUS MEETING

The minutes of the meeting of the Committee held on 12 January 2011 were approved.

11/A11 MATTERS ARISING:

Climate change (11/A02)

Mr Stirling reported that a report would be submitted to Defra before the next Audit Committee on 14 September.

Tax planning (11/A03)

Mr Ridal reported that a draft tax planning strategy paper would be prepared for the September Audit Committee meeting.

PR

The objective of the strategy would be to mitigate the tax impact of the move to the charitable sector. Mr Johnson confirmed Treasury ministers had recently agreed to tax neutrality for the transfer to the New Waterways Charity (NWC) and described two statutory instruments that would provide that tax neutrality. Responding to a question from Mr Maslin as to whether that tax neutrality would extend to losses carried forward he said he anticipated it would. The strategy would furthermore inform decisions as to where assets and debt are placed in the new structure.

PR

Mr Ridal said that the accounts would be re-cast to conform to the requirements for a charity and would be tabled at the July BW Board meeting.

BW Scotland (11/A04)

Mr Ridal reported that a meeting was scheduled for 29 June with the Scottish Government and Defra to consider the issue of BW Scotland pensions following the separation of BW Scotland in April 2011.

The Committee considered the separation of BW into NWC and BW Scotland BW with particular reference to the pension scheme and resolved that a sub-

committee of the Board should be constituted to address the practicalities of separation (minute 11/A15 below refers).

Replying to a question from Mr Sarwal, Mr Ridal said that backdated accounts had been scanned and were available to help determine the extent of cross border transfers. Mr Johnson confirmed that an analysis of pension membership data was also in hand.

It was noted that KPMG's draft report would be submitted to the BW Board at its July meeting.

11/A12 ANNUAL REPORT AND ACCOUNTS (BW/A320)

Mr Ridal presented the draft annual report for the year ended 31 March 2011, adding that a further draft would be circulated in time for the Board meeting on 16 June.

The principal change to the accounts presented to the Board in May related to:

1. BW Re-insurance, where the loss adjuster had provided an additional £500k for a personal injury claim. This had increased the CBT deficit from £7.2m to £7.7m; and
2. Finalisation of a potential deferred tax charge of £500k. This was imminent and would be incorporated into the accounts to be presented to the Board.

PR

Mr Ridal highlighted the fact that there was more cash in the trading account than in reserves but that it was planned to reduce this balance, currently £5.8m, to nil by 31 March 2012.

The Chairman raised the question of going concern during the transitional phase to third sector status and asked that Grant Thornton and KPMG provide their respective views on going concern status pre- and post-transfer to the charitable sector.

PR

Mr Hales asked whether a check on survival of recipients of pensions in payment could usefully be made. Mr Johnson explained that Capita checked the status of pensioners on a cyclical basis, the last such check having been within the last two years.

PR

Mr Sarwal recommended that statements in the Chairman's report to the effect that progress was being made in relation to the move towards charitable status be reviewed bearing in mind that consultation was not due to finish until the end of June. It was noted that the narrative sections of the report in general required refreshment in advance of the Board meeting on 16 June and that Mr Sarwal's comments would be taken into consideration.

11/A13 KEY ISSUES FROM EXTERNAL AUDIT 2010-11 (BW/A321)

Mr Lincoln explained that the external audit for the year ended 31 March 2011 had gone according to plan. An unqualified audit opinion was expected to be given subject to an adjustment in relation to the capital reserve, which was not currently in line with IFRS. The key issues covered in the audit were then considered.

Transition to waterways charity

Mr Lincoln explained that the transition to the third sector was, in the context of the 31 March 2011 accounts, largely a matter for the narrative sections of the report but added that the accounts made reference to the transitional process as appropriate. Mr Lincoln underlined the fact that a review of the transition to charitable status had not formed part of the audit brief but that the auditor had formed the opinion that the topics already discussed by the Committee, for example, tax neutrality and the separation of BW Scotland, were the main issues but it would be challenging to deal with the number of detailed actions arising during the transition period.

Transitional tax issues

It was noted that Deloitte, who were advising on transitional tax issues, were holding regular meetings with Grant Thornton and had confirmed that BW was on track addressing these issues. Mr Maslin suggested that it would be helpful if Grant Thornton could meet the transitional trustees in the near future.

Going concern

Mr Lincoln underlined the importance of ensuring that BW Scotland was a going concern as at 31 March 2012, adding that, if this were not to be the case, it would be incumbent on the BW Board to draw this to the attention of the Scottish Government. Mr Hales noted that the BW business in England and Wales, to be transferred to the new waterways charity, was currently without any external review beyond 31 March 2012 but that the BW Board has a regulatory duty to ensure to carry out a going concern review.

Investment property portfolio

The Committee considered the performance of the investment property portfolio. Mr Hugill noted the challenge of determining valuations of illiquid assets in illiquid markets and said that the BW Property Committee remit going forward was to pursue an investment strategy to achieve a more conservative configuration of assets appropriate for the NWC trustees.

Mr Lincoln agreed that the Key Issues Memorandum would make reference to the longer term growth achieved by the portfolio. **TL**

Bank accounts

Mr Lincoln highlighted an issue that had arisen during the audit in relation to bank account reconciliations, noting that Mr Pullinger was reviewing procedures.

It was resolved, subject to the comments noted above, to recommend that the annual report and accounts be approved by the Board on 16 June.

11/A14 RISK UPDATE AND COMPLIANCE REPORT (BW/A322)

In the absence of Mr Evans, Mr Stirling presented an update to the corporate risk dashboard highlighting the principal changes to the previous dashboard in relation to leadership, policy and people risks. These were discussed further.

Mr Hugill, noting the impact of the transition to charitable status on staff morale, enquired whether the executive had a clear vision as to how to maintain morale during the transition. Mr Stirling replied in the affirmative, adding that the executive was currently engaged on a series of roadshow presentations and that a senior managers' briefing would be held on Tuesday 14 June. Mr Stirling further stated that there was a perception that, as a charity, the NWC would not continue to employ professionally qualified staff

and, at more junior levels, there was concern about the possible erosion of employee benefits and increased deployment of volunteers. Mr Hales said that the transition trustees were very supportive of the executive and that his statement in the annual report would be revised to convey a strong message in this regard. Mr Bridgeman added that, as staff became more exposed to the transition trustees, their concerns would in all likelihood be alleviated.

Noting a recent fatality on the canal network at Stourport, Mr Hales requested that Vince Moran provide feedback on BW's response at the June Board meeting.

JS

11/A15 **NWC RISK (BW/A323) AND SCOTLAND SEPARATION RISK (BW/A324)**

The transition of BW into two entities carried a number of risks. The BW Scotland risk dashboard highlighted a number of issues that needed to be managed to secure a successful transition to enable BW Scotland to continue operating effectively.

Mr Stirling explained the statutory process for achieving separation, namely, a transfer order requiring parliamentary approval in relation to purely legislative issues and sign off by the Scottish Government. Mr Johnson noted that the delay to parliamentary approval arising from the need to get Scottish Government consent to the Order was limited since the scope of such consent was confined to those matters within the legislative competence of Parliament, a relatively small part of the Order.

As regards the separation of assets and liabilities, that was effected by a separate instrument, the Transfer Scheme, Mr Johnson explained that, under the terms of the Public Bodies Bill, BW assets supporting waterways activities in England and Wales could be extracted from BW and transferred to the NWC. The Transfer Scheme was made by a UK Government minister and laid before the Westminster Parliament.

NJ

The Committee recognised the importance of both sides articulating their respective viewpoints and resolved to request the BW Board to establish a sub-committee (i) to determine the split of assets and liabilities; and (ii) to address ongoing issues such as whether there is a continuing obligation to give IT systems and resources support to BW Scotland. The sub-committee would report to the Board via the Audit Committee and would comprise Messrs Sarwal, Hargreaves and Bridgeman with Mr Hales and Mr Hugill (ex-officio) in attendance as appropriate.

TH

Mr Hargreaves would be invited to join the Audit Committee.

11/A16 **INTERNAL AUDIT SUMMARY OF WORK (BW/A325)**

Mr Labbett presented the Internal Audit progress report. There were no major findings in relation to the activities undertaken during the period from January 2011 to date.

A due diligence review of Fountains Group Limited had been completed to give assurance to the trades union representatives of staff being transferred under TUPE to Fountains from BW. Whilst the review had concluded that Fountains is financially sound, Mr Hugill urged caution, noting that, whilst this may appear to be the case, there was a possibility that there was a significant level of debt sitting above the Fountains business at parent company level in order to

convey a favourable financial impression of the business for the benefit of its customers. Mr Labbett noted this but was able to reassure the Committee that the due diligence review had looked at the ownership structure at a group level and concluded that Fountains has a good financial model.

11/A17 EFFECTIVENESS OF INTERNAL CONTROL (BW/A326)

In the absence of Mr Evans, Mr Ridal presented his written report on the effectiveness of internal controls.

The current area of focus was the effectiveness of the Golden Thread, a strategy to ensure the alignment of vision, mission and purpose, objectives, strategies, business plans and targets with personal performance plans. It was agreed that Mr Evans should be asked to present on this topic to the BW Board.

RE

11/A18 CORPORATE GOVERNANCE REPORT (BW/A327)

The Corporate Governance Report presented by Mr Johnson was noted and approved. Responding to a question from Mr Hales, Mr Johnson agreed to check the date of the last Board evaluation.

NJ

(Messrs Maslin, Lincoln, Ridal, Johnson, Stirling and Miss Reid left the meeting)

11/A19 MEETING WITH THE HEAD OF AUDIT

Members of the Committee met with Mr Labbett, Head of Audit, without members of management or the external auditor being present.

Mr Labbett noted the risk of disconnection in the Golden Thread and was working with Mr Evans and the new Head of Human Resources to address this issue.

KL/RE

At the suggestion of Mr Bridgeman, it was recommended that Mr Labbett should be made available to the sub-committee to be appointed to oversee the separation of BW Scotland referred to in minute 11/A15 above. Mr Sarwal would speak with Mr Evans about this.

PS

(Messrs Maslin, Lincoln and Miss Reid re-joined the meeting. Mr Labbett left the meeting)

11/A20 MEETING WITH THE EXTERNAL AUDITOR

Members of the Committee met with the representatives from Grant Thornton without members of BW management present.

Mr Lincoln confirmed that there were no significant issues in relation to internal controls that required minuting. However, Mr Maslin observed that some minor issues had arisen caused by responsibilities being delegated by senior staff whose time had been absorbed by the transitional process but that this was notable because it had not arisen in prior years.

Mr Maslin offered the Committee whatever additional resources it required from Grant Thornton to support the transitional process and to supplement the

work being carried out by KPMG and Deloitte.

Mr Hugill moved that the BW Board be asked to recommend to the transitional trustees that Grant Thornton be appointed as external auditor to the NWC for the year beyond 31 March 2012. Mr Sarwal added that continuity of the Grant Thornton audit team should be a pre-requisite for their continued appointment and Mr Maslin assured the Committee on this point. The new legal entity would be in place by the end of July. Therefore, the Committee's recommendation would be put to the BW Board in September 2011.

NJ

(Messrs Labbett, Johnson, Stirling and Ridal re-joined the meeting)

11/A21 REMUNERATION COMMITTEE

It was noted that Mr Green had agreed to chair the Remuneration Committee.

11/A22 DATE OF NEXT MEETING

Wednesday 14 September 2011 at 10:30am, to be held at British Waterways' London office, Sheldon Square, Paddington.

There being no other business the meeting concluded at 1:30pm.

Chairman