Email: committeeservices@horsham.gov.uk

Direct line: 01403 215465



## **Audit Committee**

Wednesday, 13th December, 2017 at 5.30 pm Hastings & Knepp, Parkside, Chart Way, Horsham

Councillors: Stuart Ritchie (Chairman)

Paul Marshall (Vice-Chairman)

John Chidlow

Brian Donnelly Godfrey Newman

Tim Lloyd

Adrian Lee

You are summoned to the meeting to transact the following business

Tom Crowley Chief Executive

## **Agenda**

		Page No.
1.	Apologies for absence	
2.	Minutes	3 - 8
	To approve as correct the minutes of the meeting held on 25 <sup>th</sup> July 2017 (Note: If any Member wishes to propose an amendment to the minutes they should submit this in writing to <a href="mailto:committeeservices@horsham.gov.uk">committeeservices@horsham.gov.uk</a> at least 24 hours before the meeting. Where applicable, the audio recording of the meeting will be checked to ensure the accuracy of the proposed amendment.)	
3.	Declarations of Members' Interests	
	To receive any declarations of interest from Members of the Committee	
4.	Announcements	
	To receive any announcements from the Chairman of the Committee or the Chief Executive	
5.	Annual Audit Letter	9 - 32
	To receive the Annual Audit Letter – to be presented by the External Auditor	
6.	Audit Plan 2017/18	33 - 68
	To receive the Audit Plan for 2017/18 – to be presented by the External Auditor	
7.	Progress Report	69 - 76

To receive the HDC Audit Progress Report – to be presented by the External Auditor

8.	Treasury Management Strategy 2018/19	77 - 94
	To receive the report of the Director of Corporate Resources	
9.	Treasury Management Activity and Prudential Indicators mid-year report 2017/18	95 - 106
	To receive the report of the Director of Corporate Resources	
10.	Risk Management - Quarterly Update	107 - 118
	To receive the quarterly report of the Director of Corporate Resources on risk management.	
11.	Internal Audit - Quarterly Update Report	119 - 130
12.	Urgent Business	
	Items not on the agenda which the Chairman of the meeting is of the opinion should be considered as urgent because of the special circumstances	
	To consider the following exempt or confidential information:	
13	Internal Audit - Quarterly Undate on Audit Follow-ups	131 - 136

# Agenda Item 2

# Audit Committee 25 JULY 2017

Present: Councillors: John Chidlow, Brian Donnelly, Tim Lloyd, Paul Marshall,

Godfrey Newman and Stuart Ritchie

Apologies: Councillors: Adrian Lee

Also Present: Councillors: Peter Burgess, Leonard Crosbie, Nigel Jupp

## AAG/53 **ELECTION OF CHAIRMAN**

**RESOLVED** 

That Councillor Stuart Ritchie be elected Chairman of the Committee

for the current Council year.

Councillor Stuart Ritchie thanked the outgoing Chairman, Councillor Godfrey Newman, for his work during his tenure as chairman.

AAG/54 **APPOINTMENT OF VICE-CHAIRMAN** 

**RESOLVED** 

That Councillor Paul Marshall be appointed Vice-Chairman of the

Committee for the current Council year.

# AAG/55 TO APPROVE THE TIME OF MEETINGS OF THE COMMITTEE FOR THE ENSUING YEAR

RESOLVED

That meetings of the Committee be held at 5.30pm for the ensuing

Council year.

## AAG/56 MINUTES

The minutes of the meeting held on 22<sup>nd</sup> March 2017 were approved as a correct record and signed by the Chairman.

## AAG/57 **DECLARATIONS OF MEMBERS' INTERESTS**

There were no declarations of interest.

## AAG/58 ANNOUNCEMENTS

There were no announcements.

## AAG/59 AUDIT RESULTS REPORT

The external audit manager presented the audit results report which proposed an unqualified opinion on the statement of accounts.

One adjusted misstatement was reported. The Committee agreed not to adjust two unadjusted misstatements that had been identified.

An unqualified value for money conclusion was also proposed. The report stated that the external auditors were satisfied with the current Medium Term Financial Strategy but the Council should not reduce its efforts to seek out methods of generating savings without impacting services whilst retaining a sustainable financial position.

**RESOLVED** 

That the Audit Results Report be noted.

## AAG/60 **LETTER OF REPRESENTATION**

**RESOLVED** 

That the letter and appendix of unadjusted misstatements be agreed by the Audit Committee and signed by the Director of Corporate Resources and the Chairman of the Audit Committee.

# AAG/61 TREASURY MANAGEMENT ACTIVITY AND PRUDENTIAL INDICATORS 2016/17

**RESOLVED** 

That the Committee noted the following:

- i) The Treasury Management stewardship report for 2016/17
- ii) The actual prudential indicators for 2016/17

**REASON** 

i) The annual treasury report is a requirement of the Council's reporting procedures.

ii) This report also covers the actual Prudential Indicators for 2016/17 in accordance with the requirements of the relevant CIPFA Codes of Practice.

## AAG/62 STATEMENT OF ACCOUNTS 2016/17

The Chairman congratulated the Finance team on a well presented set of financial statements that was produced in a shorter timescale, on track to achieve the brought forward statutory deadline in 2017/18.

#### **RESOLVED**

That the Statement of Accounts 2016/17 be approved.

#### **REASON**

- i) It is a requirement of the Accounts and Audit (England) Regulations 2016 that the Statement of Accounts are approved by 30 September 2017
- ii) The external auditors plan to issue an unqualified audit opinion on the financial statements for 2016/17

## AAG/63 RISK MANAGEMENT - QUARTERLY UPDATE

The Director of Corporate Resources presented the latest quarterly update of the Corporate Risk Register.

Members agreed that a significant risk would be a breach of data protection. The committee agreed that more e-learning courses should be advertised and available to Council Members.

**RESOLVED** 

That the report be noted.

REASON

To ensure that the Council has adequate risk management arrangements in place.

## AAG/64 INTERNAL AUDIT - QUARTERLY UPDATE REPORT

The Chief Internal Auditor presented the report to Members for noting.

Since the last quarterly meeting in March 2017, 10 audit reviews have been completed. Council Tax and Payroll achieved an overall assurance opinion of "Substantial". The following audits were assessed as "Satisfactory": Project Governance (Broadbridge Heath Leisure Centre); Buildings Maintenance and

Facilities Management; Risk Management; Business Rates; Treasury Management and BACS. Housing Benefits and Cash and Bank were both given "Limited" Assurance.

Two amendments have been made to the 2017/18 audit plan. The Parking Enforcement audit has been replaced by a 'consultancy' review of the ANPR (Automatic Number Plate Recognition) system, and the audit of mobile devices has been replaced by an audit of cyber security controls. The audits of Parking Enforcement and Mobile Devices will be considered for the 2018/19 audit plan.

#### RESOLVED

(i) That the summary of audit and project work undertaken since March 2017 be noted.

#### **REASONS**

- (i) To comply with the requirements set out in the Public Sector Internal Audit Standards 2013 (amended April 2017).
- (ii) The Committee is responsible for reviewing the effectiveness of the Council's system of internal control.

## AAG/65 ANNUAL INTERNAL AUDIT REPORT 2016/17

The Chief Internal Auditor advised that the annual report had been compiled to:

- Provide a statement on conformance with the Public Sector Internal Audit Standards;
- Summarise the effectiveness of internal audit work; and
- Summarise the work undertaken by Internal Audit during 2016/17 and provide an overall opinion on the adequacy of the Council's governance arrangements, risk management systems and control environment.

The Council's Internal Audit Service operated in accordance with the Public Sector Internal Audit Standards, which required the Chief Internal Auditor to undertake a self-assessment of the internal audit service against a Quality Assurance and Improvement Plan checklist the results of which were outlined as part of the Annual Audit Report. It was noted that the Internal Audit Team had maintained its independence throughout 2016/17 in accordance with the Audit Charter.

During the year, 86% of audits had been completed against a target of 85%.

The Chief Internal Auditor reported that he was of the overall opinion that "Satisfactory" assurance could be given that there was generally a sound

system of internal control, designed to meet the Council's objectives, and that the controls were generally being applied consistently.

It was agreed that the Chief Internal Auditor (CIA) would find out whether audits not completed during 2015/16 were covered during 2016/17. It was also agreed that the CIA and Director of Corporate Resources would consider whether the Communications audit (not undertaken during 2016/17) should be undertaken during 2017/18. The information will be reported back at the next meeting.

#### RESOLVED

- i) That the statement of compliance with the Public Sector Internal Audit Standards be noted.
- ii) That the performance of internal audit against performance targets be noted
- iii) That the opinion of the Chief Internal Auditor on the overall adequacy and effectiveness of the Council's internal control environment, governance and risk management systems be noted

#### **REASONS**

- To comply with the requirements set out in the Public Sector Internal Auditing Standards 2013 (Amended April 2017).
- ii) The Audit Committee is responsible for reviewing the effectiveness of the Council's system of internal control.

## AAG/66 ANNUAL GOVERNANCE STATEMENT 2016/17

The Director of Corporate Resources reported that the annual review of the Council's governance, risk management and internal control arrangements has been undertaken to support the production of the Annual Governance Statement for 2016/17.

## **RESOLVED**

That the Annual Governance Statement for 2016/17 be approved.

#### **REASON**

As part of good governance, it is important that the Annual Governance Statement is approved by the Audit Committee.

## AAG/67 **URGENT BUSINESS**

There were no urgent matters to be considered.

## AAG/68 EXCLUSION OF THE PRESS AND PUBLIC

#### **RESOLVED**

That, under Section 100A(2) of the Local Government Act 1972, the press and public be excluded from the meeting for the following items of business on the grounds that they involve the likely disclosure of exempt information, as defined in Part I of Schedule 12A of the Act, by virtue of the paragraph specified against each item, and in all the circumstances of the case, the public interest in maintaining the exemption outweighs the public interest in disclosing the information.

## AAG/69 **AUDIT FOLLOW-UPS**

The Chief Internal Auditor summarised the progress on the implementation of agreed actions since March 2017.

#### **RESOLVED**

- i) That the progress in terms of agreed actions implemented since March 2017 be noted.
- ii) That any areas of particular concern highlighted by the Chief Internal Auditor be noted

#### **REASON**

The Audit Committee is responsible for reviewing the effectiveness of the Council's system of internal control.

The meeting closed at 7.20 pm having commenced at 5.30 pm

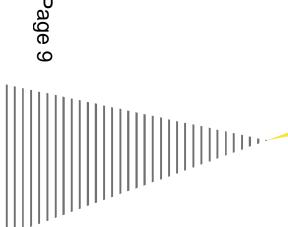
CHAIRMAN

# **Horsham District Council**

Annual Audit Letter for the year ended 31 March 2017

July 2017

Ernst & Young LLP





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Public Sector Audit Appointments Ltd (PSAA) have issued a "Statement of responsibilities of auditors and audited bodies". It is available from the Chief Executive of each audited body and via the PSAA website (www.psaa.co.uk)

The Statement of responsibilities serves as the formal terms of engagement between appointed auditors and audited bodies. It summarises where the different responsibilities of auditors and audited bodies begin and end, and what is to be expected of the audited body in certain areas.

The "Terms of Appointment (updated 23 February 2017)" issued by PSAA sets out additional requirements that auditors must comply with, over and above those set out in the National Audit Office Code of Audit Practice (the Code) and statute, and covers matters of practice and procedure which are of a recurring nature.

This Annual Audit Letter is prepared in the context of the Statement of responsibilities. It is addressed to the Members of the audited body, and is prepared for their sole use. We, as appointed auditor, take no responsibility to any third party.

Our Complaints Procedure – If at any time you would like to discuss with us how our service to you could be improved, or if you are dissatisfied with the service you are receiving, you may take the issue up with your usual partner or director contact. If you prefer an alternative route, please contact Steve Varley, our Managing Partner, 1 More London Place, London SE1 2AF. We undertake to look into any complaint carefully and promptly and to do all we can to explain the position to you. Should you remain dissatisfied with any aspect of our service, you may of course take matters up with our professional institute. We can provide further information on how you may contact our professional institute.



## **Executive Summary**

We are required to issue an annual audit letter to Horsham District Council (the Council) following completion of our audit procedures for the year ended 31 March 2017.

Below are the results and conclusions on the significant areas of the audit process.

Area of Work	Conclusion
Opinion on the Council's:  ► Financial statements	Unqualified – the financial statements give a true and fair view of the financial position of the Council as at 31 March 2017 and of its expenditure and income for the year then ended
<ul> <li>Consistency of other information published with the financial statements</li> </ul>	Other information published with the financial statements was consistent with the Annual Accounts
Concluding on the Council's arrangements for securing economy, efficiency and effectiveness	We concluded that you have put in place proper arrangements to secure value for money in your use of resources

Area of Work	Conclusion		
Reports by exception:			
<ul> <li>Consistency of Governance Statement</li> </ul>	The Governance Statement was consistent with our understanding of the Council		
► Public interest report	We had no matters to report in the public interest		
<ul> <li>Written recommendations to the Council, which should be copied to the Secretary of State</li> </ul>	We had no matters to report		
<ul> <li>Other actions taken in relation to our responsibilities under the Local Audit and Accountability Act 2014</li> </ul>	We had no matters to report		

Area of Work	Conclusion
Reporting to the National Audit Office (NAO) on our review of the Council's Whole of Government Accounts return (WGA).	The Council is below the specified audit threshold of £350 million. Therefore, we did not perform any audit procedures on the consolidation pack.

As a result of the above we have also:

Area of Work	Conclusion
Issued a report to those charged with governance of the Council communicating significant findings resulting from our audit.	Our Audit Results Report was presented on 25 July 2017
Issued a certificate that we have completed the audit in accordance with the requirements of the Local Audit and Accountability Act 2014 and the National Audit Office's 2015 Code of Audit Practice.	Our certificate was issued on 28 July 2017

In December 2017 we will also issue a report to those charged with governance of the Council summarising the certification work we have undertaken.

We would like to take this opportunity to thank the Council's staff for their assistance during the course of our work.

Paul King

Executive Director
For and on behalf of Ernst & Young LLP



## Purpose

## The Purpose of this Letter

The purpose of this annual audit letter is to communicate to Members and external stakeholders, including members of the public, the key issues arising from our work, which we consider should be brought to the attention of the Council.

We have already reported the detailed findings from our audit work in our 2016/17 Audit Results Report presented to the 25 July 2017 meeting of the Audit Committee, representing those charged with governance. We do not repeat those detailed findings in this letter. The matters reported here are the most significant for the Council.



## Responsibilities

## Responsibilities of the Appointed Auditor

Our 2016/17 audit work has been undertaken in accordance with the Audit Plan that we presented to the Audit Committee on 4 January 2017 and is conducted in accordance with the National Audit Office's 2015 Code of Audit Practice, International Standards on Auditing (UK and Ireland), and other guidance issued by the National Audit Office.

As auditors we are responsible for:

- Expressing an opinion:
  - On the 2016/17 financial statements; and
  - On the consistency of other information published with the financial statements.
- Forming a conclusion on the arrangements the Council has to secure economy, efficiency and effectiveness in its use of resources.
- ► Reporting by exception:
  - ▶ If the annual governance statement is misleading or not consistent with our understanding of the Council;
  - ► Any significant matters that are in the public interest;
  - Any written recommendations to the Council, which should be copied to the Secretary of State; and
  - ▶ If we have discharged our duties and responsibilities as established by thy Local Audit and Accountability Act 2014 and Code of Audit Practice.

Alongside our work on the financial statements, we also review and report to the National Audit Office (NAO) on you Whole of Government Accounts return. The Council is below the specified audit threshold of £350 million. Therefore, we did not perform any audit procedures on the return.

## Responsibilities of the Council

The Council is responsible for preparing and publishing its statement of accounts accompanied by an Annual Governance Statement. In the AGS, the Council reports publicly each year on how far it complies with its own code of governance, including how it has monitored and evaluated the effectiveness of its governance arrangements in year, and any changes planned in the coming period.

The Council is also responsible for putting in place proper arrangements to secure economy, efficiency and effectiveness in its use of resources.



## **Financial Statement Audit**

## Key Issues

The Council's Statement of Accounts is an important tool for the Council to show how it has used public money and how it can demonstrate its financial management and financial health.

We audited the Council's Statement of Accounts in line with the National Audit Office's 2015 Code of Audit Practice, International Standards on Auditing (UK and Ireland), and other guidance issued by the National Audit Office and issued an unqualified audit report on 28 July 2017.

Our detailed findings were reported to the 25 July 2017 meeting of the Audit Committee.

The key issues identified as part of our audit were as follows:

#### Significant Risk

#### Management override of controls

A risk present on all audits is that management is in a unique position to perpetrate fraud because of its ability to manipulate accounting records directly or indirectly, and prepare fraudulent financial statements by overriding controls that otherwise appear to be operating effectively.

Auditing standards require us to respond to this risk by testing the appropriateness of journals, testing accounting estimates for possible management bias and obtaining an understanding of the business rationale for any significant unusual transactions.

For local authorities the potential for the incorrect classification of revenue spend as capital is a particular area where there is a risk of management override. We therefore review capital expenditure on property, plant and equipment to ensure it meets the relevant accounting requirements to be capitalised.

#### Conclusion

We obtained a full list of journals posted to the general ledger during the year, and analysed these journals using criteria we set to identify any unusual journal types or amounts. We then tested a sample of journals that met our criteria and tested these to supporting documentation.

We considered the following accounting estimates deemed most susceptible to bias: Business Rates Appeals Provision; Valuation of Property, Plant and Equipment and Investment Property and the Pension Asset and disclosures. We concluded that these estimates were reasonably calculated.

We did not identify any material weaknesses in controls or evidence of material management override.

We did not identify any instances of inappropriate judgements being applied.

We did not identify any other transactions during our audit which appeared unusual or outside the Council's normal course of business

Our testing did not identify any expenditure which had been inappropriately capitalised.

The Council's Statement of Accounts is an important tool for the Council to show how it has used public money and how it can demonstrate its financial management and financial health.

## Our application of materiality

When establishing our overall audit strategy, we determined a magnitude of uncorrected misstatements that we judged would be material for the financial statements as a whole.

Item	Thresholds applied		
Planning materiality	We determined planning materiality to be £1.396 million (2016: £1.550 million), which is 2% of gross operating expenditure reported in the accounts of £69.8 million, adjusted for the Parish and Town Council precepts; interest payable; net interest on net defined benefit liability and investment property expenditure.		
	We consider gross operating expenditure to be one of the principal considerations for stakeholders in assessing the financial performance of the Council.		
Reporting threshold	We agreed with the Audit Committee that we would report to the Committee all audit differences in excess of £69,800 (2016: £77,500)		

We also identified the following areas where misstatement at a level lower than our overall materiality level might influence the reader. For these areas we developed an audit strategy specific to these areas. The areas identified and audit strategy applied include:

- Remuneration disclosures including any severance payments, exit packages and termination benefits: Strategy applied: no specific testing threshold applied, the impact of any issues were considered individually
- · Related party transactions. Strategy applied: no specific testing threshold applied, the impact of any issues were considered individually

We evaluate any uncorrected misstatements against both the quantitative measures of materiality discussed above and in light of other relevant qualitative considerations.



## Value for Money

We are required to consider whether the Council has put in place 'proper arrangements' to secure economy, efficiency and effectiveness on its use of resources. This is known as our value for money conclusion.

Proper arrangements are defined by statutory guidance issued by the National Audit Office. They comprise your arrangements to:

- Take informed decisions;
- Deploy resources in a sustainable manner; and
- Work with partners and other third parties.



We identified one significant risk in relation to these arrangements. The table below presents the findings of our work in response to the risk identified.

We have performed the procedures outlined in our audit plan. We did not identify any significant weaknesses in the Council's arrangements to ensure it took properly informed decisions and deployed resources to achieve planned and sustainable outcomes for taxpayers and local people.

We therefore issued an unqualified value for money conclusion on 28 July 2017.

#### Significant Risk

Local government continues to face considerable financial challenges and Horsham District Council is not immune from these pressures.

We are aware from our review of the Council's budget monitoring for 2016/17 to quarter 2 that it is forecasting a budget underspend of around £94,000 for the year. The Council is also planning to set a balanced budget for 2017/18 and 2018/19.

However, the financial position in future years is far more challenging and achieving financial balance will become progressively harder. The current medium term financial plan is predicting significant budget gaps over the remaining years of the Medium Term Financial Strategy (MTFS) to 2021 of £0.5 million in 2019/20 and £2.3 million in 2020/21 before remedial action.

## Conclusion

We performed a detailed review of how the Medium Term Financial Strategy (MTFS) is created; examined and challenged the key assumptions used by the Council to create the MTFS; and reviewed the extent to which the Council is dependent upon future savings. For significant savings we reviewed the estimated savings in order to ensure that the Council's assumptions were reasonable.

The Council achieved a greater surplus in 2016/17 than initially budgeted and its financial position remains sound at 31 March 2017. The Council has a good recent record of identifying and making savings, and in meeting its budget. Despite initially predicting budget gaps for 2015/16, 2016/17 and 2017/18, the Council were able to set balanced budgets for all periods, including a small predicted surplus. The current MTFS also shows a surplus or breakeven position for the next three years, which is a significant improvement from the previous MTFS in 2015/16 which showed forecast budget gaps over the period.

The current MTFS covers the four year period 2017/18 to 2020/21 and sets out key planning assumptions and resources projections together with information about key areas for capital and revenue investment and financing and treasury management strategies. The key driver of the financial projections in the MTFS continues to be the impact of reductions in central government funding over the medium term. The estimates reflected in the MTFS include significant reductions in both Revenue Support Grant and specific grants over the period. There is explicit recognition that there remains some uncertainly over the timing and scale of future funding reductions.

Although we remain satisfied that the MTFS has been prudently updated in the light of the current economic climate and that the assumptions underpinning it remain reasonable, the uncertainty inherent in the funding from central government mean that the Council cannot reduce its efforts to seek out methods to generate savings without impacting on services and retaining a sustainable financial position



## Other Reporting Issues

### Whole of Government Accounts

We performed the procedures required by the National Audit Office on the accuracy of the consolidation pack prepared by the Council for Whole of Government Accounts purposes. We had no issues to report.

The Council is below the specified audit threshold of £350 million. Therefore, we did not perform any audit procedures on the consolidation pack.

## **Annual Governance Statement**

We are required to consider the completeness of disclosures in the Council's Annual Governance Statement, identify any inconsistencies with the other information of which we are aware from our work, and consider whether it is misleading.

We completed this work and did not identify any areas of concern.

## Report in the Public Interest

We have a duty under the Local Audit and Accountability Act 2014 to consider whether, in the public interest, to report on any matter that comes to our attention in the course of the audit in order for it to be considered by the Council or brought to the attention of the public.

We did not identify any issues which required us to issue a report in the public interest.

## Written Recommendations

We have a duty under the Local Audit and Accountability Act 2014 to designate any audit recommendation as one that requires the Council to consider it at a public meeting and to decide what action to take in response.

We did not identify any issues which required us to issue a written recommendation.

## Objections Received

We did not receive any objections to the 2016/17 financial statements from members of the public.

## Other Powers and Duties

We identified no issues during our audit that required us to use our additional powers under the Local Audit and Accountability Act 2014.

## Independence

We communicated our assessment of independence in our Audit Results Report to the Audit Committee on 25 July 2017. In our professional judgement the firm is independent and the objectivity of the audit engagement partner and audit staff has not been compromised within the meaning regulatory and professional requirements.

## **Control Themes and Observations**

As part of our work, we obtained an understanding of internal control sufficient to plan our audit and determine the nature, timing and extent of testing performed. Although our audit was not designed to express an opinion on the effectiveness of internal control, we are required to communicate to you significant deficiencies in internal control identified during our audit.

The matters reported are shown below and are limited to those deficiencies that we identified during the audit and that we concluded are of sufficient importance to merit being reported.

Description	Impact
Following the departure of the Reconciliations Officer, Internal Audit identified that the	Unresolved bank reconciliation differences may mean errors in other financial systems are not identified on a timely basis.
reconciliation differences on the bank	Delays in resolving issues may result in errors being repeated or compounded.
reconciliation were not being investigated and resolved early enough.	This did not have a significant impact on the audit.
	Recommendation:
	• Each month's reconciliations should be completed before the end of the following month.
	<ul> <li>Training should be provided to staff with the appropriate accounting knowledge so that the bank reconciliation can be completed by more than a single member of staff.</li> </ul>



# Focused on your future

Name	Summary of key measures	Impact
Earlier deadline for production and audit of the financial statements from 2017/18	The Accounts and Audit Regulations 2015 introduced a significant change in statutory deadlines from the 2017/18 financial year. From that year the timetable for the preparation and approval of accounts will be brought forward with draft accounts needing to be prepared by 31 May and the publication of the audited accounts by 31 July.	These changes provide challenges for both the preparers and the auditors of the financial statements.  To prepare for this change the Council has taken a number of steps as outlined below:  Critically reviewed and amended the closedown process to achieve draft accounts production by 5 June for 2016/17  Streamlined the Statement of Accounts removing all non-material disclosure notes  Brought forward the commissioning and production of key externally provided information such as IAS 19 pension information and asset valuations  Provided training to finance staff and service departments regarding the requirements and implications of earlier closedown  Prepared the comparators for new notes in advance of year-end  As auditors, nationally we have:  Issued a thought piece on early closedown  As part of the strategic Alliance with CIPFA jointly presented accounts closedown workshops across England, Scotland and Wales  Presented at CIPFA early closedown events and on the subject at the Local Government Accounting Conferences in July 2017  Locally we have:  Had regular discussions through the year on the Council's proposals to bring forward the closedown timetable  Brought forward the 2016/17 audit to June 2017, and issued our audit report before 31 July 2017  Had discussions of the impact of the Council's change in financial management system on the audit  Together with the Council we have agreed areas for early audit work which have included testing of major income and expenditure streams at month 9, reviewing controls testing performed by Internal Audit, discussing and agreeing material estimation procedures by month 9



## Appendix A Audit Fees

Our fee for 2016/17 is in line with the scale fee set by the PSAA and reported in our 4 January 2017 Audit Plan and 25 July 2017 Annual Results Report.

Description	Final Fee 2016/17 £	Planned Fee 2016/17 £	Scale Fee 2016/17 £	Final Fee 2015/16 £
Total Audit Fee - Code work	50,094	50,094	50,094	50,094
Total Audit Fee - Certification of claims and returns	TBC	12,383	12,383	13,171*

<sup>\*</sup>including additional £811 fee variation levied in addition to the scale fee.

We confirm we have not undertaken any non-audit work outside of the PSAA's requirements.

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## EY | Assurance | Tax | Transactions | Advisory

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ED None

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Ernst & Young LLP, 1 More London Place, London, SE1 2AF.

ey.com





Private and Confidential 4 December 2017

Horsham District Council Parkside Chart Way Horsham West Sussex RH12 1RL

Dear Audit Committee Members

Audit planning report

We are pleased to attach our Audit Plan which sets out how we intend to carry out our responsibilities as auditor. Its purpose is to provide the Audit Committee with a basis to review our proposed audit approach and scope for the 2017/18 audit in accordance with the requirements of the Local Audit and Accountability Act 2014, the National Audit Office's 2015 Code of Audit Practice, the Statement of Responsibilities issued by Public Sector Audit Appointments (PSAA) Ltd, auditing standards and other professional requirements. It is also to ensure that our audit is aligned with the Committee's service expectations.

This plan summarises our initial assessment of the key risks driving the development of an effective audit for the Council, and outlines our planned audit strategy in response to those risks.

This report is intended solely for the information and use of the Audit Committee and management, and is not intended to be and should not be used by anyone other than these specified parties.

We welcome the opportunity to discuss this report with you on 13 December 2017 as well as understand whether there are other matters which you consider may influence our audit.

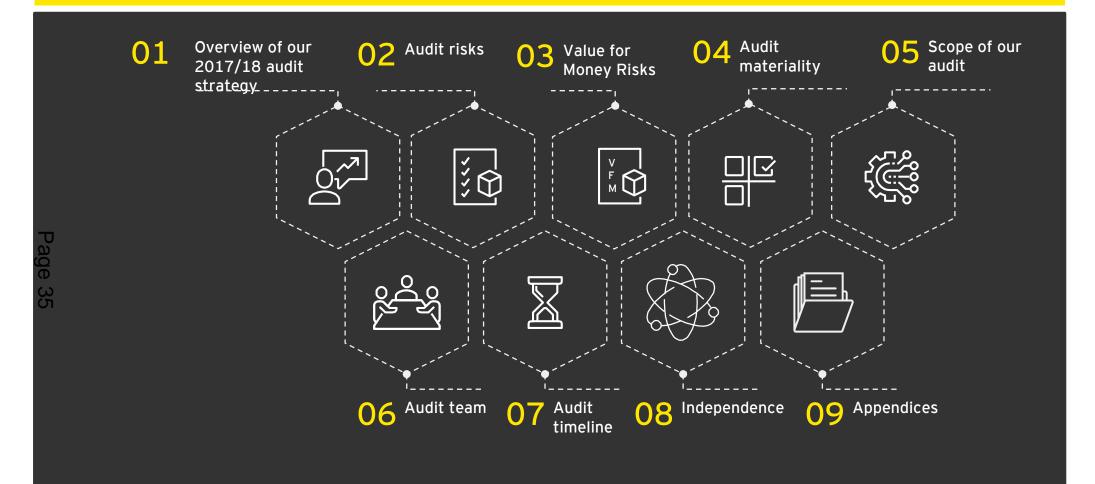
Yours faithfully

Paul King

For and on behalf of Ernst & Young LLP

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# **Contents**



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The "Terms of Appointment (updated February 2017)" issued by the PSAA sets out additional requirements that auditors must comply with, over and above those set out in the National Audit Office Code of Audit Practice (the Code) and in legislation, and covers matters of practice and procedure which are of a recurring nature.

This report is made solely to the Audit Committee and management of Horsham District Council in accordance with the statement of responsibilities. Our work has been undertaken so that we might state to the Audit Committee, and management of Horsham District Council those matters we are required to state to them in this report and for no other purpose. To the fullest extent permitted by law we do not accept or assume responsibility to anyone other than the Audit Committee and management of Horsham District Council for this report or for the opinions we have formed. It should not be provided to any third-party without our prior written consent.





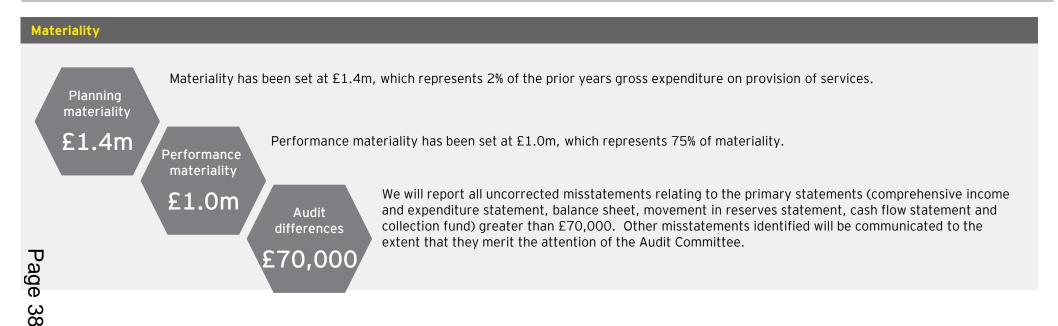
# Overview of our 2017/18 audit strategy

The following 'dashboard' summarises the significant accounting and auditing matters outlined in this report. It seeks to provide the Audit Committee with an overview of our initial risk identification for the upcoming audit and any changes in risks identified in the current year.

Audit risks and areas of focus				
Risk / area of focus	Risk identified	Change from PY	Details	
Misstatements due to fraud or error	Fraud risk	No change in risk or focus	As identified in ISA 240, management is in a unique position to perpetrate fraud because of its ability to manipulate accounting records directly or indirectly and prepare fraudulent financial statements by overriding controls that would otherwise appear to be operating effectively.	
Introduction of new financial management system on 4 September 2017	Other risk	Increase in risk or focus	The Council introduced its new Technology One financial management system with effect from 4 September 2017. It put in place measures to migrate data on 2017/18 transactions and balances from the old to the new financial management system. The Council's 2017/18 financial statements will be prepared using data taken from the new general ledger at the end of the financial year.  To ensure the Council prepares materially accurate and complete 2017/18 financial statements it is essential that the Council is assured that it has migrated all financial data to its new general ledger.	
uation of Land and Buildings	Other risk	No change in risk or focus	The fair value of Property, Plant and Equipment (PPE) and Investment Properties (IP) represent significant balances in the Council's accounts and are subject to valuation changes, impairment reviews and depreciation charges. Management is required to make material judgemental inputs and apply estimation techniques to calculate the year-end balances recorded in the balance sheet.	
Pension Liability Valuation	Other risk	No change in risk or focus	The Local Authority Accounting Code of Practice and IAS19 require the Council to make extensive disclosures within its financial statements regarding its membership of the Local Government Pension Scheme administered by West Sussex County Council.  The Council's pension fund asset is a material estimated balance and the Code requires that this asset be disclosed on the Council's balance sheet. At 31 March 2017 this totalled £2 million.  The information disclosed is based on the IAS 19 report issued to the Council by the actuary to the County Council.  Accounting for this scheme involves significant estimation and judgement and therefore management engages an actuary to undertake the calculations on their behalf. ISAs (UK and Ireland) 500 and 540 require us to undertake procedures on the use of management experts and the assumptions underlying fair value estimates.	



## Overview of our 2017/18 audit strategy (continued)



# Overview of our 2017/18 audit strategy

### **Audit scope**

This Audit Plan covers the work that we plan to perform to provide you with:

- Our audit opinion on whether the financial statements of Horsham District Council give a true and fair view of the financial position as at 31 March 2018 and of the income and expenditure for the year then ended; and
- Our conclusion on the Council's arrangements to secure economy, efficiency and effectiveness.

We will also review and report to the National Audit Office (NAO), to the extent and in the form required by them, on the Council's Whole of Government Accounts return.

Our audit will also include the mandatory procedures that we are required to perform in accordance with applicable laws and auditing standards.

₩hen planning the audit we take into account several key inputs:

Strategic, operational and financial risks relevant to the financial statements;

Developments in financial reporting and auditing standards;

The quality of systems and processes;

- Changes in the business and regulatory environment; and,
- Management's views on all of the above.

By considering these inputs, our audit is focused on the areas that matter and our feedback is more likely to be relevant to the Council.



# Audit risks

## Our response to significant risks

We have set out the significant risks (including fraud risks denoted by\*) identified for the current year audit along with the rationale and expected audit approach. The risks identified below may change to reflect any significant findings or subsequent issues we identify during the audit.

Misstatements due to fraud or error

Page

Pinancial statement impact

We have assessed that the risk of management override is most likely to affect the estimates in the financial statements, such as year end accruals, provisions and asset valuations. These impact both on the Balance Sheet and Income Statement

### What is the risk?

The financial statements as a whole are not free of material misstatements whether caused by fraud or error.

As identified in ISA (UK and Ireland) 240, management is in a unique position to perpetrate fraud because of its ability to manipulate accounting records directly or indirectly and prepare fraudulent financial statements by overriding controls that otherwise appear to be operating effectively. We identify and respond to this fraud risk on every audit engagement.

### What will we do?

- ▶ Identifying fraud risks during the planning stages.
- ► Inquiry of management about risks of fraud and the controls put in place to address those risks.
- Understanding the oversight given by those charged with governance of management's processes over fraud.
- Consideration of the effectiveness of management's controls designed to address the risk of fraud.
- Determining an appropriate strategy to address those identified risks of fraud.
- Performing mandatory procedures regardless of specifically identified fraud risks, including testing of journal entries and other adjustments in the preparation of the financial statements.
- Reviewing accounting estimates for evidence of management bias.
- Evaluating the business rationale for significant unusual transactions.

# Audit risks

### Other areas of audit focus

We have identified other areas of the audit, that have not been classified as significant risks, but are still important when considering the risks of material misstatement to the financial statements and disclosures and therefore may be key audit matters we will include in our audit report.

### What is the risk/area of focus?

#### What will we do?

## Introduction of new financial management system on 4 September 2017

The Council introduced its new Technology
One financial management system with effect
from 4 September 2017. It put in place
measures to migrate data on 2017/18

Council sand balances from the old to the
measures to migrate data on 2017/18

Council sand balances from the old to the
measures financial management system. The
Council's 2017/18 financial statements will be
measured using data taken from the new
measured using data taken from the new
measured ledger at the end of the financial year.
To ensure the Council prepares materially
accurate and complete 2017/18 financial
statements it is essential that the Council is
assured that it has migrated all financial data
to its new general ledger.

- We will review the actions taken by the Council to ensure the complete and accurate migration of financial data to the new general ledger. This will include reviewing the effectiveness of the reconciliation processes.
- ► Where we judge we are able to do so we will seek to rely on any relevant controls over the migration of data established by the Council, and any relevant work of internal audit.
- If we are unable to gain sufficient assurance that the Council has migrated all the relevant data completely and accurately we may be required to undertake additional audit procedures, necessitating an additional audit fee. We will engage early with the Director of Corporate Services if this situation arises and report back to the Committee.

### Valuation of Land and Buildings

The fair value of Property, Plant and Equipment (PPE) and Investment Properties (IP) represent significant balances in the Council's accounts and are subject to valuation changes, impairment reviews and depreciation charges. Management is required to make material judgemental inputs and apply estimation techniques to calculate the yearend balances recorded in the balance sheet.

#### We will:

- Consider the work performed by the Council's valuers (Wilks, Head & Eve), including the adequacy of the scope
  of the work performed, their professional capabilities and the results of their work;
- Sample testing key asset information used by the valuers in performing their valuation (e.g. floor plans to support valuations based on price per square metre);
- Consider the annual cycle of valuations to ensure that assets have been valued within a 5 year rolling programme as required by the Code for PPE and annually for IP. We have also considered if there are any specific changes to assets that have occurred and that these have been communicated to the valuer;
- Review assets not subject to valuation in 2017/18 to confirm that the remaining asset base is not materially misstated;
- ► Consider changes to useful economic lives as a result of the most recent valuation; and
- Test accounting entries have been correctly processed in the financial statements,

# Audit risks

## Other areas of audit focus (continued)

We have identified other areas of the audit, that have not been classified as significant risks, but are still important when considering the risks of material misstatement to the financial statements and disclosures and therefore may be key audit matters we will include in our audit report.

### What is the risk/area of focus?

### Pension Asset Valuation

The Local Authority Accounting Code of Practice and IAS19 require the Council to make extensive disclosures within its financial statements regarding its membership of the Local Government Pension Scheme administered by West Sussex County Council.

The Council's pension fund asset is a material stimated balance and the Code requires that mis asset be disclosed on the Council's balance sheet. At 31 March 2017 this totalled £2 collion.

The information disclosed is based on the IAS 19 report issued to the Council by the actuary to the County Council.

Accounting for this scheme involves significant estimation and judgement and therefore management engages an actuary to undertake the calculations on their behalf. ISAs (UK and Ireland) 500 and 540 require us to undertake procedures on the use of management experts and the assumptions underlying fair value estimates.

#### What will we do?

#### We will:

- Liaise with the auditors of West Sussex County Council Pension Fund, to obtain assurances over the information supplied to the actuary in relation to Horsham District Council;
- Assess the work of the Pension Fund actuary (Hymans Robertson) including the assumptions they have used by relying on the work of PWC Consulting Actuaries commissioned by Public Sector Auditor Appointments for all Local Government sector auditors, and considering any relevant reviews by the EY actuarial team; and
- Review and test the accounting entries and disclosures made within the Council's financial statements in relation to IAS19.





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### Value for Money

### **Background**

We are required to consider whether the Council has put in place 'proper arrangements' to secure economy, efficiency and effectiveness on its use of resources. This is known as our value for money conclusion.

For 2017/18 this is based on the overall evaluation criterion:

"In all significant respects, the audited body had proper arrangements to ensure it took properly informed decisions and deployed resources to achieve planned and sustainable outcomes for taxpayers and local people"

Proper arrangements are defined by statutory guidance issued by the National Audit Office. They comprise your arrangements to:

- Take informed decisions;
- Deploy resources in a sustainable manner; and
   Work with partners and other third parties.

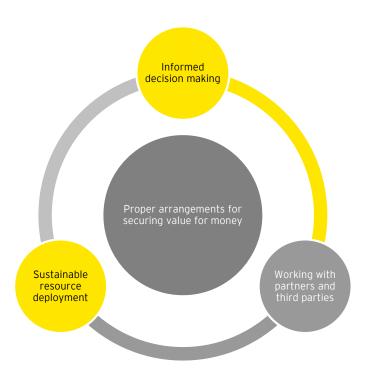
considering your proper arrangements, we will draw on the requirements of the CIPFA/SOLACE framework for local government to ensure that our assessment is made against a framework that you are already required have in place and to report on through documents such as your annual governance statement.

We are only required to determine whether there are any risks that we consider significant, which the Code of Audit Practice defines as:

"A matter is significant if, in the auditor's professional view, it is reasonable to conclude that the matter would be of interest to the audited body or the wider public"

Our risk assessment supports the planning of sufficient work to enable us to deliver a safe conclusion on arrangements to secure value for money and enables us to determine the nature and extent of further work that may be required. If we do not identify any significant risks there is no requirement to carry out further work.

Our risk assessment has therefore considered both the potential financial impact of the issues we have identified, and also the likelihood that the issue will be of interest to local taxpayers, the Government and other stakeholders. This has resulted in the identification of the significant risks noted on the following page which we view as relevant to our value for money conclusion.



# Value for Money Risks

What is the significant value for money risk?	What arrangements does the risk affect?	What will we do?
Local government continues to face considerable financial challenges and Horsham District Council is not immune from these pressures.  We are aware from our review of the Council's budget monitoring for 2017/18 to quarter 2 that it is forecasting a budget surplus of around £250,000 for the year. The Council is also planning to set a balanced budget for 2018/19 and 2019/20.  We wever, the financial position in future years is far more callenging and achieving financial balance will continue to become progressively harder. The current medium term financial plan is redicting significant budget gaps over the remaining years of the medium term financial plan to 2022 of £1.7m in 2020/21 and £2.3m in 2021/22 after assuming that income and efficiency actions being worked on are implemented.	Deploy resources in a sustainable manner	<ul> <li>Our approach will focus on:         <ul> <li>Detailed review of how the medium term financial plan is created.</li> </ul> </li> <li>Examine and challenge the key assumptions used by the Council to create the medium term financial plan.</li> <li>Review the extent to which the Council is dependent upon future savings. For significant savings we will test the estimated savings in order to ensure that the Council's assumptions are reasonable.</li> </ul>
During the year the Council entered into the purchase of the Forum Shopping Centre (the Forum) for some £15m.  This is a significant transaction for the Council and requires a significant use of reserves and some external borrowing to manage cashflow.  Given the value of this transaction and the fact that the Council has taken the decision to fund this in part through external borrowing and in part from reserves, we have at this stage assessed this as a significant risk for the value for money conclusion.  The purchase of the Centre has changed the way in which the Council manages its cashflow, requiring use of short term borrowing.	Take informed decisions	<ul> <li>Our approach will focus on:         <ul> <li>Detailed review of the arrangements through which the Council entered into the purchase of the Centre to ensure that this represents value for money for the Council, including the business case for the purchase and the advice sought by the Council to support the decision.</li> <li>Examine and challenge the key assumptions used by the Council in arranging the financing of the purchase.</li> <li>Review the Council's cashflow management to understand the impact of the purchase of the Centre on the Council's ability to meet its financial commitments and that this was communicated to members.</li> </ul> </li> </ul>



## **₩** Audit materiality

## Materiality

### **Materiality**

For planning purposes, materiality for 2017/18 has been set at £1.4m. This represents 2% of the Council's prior year gross expenditure on provision of services. It will be reassessed throughout the audit process. We have provided supplemental information about audit materiality in Appendix D.



We request that the Audit Committee confirm its understanding of, and agreement to, these materiality and reporting levels.

### **Key definitions**

**Planning materiality** - the amount over which we anticipate misstatements would influence the economic decisions of a user of the financial statements.

**Performance materiality** - the amount we use to determine the extent of our audit procedures. We have set performance materiality at £1.0m which represents 75% of planning materiality. The rationale for using 75% is based on the anticipation of identifying few or no errors during the audit. This expectation has been built on our experience of the Council in prior years.

**Audit difference threshold** - we propose that misstatements identified below this threshold are deemed clearly trivial. We will report to you all uncorrected misstatements over this amount relating to the comprehensive income and expenditure statement, balance sheet and collection fund that have an effect on income or that relate to other comprehensive income.

Other uncorrected misstatements, such as reclassifications and misstatements in the cashflow statement and movement in reserves statement or disclosures, and corrected misstatements will be communicated to the extent that they merit the attention of the audit committee, or are important from a qualitative perspective.

**Specific materiality** - We have set a materiality of nil for remuneration disclosures , related party transactions, members' allowances and exit packages which reflects our understanding that an amount less than our materiality would influence the economic decisions of users of the financial statements in relation to this.



# Our Audit Process and Strategy

### Objective and Scope of our Audit scoping

Under the Code of Audit Practice our principal objectives are to review and report on the Council's financial statements and arrangements for securing economy, efficiency and effectiveness in its use of resources to the extent required by the relevant legislation and the requirements of the Code.

We issue an audit report that covers:

#### 1. Financial statement audit

Our objective is to form an opinion on the financial statements under International Standards on Auditing (UK and Ireland).

We also perform other procedures as required by auditing, ethical and independence standards, the Code and other regulations. We outline below the procedures we will undertake during the course of our audit.

### Procedures required by standards

 $oldsymbol{2}$  Addressing the risk of fraud and error;

- Significant disclosures included in the financial statements;
- Entity-wide controls;
- Reading other information contained in the financial statements and reporting whether it is inconsistent with our understanding and the financial statements; and
- · Auditor independence.

### Procedures required by the Code

- Reviewing, and reporting on as appropriate, other information published with the financial statements, including the Annual Governance; and
- Reviewing and reporting on the Whole of Government Accounts return, in line with the instructions issued by the NAO [delete if not applicable]

### 2. Arrangements for securing economy, efficiency and effectiveness (value for money)

We are required to consider whether the Council has put in place 'proper arrangements' to secure economy, efficiency and effectiveness on its use of resources.

## Our Audit Process and Strategy (continued)

### **Audit Process Overview**

#### Our audit involves:

- ▶ Identifying and understanding the key processes and internal controls; and
- Substantive tests of detail of transactions and amounts.

Our initial assessment of the key processes across the Council has identified the following key processes where we will seek to rely on controls, both manual and IT:

payroll

For 2017/18 we plan to follow a substantive approach to the audit, with the exception of payroll as above as we have concluded this is the most efficient way to obtain the level of audit assurance required to conclude that the financial statements are not materially misstated in view of the implementation of the new financial anagement system.

# Analytics:

we will use our computer-based analytics tools to enable us to capture whole populations of your financial data, in particular journal entries. These tools:

- Help identify specific exceptions and anomalies which can then be subject to more traditional substantive audit tests; and
- Give greater likelihood of identifying errors than random sampling techniques.

We will report the findings from our process and analytics work, including any significant weaknesses or inefficiencies identified and recommendations for improvement, to management and the Audit Committee.

### Internal audit:

We will regularly meet with the Head of Internal Audit, and review internal audit plans and the results of their work. We will reflect the findings from these reports, together with reports from any other work completed in the year, in our detailed audit plan, where they raise issues that could have an impact on the financial statements.





# Audit team

# Audit team structure: Working together with the Council Client Service We are working together with officers to identify continuing improvements in communication and Paul King processes for the 2017/18 audit. Associate Partner Paul King We will continue to keep our audit approach under Associate review to streamline it where possible. Partner Page 53 Hannah Lill Simon Mooney \* Key Audit Partner



# Use of specialists

When auditing key judgements, we are often required to rely on the input and advice provided by specialists who have qualifications and expertise not possessed by the core audit team. The areas where either EY or third party specialists provide input for the current year audit are:

Area	Specialists
Valuation of Land and Buildings	Wilkes, Head and Eve - RICS Registered Valuers
Pensions disclosure	EY pensions specialists Hymans Robertson - Actuary

Description of the independence of the individuals performing the work.

We also consider the work performed by the specialist in light of our knowledge of the Council's business and processes and our assessment of audit risk in the particular area. For example, we would typically perform the following procedures:

- Analyse source data and make inquiries as to the procedures used by the specialist to establish whether the source data is relevant and reliable;
- Assess the reasonableness of the assumptions and methods used;
- ► Consider the appropriateness of the timing of when the specialist carried out the work; and
- Assess whether the substance of the specialist's findings are properly reflected in the financial statements.





## Audit timeline

## Timetable of communication and deliverables

### Timeline

Below is a timetable showing the key stages of the audit and the deliverables we have agreed to provide to you through the audit cycle in 2017/18.

From time to time matters may arise that require immediate communication with the Audit Committee and we will discuss them with the Audit Committee Chair as appropriate. We will also provide updates on corporate governance and regulatory matters as necessary.

October		
November		
December	Audit Committee	Audit Planning Report
January		
February		
March		
April	Audit Committee	Interim audit update
May		
June		
July	Audit Committee	Audit Results Report
		Audit opinions and completion certificates
August		Annual Audit Letter
	December January February  March April  May June  July	December Audit Committee  January  February  March  April Audit Committee  May  June  July Audit Committee





# Introduction

The FRC Ethical Standard and ISA (UK) 260 "Communication of audit matters with those charged with governance", requires us to communicate with you on a timely basis on all significant facts and matters that bear upon our integrity, objectivity and independence. The Ethical Standard, as revised in June 2016, requires that we communicate formally both at the planning stage and at the conclusion of the audit, as well as during the course of the audit if appropriate. The aim of these communications is to ensure full and fair disclosure by us to those charged with your governance on matters in which you have an interest.

### Required communications

### Planning stage

- ▶ The principal threats, if any, to objectivity and independence identified by Ernst & Young (EY) including consideration of all relationships between the you, your affiliates and directors and us;
- The safeguards adopted and the reasons why they are considered to be effective, including any age<sub>\*</sub>58 Engagement Quality review;
  - The overall assessment of threats and safeguards; Information about the general policies and process within EY to maintain objectivity and independence.
- Where EY has determined it is appropriate to apply more restrictive independence rules than permitted under the Ethical Standard [note: additional wording should be included in the communication reflecting the client specific situation]

### Final stage

- In order for you to assess the integrity, objectivity and independence of the firm and each covered person, we are required to provide a written disclosure of relationships (including the provision of non-audit services) that may bear on our integrity, objectivity and independence. This is required to have regard to relationships with the entity, its directors and senior management, its affiliates, and its connected parties and the threats to integrity or objectivity, including those that could compromise independence that these create. We are also required to disclose any safeguards that we have put in place and why they address such threats, together with any other information necessary to enable our objectivity and independence to be assessed;
- Details of non-audit services provided and the fees charged in relation thereto;
- Written confirmation that the firm and each covered person is independent and, if applicable, that any non-EY firms used in the group audit or external experts used have confirmed their independence to us;
- Written confirmation that all covered persons are independent;
- Details of any inconsistencies between FRC Ethical Standard and your policy for the supply of non-audit services by EY and any apparent breach of that policy;
- Details of any contingent fee arrangements for non-audit services provided by us or our network firms; and
- ▶ An opportunity to discuss auditor independence issues.

In addition, during the course of the audit, we are required to communicate with you whenever any significant judgements are made about threats to objectivity and independence and the appropriateness of safeguards put in place, for example, when accepting an engagement to provide non-audit services.

We also provide information on any contingent fee arrangements, the amounts of any future services that have been contracted, and details of any written proposal to provide non-audit services that has been submitted;

We ensure that the total amount of fees that EY and our network firms have charged to you and your affiliates for the provision of services during the reporting period, analysed in appropriate categories, are disclosed.



## Relationships, services and related threats and safeguards

We highlight the following significant facts and matters that may be reasonably considered to bear upon our objectivity and independence, including the principal threats, if any. We have adopted the safeguards noted below to mitigate these threats along with the reasons why they are considered to be effective. However we will only perform non -audit services if the service has been pre-approved in accordance with your policy.

### **Overall Assessment**

Overall, we consider that the safeguards that have been adopted appropriately mitigate the principal threats identified and we therefore confirm that EY is independent and the objectivity and independence of Paul King, your audit engagement partner and the audit engagement team have not been compromised.

### Self interest threats

A self interest threat arises when EY has financial or other interests in the Council. Examples include where we receive significant fees in respect of non-audit services; where we need to recover long outstanding fees; or where we enter into a business relationship with you. At the time of writing, there are no long outstanding fees.

We believe that it is appropriate for us to undertake permissible non-audit services and we will comply with the policies that you have approved.

when of the services are prohibited under the FRC's ES or the National Audit Office's Auditor Guidance Note 01 and the services have been approved in accordance with pur policy on pre-approval. The ratio of non audit fees to audits fees is not permitted to exceed 70%.

At the time of writing, no non-audit services have been undertaken, therefore the current ratio of non-audit fees to audit fees is zero. No additional safeguards are writing are undertaken, therefore the current ratio of non-audit fees to audit fees is zero. No additional safeguards are writing, no non-audit services have been undertaken, therefore the current ratio of non-audit fees to audit fees is zero. No additional safeguards are

A self interest threat may also arise if members of our audit engagement team have objectives or are rewarded in relation to sales of non-audit services to you. We confirm that no member of our audit engagement team, including those from other service lines, has objectives or is rewarded in relation to sales to you, in compliance with Ethical Standard part 4.

There are no other self interest threats at the date of this report.

### Self review threats

Self review threats arise when the results of a non-audit service performed by EY or others within the EY network are reflected in the amounts included or disclosed in the financial statements.

There are no self review threats at the date of this report.

### Management threats

Partners and employees of EY are prohibited from taking decisions on behalf of management of the Council. Management threats may also arise during the provision of a non-audit service in relation to which management is required to make judgements or decision based on that work.

There are no management threats at the date of this report.

# Independence

## Relationships, services and related threats and safeguards

### Other threats

Other threats, such as advocacy, familiarity or intimidation, may arise.

There are no other threats at the date of this report.

## Other communications

### EY Transparency Report 2017

Ernst & Young (EY) has policies and procedures that instil professional values as part of firm culture and ensure that the highest standards of objectivity, independence and integrity are maintained.

Details of the key policies and processes in place within EY for maintaining objectivity and independence can be found in our annual Transparency Report which the firm is required to publish by law. The most recent version of this Report is for the year ended 1 July 2017 and can be found here:

http://www.ey.com/uk/en/about-us/ey-uk-transparency-report-20167

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## Appendix A

### Fees

The duty to prescribe fees is a statutory function delegated to Public Sector Audit Appointments Ltd (PSAA) by the Secretary of State for Communities and Local Government.

PSAA has published a scale fee for all relevant bodies. This is defined as the fee required by auditors to meet statutory responsibilities under the Local Audit and Accountability Act 2014 in accordance with the NAO Code.

	Planned fee 2017/18	Scale fee 2016/17	Final Fee 2016/17
	£	£	£
Total Fee - Code work	50,094	50,094	50,094
Other non-audit services not cayered above (Housing Menefits)	ТВС	12,383	12,383
Total fees	TBC	62,477	62,477

All fees exclude VAT

The audit fee covers the:

- Audit of the financial statements
- Value for money conclusion
- Whole of Government accounts.

For Horsham District Council our indicative fee is set at the scale fee level. This indicative fee is based on certain assumptions, including:

- The overall level of risk in relation to the audit of the financial statements is not significantly different from that of the prior year
- Officers meeting the agreed timetable of deliverables;
- The operating effectiveness of the internal controls for the key processes identified within our audit strategy;
- We can rely on the work of internal audit as planned;
- Our accounts opinion and value for money conclusion being unqualified;
- Appropriate quality of documentation is provided by the council;
- ▶ There is an effective control environment; and
- Prompt responses are provided to our draft reports.

If any of the above assumptions prove to be unfounded, we will seek a variation to the agreed fee. This will be discussed with the Council in advance.

Fees for the auditor's consideration of correspondence from the public and formal objections will be charged in addition to the scale fee.



# Regulatory update

In previous reports to the Audit Committee, we highlighted the issue of regulatory developments. The following table summarises progress on implementation:

Earlier deadline for production and	d audit of the financial statements from 2017/18
Proposed effective date	Effective for annual periods beginning on or after 1 April 2017.
netails သ ge 6	The Accounts and Audit Regulations 2015 introduced a significant change in statutory deadlines from the 2017/18 financial year. From that year the timetable for the preparation and approval of accounts will be brought forward with draft accounts needing to be prepared by 31 May and the publication of the audited accounts by 31 July.
Impact on Horsham District Council	These changes provide challenges for both the preparers and the auditors of the financial statements.
Council	We are holding faster close workshops for clients in November and December 2017 to facilitate early discussion and sharing of ideas and good practice.
	We are working with the Council on ideas coming from the workshop, for example:
	<ul> <li>Streamlining the Statement of Accounts removing all non-material disclosure notes;</li> <li>Bringing forward the commissioning and production of key externally provided information such as IAS 19 pension information, asset valuations;</li> <li>Providing training to departmental finance staff regarding the requirements and implications of earlier closedown;</li> <li>Re-ordering tasks from year-end to monthly/quarterly timing, reducing year-end pressure;</li> <li>Establishing and agreeing working materiality amounts with the auditors.</li> </ul>



## Required communications with the Audit Committee

We have detailed the communications that we must provide to the Audit Committee. Our Reporting to you Required communications What is reported? When and where Terms of engagement Confirmation by the Audit Committee of acceptance of terms of engagement as written in The statement of responsibilities serves as the the engagement letter signed by both parties. formal terms of engagement between the PSAA's appointed auditors and audited bodies. Our responsibilities Reminder of our responsibilities as set out in the engagement letter The statement of responsibilities serves as the formal terms of engagement between the PSAA's appointed auditors and audited bodies. Planning and audit Communication of the planned scope and timing of the audit, any limitations and the Audit planning report approach ag e significant risks identified. When communicating key audit matters this includes the most significant risks of material misstatement (whether or not due to fraud) including those that have the greatest effect on the overall audit strategy, the allocation of resources in the audit and directing the efforts of the engagement team Significant findings from Our view about the significant qualitative aspects of accounting practices including Audit results report accounting policies, accounting estimates and financial statement disclosures the audit Significant difficulties, if any, encountered during the audit Significant matters, if any, arising from the audit that were discussed with management Written representations that we are seeking Expected modifications to the audit report Other matters if any, significant to the oversight of the financial reporting process



# Required communications with the Audit Committee (continued)

		Our Reporting to you
Required communications	What is reported?	When and where
Going concern	Events or conditions identified that may cast significant doubt on the entity's ability to continue as a going concern, including:  ► Whether the events or conditions constitute a material uncertainty  ► Whether the use of the going concern assumption is appropriate in the preparation and presentation of the financial statements  ► The adequacy of related disclosures in the financial statements	Audit results report
Susstatements OD OO	<ul> <li>Uncorrected misstatements and their effect on our audit opinion, unless prohibited by law or regulation</li> <li>The effect of uncorrected misstatements related to prior periods</li> <li>A request that any uncorrected misstatement be corrected</li> <li>Corrected misstatements that are significant</li> <li>Material misstatements corrected by management</li> </ul>	Audit results report
Fraud	<ul> <li>Enquiries of the Audit Committee to determine whether they have knowledge of any actual, suspected or alleged fraud affecting the entity</li> <li>Any fraud that we have identified or information we have obtained that indicates that a fraud may exist</li> <li>A discussion of any other matters related to fraud</li> </ul>	Audit results report
Related parties	<ul> <li>Significant matters arising during the audit in connection with the entity's related parties including, when applicable:</li> <li>Non-disclosure by management</li> <li>Inappropriate authorisation and approval of transactions</li> <li>Disagreement over disclosures</li> <li>Non-compliance with laws and regulations</li> <li>Difficulty in identifying the party that ultimately controls the entity</li> </ul>	Audit results report



# Required communications with the Audit Committee (continued)

		Our Reporting to you
Required communications	What is reported?	When and where
Independence	Communication of all significant facts and matters that bear on EY's, and all individuals involved in the audit, objectivity and independence  Communication of key elements of the audit engagement partner's consideration of independence and objectivity such as:  The principal threats  Safeguards adopted and their effectiveness  An overall assessment of threats and safeguards  Information about the general policies and process within the firm to maintain objectivity and independence	Audit Planning Report and Audit Results Report
ternal confirmations	<ul> <li>Management's refusal for us to request confirmations</li> <li>Inability to obtain relevant and reliable audit evidence from other procedures</li> </ul>	Audit results report
equiations of laws and regulations	<ul> <li>Audit findings regarding non-compliance where the non-compliance is material and believed to be intentional. This communication is subject to compliance with legislation on tipping off</li> <li>Enquiry of the Audit Committee into possible instances of non-compliance with laws and regulations that may have a material effect on the financial statements and that the Audit Committee may be aware of</li> </ul>	Audit results report
Internal controls	► Significant deficiencies in internal controls identified during the audit	Audit results report
Representations	Written representations we are requesting from management and/or those charged with governance	Audit results report
Material inconsistencies and misstatements	Material inconsistencies or misstatements of fact identified in other information which management has refused to revise	Audit results report
Auditors report	<ul> <li>Key audit matters that we will include in our auditor's report</li> <li>Any circumstances identified that affect the form and content of our auditor's report</li> </ul>	Audit results report
Fee Reporting	<ul> <li>Breakdown of fee information when the audit plan is agreed</li> <li>Breakdown of fee information at the completion of the audit</li> <li>Any non-audit work</li> </ul>	Audit planning report and Audit results report
Certification work	Summary of certification work undertaken	Certification report

## Additional audit information

### Other required procedures during the course of the audit

In addition to the key areas of audit focus outlined in section 2, we have to perform other procedures as required by auditing, ethical and independence standards and other regulations. We outline the procedures below that we will undertake during the course of our audit.

## by auditing standards

Our responsibilities required 
Identifying and assessing the risks of material misstatement of the financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion.

### Obtaining an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Council's internal control.

 Evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by management.

### Concluding on the appropriateness of management's use of the going concern basis of accounting.

- Evaluating the overall presentation, structure and content of the financial statements, including the disclosures, and whether the financial statements represent the underlying transactions and events in a manner that achieves fair presentation.
- Obtaining sufficient appropriate audit evidence regarding the financial information of the entities or business activities within the Council to express an opinion on the consolidated financial statements. Reading other information contained in the financial statements, including the board's statement that the annual report is fair, balanced and understandable, the Audit Committee reporting appropriately addresses matters communicated by us to the Audit Committee and reporting whether it is materially inconsistent with our understanding and the financial statements; and
- Maintaining auditor independence.

### Purpose and evaluation of materiality

For the purposes of determining whether the accounts are free from material error, we define materiality as the magnitude of an omission or misstatement that, individually or in the aggregate, in light of the surrounding circumstances, could reasonably be expected to influence the economic decisions of the users of the financial statements. Our evaluation of it requires professional judgement and necessarily takes into account qualitative as well as quantitative considerations implicit in the definition. We would be happy to discuss with you your expectations regarding our detection of misstatements in the financial statements.

### Materiality determines:

▶ The level of work performed on individual account balances and financial statement disclosures.

The amount we consider material at the end of the audit may differ from our initial determination. At this stage, however, it is not feasible to anticipate all of the circumstances that may ultimately influence our judgement about materiality. At the end of the audit we will form our final opinion by reference to all matters that could be significant to users of the accounts, including the total effect of the audit misstatements we identify, and our evaluation of materiality at that date.

## **Horsham District Council**

Audit Committee Progress Report

December 2017



The Members
Audit Committee
Horsham District Council
Parkside
Chart Way
Horsham
West Sussex, RH12 1RL

4 December 2017

### **Audit Progress Report**

We are pleased to attach our Audit Progress Report.

This progress report summarises the work we have undertaken since the last meeting of the Audit Committee in July 2017. The purpose of this report is to provide the Committee with an overview of our plans for the 2017/18 audit, to ensure they are aligned with your service expectations.

Our audits are undertaken in accordance with the requirements of the Local Audit and Accountability Act 2014, the National Audit Office's 2015 Code of Audit Practice, the Statement of Responsibilities issued by Public Sector Audit Appointments (PSAA) Ltd, auditing standards and other professional requirements. The "Terms of Appointment (updated February 2017)" issued by the PSAA sets out additional requirements that auditors must comply with, over and above those set out in the National Audit Office Code of Audit Practice (the Code) and in legislation, and covers matters of practice and procedure which are of a recurring nature.

We welcome the opportunity to discuss this report with you as well as understand whether there are other matters which you consider may influence our audits.

Yours faithfully

Paul King Associate Partner For and on behalf of Ernst & Young LLP Enc.

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In April 2015 Public Sector Audit Appointments Ltd (PSAA) issued "Statement of responsibilities of auditors and audited bodies 2015-16". It is available from the Chief Executive of each audited body and via the PSAA website (www.psaa.co.uk)

The Statement of responsibilities serves as the formal terms of engagement between appointed auditors and audited bodies. It summarises where the different responsibilities of auditors and audited bodies begin and end, and what is to be expected of the audited body in certain areas.

The 'Terms of Appointment from 1 April 2015' issued by PSAA sets out additional requirements that auditors must comply with, over and above those set out in the National Audit Office Code of Audit Practice (the Code) and statute, and covers matters of practice and procedure which are of a recurring nature.

This Annual Plan is prepared in the context of the Statement of responsibilities. It is addressed to the Audit Committee, and is prepared for the sole use of the audited body. We, as appointed auditor, take no responsibility to any third party.

Our Complaints Procedure – If at any time you would like to discuss with us how our service to you could be improved, or if you are dissatisfied with the service you are receiving, you may take the issue up with your usual partner or director contact. If you prefer an alternative route, please contact Steve Varley, our Managing Partner, 1 More London Place, London SE1 2AF. We undertake to look into any complaint carefully and promptly and to do all we can to explain the position to you. Should you remain dissatisfied with any aspect of our service, you may of course take matters up with our professional institute. We can provide further information on how you may contact our professional institute.

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# 2017/18 audit

#### Fee letter

We issued our 2017/18 fee letter to the Council in April 2017.

#### Financial statements audit

We adopt a risk based approach to the audit and, as part of our ongoing planning, we held an audit planning meeting with key officers to discuss significant issues for the audit, how we can work together to improve the accounts production and audit process for 2017/18 and meet the earlier audit deadlines in 2017/18. We will continue to liaise with officers to ensure the 2017/18 audit runs as smoothly as possible and identify any risks at the earliest opportunity.

We have been liaising with Internal Audit with a view to placing reliance on the testing of controls which they perform in the normal course of their annual plan as much as possible.

We have set out an outline timetable for the audit in the Audit Plan.

#### Planning visit

Our work to identify the Council's material income and expenditure systems and to walk through these systems has been substantially completed and our early substantive testing and review of the controls work performed by Internal Audit is planned for March 2017.

We will update the Committee when the planning and early substantive testing has been completed.

#### **Internal Audit**

Internal Audit is a key part of the Council's internal control environment that we review during our assessment process. This process helps us to assess the level of risk of material errors occurring in the financial statements and informs the level of testing that we are required to complete in support of the audit opinion. We consider Internal Audit's progress with their annual audit plan and the results of their testing of financial systems and, where it is appropriate to do so, we will undertake procedures to enable us to place reliance upon this testing.

#### Post Statements audit

We have agreed dates for our post statements audit with officers and agreed a timetable for the receipt of the draft financial statements and working papers. We are planning to commence our post-statements work in June 2018.

We will continue to use our computer-based analytics tools to enable us to capture whole populations of your financial data, in particular payroll and journal entries.

We will also review and report to the National Audit Office, to the extent and in the form required by them, on your whole of government accounts return.

#### Value for money assessment

We are required to reach our statutory conclusion on arrangements to secure value for money based on the overall evaluation criterion. There have been no changes from 2016/17 to the supporting sub-criteria as set out in the Audit Plan.

We have carried out our initial risk assessment. This has resulted in the following significant VFM risks which we view as relevant to our value for money conclusion, which we reported to you in our Annual Audit Plan to the January Committee.

#### Significant value for money risks

#### Our audit approach

#### **Sustainable Resource Development**

Local government continues to face considerable financial challenges and Horsham District Council is not immune from these pressures.

We are aware from our review of the Council's budget monitoring for 2017/18 to quarter 2 that it is forecasting a budget underspend of around £250,000 for the year. The Council is also planning to set a balanced budget for 2018/19 and 2019/20.

However, the financial position in future years is far more challenging and achieving financial balance will continue to become progressively harder. The current medium term financial plan is predicting significant budget gaps over the remaining years of the medium term financial plan to 2022 of £1.7m in 2020/21 and £2.3m in 2021/22 after assuming that income and efficiency actions being worked on are implemented.

Our approach will focus on:

- ► Detailed review of how the medium term financial plan is created.
- Examine and challenge the key assumptions used by the Council to create the medium term financial plan.
- Review the extent to which the Council is dependent upon future savings. For significant savings we will test the estimated savings in order to ensure that the Council's assumptions are reasonable.

#### Take informed decisions

During the year the Council entered into the purchase of the Forum Shopping Centre (the Forum) for some £14m.

This is a significant transaction for the Council and requires a significant use of reserves and some external borrowing to manage cashflow.

Given the value of this transaction and the fact that the Council has taken the decision to fund this in part through external borrowing and in part from reserves, we have at this stage assessed this as a significant risk for the value for money conclusion.

The purchase of the Centre has changed the way in which the Council manages its cashflow, requiring increased use of short term borrowing. Our approach will focus on:

- ▶ Detailed review of the arrangements through which the Council entered into the purchase of the Centre to ensure that this represents value for money for the Council, including the business case for the purchase and the advice sought by the Council to support the decision.
- Examine and challenge the key assumptions used by the Council in arranging the financing of the purchase.
- Review the Council's cashflow management to understand the impact of the purchase of the Centre on the Council's ability to meet its financial commitments and that this was communicated to members.

# 2016/17 Grant Certification Work

We completed the certification of your 2016/17 housing benefit subsidy claim in November 2017. We identified significantly fewer errors in our testing this year, with only one out of 20 cases failing in each of the two areas we test (non-HRA Rent Rebates and Rent Allowances). The additional testing performed by CenSus also identified fewer errors than in previous years and there were no amendments required to the claim form.

The error extrapolations included in our qualification letter totalled £14,484, increasing current year LA error and administrative delay by £12,629 and eligible overpayments by £1,855. The Council has not breached the LA Error Threshold this year, therefore the clawback is expected to be limited to that shown in the qualification letter.

We will present our formal certification report to the next meeting of the Audit Committee.

## EY | Assurance | Tax | Transactions | Advisory

## Ernst & Young LLP

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#### **Report to Audit Committee**

Date of meeting 13 December 2017 By the Director of Corporate Resources

#### **DECISION REQUIRED**

Not exempt



# **Treasury Management Strategy 2018/19**

# **Executive Summary**

This report is a statutory requirement setting the strategy for treasury management and specific treasury management indicators for the financial year 2018/19. The strategy is set against the context of the projected interest rates and the Council's capital spend.

The new strategy leaves investment criteria and limits largely unchanged as investments are expected to fall and some borrowing is envisaged. CIPFA and the DCLG are reviewing and consulting on the regulatory background to this strategy that may change it significantly. The results of this are expected in the next few months but are not yet finalised, so this report is based on the existing regulations.

#### Recommendations

The Committee is recommended to recommend that the full Council:

- i) approve the Treasury Management Strategy for 2018/19.
- ii) approve the Treasury Management Indicators for 2018/19.

#### **Reasons for Recommendations**

- i) The Council has adopted the Chartered Institute of Public Finance and Accountancy's Treasury Management in the Public Services: Code of Practice 2011 Edition (the CIPFA Code) which requires the Council to approve a treasury management strategy before the start of each financial year.
- ii) The Department for Communities and Local Government (DCLG) issued revised guidance on local authority investments in March 2010 that requires the Council to approve an investment strategy before the start of each financial year.

#### **Background Paper**

"Medium Term Financial Strategy 2018/19 to 2021/22" - Cabinet 23 November 2017

**Consultation:** Arlingclose Limited

Wards affected: All

Contact: Julian Olszowka, Group Accountant, Technical, 01403 215310

# **Background Information**

## 1 Introduction

## The purpose of this report

1.1 The Council has significant investments and borrowing which bring with them financial risks including the loss of invested funds and the revenue effect of changing interest rates. It therefore requires an overall strategy as well as sets of practices and procedures to identify, monitor and control those risks. There is a body of statute and other regulation that lays down what a strategy should do. This report sets out a Treasury Management Strategy for 2018/19 that fulfils the legal requirement and provides a workable framework for day-to-day operations.

## 2 Background

## **Economic background**

- 2.1 The Council's Treasury Management Strategy must take account of expectations for the economy and specifically the finance sector. The Council receives advice on this from Arlingclose Ltd and Appendix A is a commentary by them on the economic background, the outlook for creditworthiness and interest rates.
- 2.2 The forecast for the Bank Rate is that it remains at 0.50%. For the purpose of the budget any new investments are estimated to be on or about the Bank Rate.
- 2.3 The treasury management environment remains difficult with yields and quality counterparties remaining reduced in the aftermath of the financial crisis of 2008 with no return to pre-crisis rates envisaged in the medium term. Governments and regulators have put in place measures prompted by the crisis that restrict any government bail-out of individual financial institutions exposing the Council to participate in a bail-in if has invested in an affected institution.

#### Statutory background

- 2.4 This report fulfils the Council's legal obligation under the Local Government Act 2003 to have regard to both the CIPFA Code and the Department for Communities and Local Government (DCLG) Guidance that requires the Council to approve an investment strategy before the start of each financial year.
- 2.5 The regulatory background is complicated by the current revision by both CIPFA and DCLG of their codes and guidance on treasury management and prudential indicators. The Council must have regard to both sets of codes and guidance. The expectation is that the final CIPFA codes will only be available in late December and DCLG guidance in late January. These dates are not guaranteed and the timing relative to the Council's meetings dealing with 2018/19 is problematic. The background to possible changes to the regulations is further explained in Appendix B. The Director of Corporate Resources will monitor the situation and bring an updated strategy to the Council if needed.

#### **Relevant Council policy**

- 2.6 In February 2012 the Council adopted the Chartered Institute of Public Finance and Accountancy's Treasury Management in the Public Services: Code of Practice 2011 Edition (the CIPFA Code) which requires the Council to approve a Treasury Management Strategy before the start of each financial year.
- 2.7 The existing Treasury Management Strategy 2017/18 was approved by the Council on 15 February 2017 having been approved by this Committee on 4 January 2017.

# 3 Current and Position and Projection

3.1 The Council's treasury portfolio at the end of November 2017 was:

	Principal £m	Average Interest Rate %
Call accounts	0.8	0.05
Money Market Funds	22.9	0.51
Short-term deposits	3.0	0.45
Long-term deposits	5.8	1.58
Pooled Funds	15.9	3.90
Total Investments	48.4	1.74
Long-term PWLB loans	4.0	3.38
Short term borrowing	0	0
Total Borrowing	4.0	3.38
Net Investments	45.1	1.59

- 3.2 The current cash balances are reducing from the high levels of last year. Last year the comparative figure for total net investments was £48m. However, bearing in mind the spend on the Forum Retail Units it is healthier than we might have expected. At the time of the purchase there was some temporary short term borrowing to ensure the £15m of cash was available for the purchase but that has since been repaid. That said the rest of 2017/18 should see significant outflows as the capital spend on the Bridge Leisure centre and the new waste and recycling fleet add to the usual net outflow of cash in the latter end of a financial year as tax income slows while precept and other outflows do not reduce to the same degree.
- 3.3 The table shows that pooled funds, other than money market funds, which were a new introduction for 2016/17, have produced a step up in yields. The return from them exceeds other classes of investment but the volatility of their capital value means they are regarded as a longer term investment. At the end of October 2017 the pooled funds showed at small overall gain of £18,400. The month before that was a £39,300 capital loss which demonstrates some of the volatility in the fund values.

3.4 At the strategic level, treasury management works within the context of the Council's balance sheet and how much cash it represents. Below is the current projected analysis of the balance sheet to illustrate the trajectory of the Council's funds. It should be noted that the end of year cash balances are usually the low points in the year.

All figures at year- end £m	Actual 16/17	Estimate 17/18	Estimate 18/19	Estimate 19/20	Estimate 20/21
CFR	16.0	30.4	38.9	39.0	38.0
Less external borrowing	4.0	4.0	9.0	5.0	5.0
Internal borrowing	12.0	26.4	29.9	34.0	33.0
Useable reserves, receipts, contributions held	52.4	48.6	43.3	47.7	52.2
Working capital/other balance.	8.6	6.7	6.2	5.8	5.8
Estimated Investments	49.0	28.9	19.6	19.5	25.0

- 3.5 The projection includes capital spend approved to date and an estimate of new bids for 2018/19 and will be revised as the budget is finalised and a revised table will accompany the final Budget Report 2018/19. The use of reserves is in line with the Medium Term Financial Strategy report to the Cabinet of 23 November 2017. The same risks mentioned in that report especially around future New Homes Bonus payments apply to this projection. The projections also include a continued flow through the Council of developer contributions.
- 3.6 The Council can finance some of its capital programme from capital receipts and other resources but will not finance the whole programme. This gives rise to an underlying need to borrow for capital purposes which is measured by the Capital Financing Requirement (CFR). Up to this point the Council's strategy has been to maintain borrowing and investments below their underlying levels, sometimes known as internal borrowing. With the large increases in the CFR in the next two years due to the estimated capital programme it is judged that it may well be necessary to supplement internal borrowing with some external borrowing and the above table assumes £5m of long term borrowing in 2018/19. This leaves the council with significant investment balances but can be seen as a reasonable balance between running down investments and borrowing.
- 3.7 CIPFA's Prudential Code for Capital Finance in Local Authorities recommends that the Council's total debt should be lower than its highest forecast CFR over the next three years. The table shows borrowing will be well under the CFR so the Council expects to comply with this recommendation during 2018/19.

# 4 Borrowing Strategy

- 4.1 The Council currently holds a £4m long-term Public Works Loan Board (PWLB) loan, as it did in the previous year, as part of its strategy for funding previous years' capital programmes. The Council's capital financing requirement (CFR, or underlying need to borrow for capital purposes) as at 31 March 2018 is expected to be £30.4m, and is forecast to rise to £38.9m by March 2019 as capital expenditure is incurred.
- 4.2 The Council's chief objective when borrowing money is to strike an appropriately low risk balance between securing low interest costs and achieving cost certainty over the period for which funds are required. With short-term interest rates lower than long-term borrowing rates, the Council has felt it was more cost effective in the short-term to use internal resources. Effectively the Council has borrowed from its own internal funds; sometimes termed internal borrowing.
- 4.3 The Council has so far only borrowed externally following its first unfinanced project of Steyning Health Centre in 2005 (refinanced in 2009). The underlying need to borrow has been increasing with the projects requiring funding. As stated above although investment balances do not entirely disappear in the projection there is £5m of external borrowing planned for the year. This planned amount will not, of course, bind the Council's actual borrowing decision which will be made by the Director of Corporate Resources during the year weighing up interest rate projections against the latest capital plans.
- 4.4 The alternative to long term external borrowing would be to rely on internal or short-term external borrowing. This would have the risk of incurring additional costs by deferring borrowing into future years when long-term borrowing rates are forecast to rise modestly. Arlingclose will assist the Council with this 'cost of carry' and breakeven analysis.
- 4.5 The approved sources of long-term and short-term borrowing are:
  - Public Works Loan Board and any successor body
  - Any institution approved for investments (see below)
  - Any other bank or building society authorised to operate in the UK
  - UK public and private sector pension funds (except West Sussex County Council Pension Fund)
  - Capital market bond investors
  - UK Municipal Bond Agency and other special purpose companies created to enable joint local authority bond issues.
- 4.6 In addition, capital finance may be raised by the following methods that are not borrowing, but may be classed as other debt liabilities:
  - Operating and finance leases
  - Hire purchase
  - Private Finance Initiative
  - Sale and leaseback
- 4.7 The Council has previously raised its long-term borrowing from the PWLB, but it will, if required, investigate other sources of finance amongst the sources listed above, that may be available at more favourable rates.

- 4.8 Municipal Bonds Agency: UK Municipal Bonds Agency plc was established in 2014 by the Local Government Association as an alternative to the PWLB. It plans to issue bonds on the capital markets and lend the proceeds to local authorities. This will be a more complicated source of finance than the PWLB for two reasons: borrowing authorities will be required to provide bond investors with a joint and several guarantee to refund their investment in the event that the agency is unable to for any reason; and there will be a lead time of several months between committing to borrow and knowing the interest rate payable. Any decision to borrow from the Agency will therefore be the subject of a separate report to full Council.
- 4.9 Short-term and variable rate loans leave the Council exposed to the risk of short-term interest rate rises and are therefore subject to the limit on the net exposure to variable interest rates in the treasury management indicators below.
- 4.10 **Debt Rescheduling:** The PWLB allows authorities to repay loans before maturity and either pay a premium or receive a discount according to a set formula based on current interest rates. The Council may take advantage of this and replace some loans with new loans, or repay loans without replacement, where this is expected to lead to an overall saving or reduction in risk.

## 5 Investment Strategy

- 5.1 The Council holds significant funds, representing income received in advance of expenditure plus balances and reserves held. In the past year, the Council's total investments have ranged between £40m and £67m, and although the level of reserves is expected to reduce in the longer term, there will still be significant short to medium-term cash flow surpluses leading to larger sums being held than the core reserves of the Council would indicate. The current projections show year-end balances around £20m for the next three years.
- 5.2 Both the CIPFA Code and the DCLG Guidance require the Council to invest its funds prudently, and to have regard to the security and liquidity of its investments before seeking the highest rate of return, or yield. The Council's objective when investing money is to strike an appropriate balance between risk and return, minimising the risk of incurring losses from defaults and the risk of receiving unsuitably low investment income. Where balances are expected to be invested for more than one year, the Council will aim to achieve a total return that is equal or higher than the prevailing rate of inflation, in order to maintain the spending power of the sum invested.
- 5.3 Given the increasing risk and very low returns from short-term unsecured bank investments, the Council aims to diversify into more secure and/or higher yielding asset classes during 2018/19. This is especially the case for the cash balances that are available for longer-term investment. This diversification will represent a continuation of the present strategy.

5.4 The Council may invest its surplus funds with any of the counterparty types in the table below; subject to the cash limits (per counterparty) and the time limits shown (these are unchanged from 2017/18 strategy):

Credit	Banks	Banks	Government	Corporate	Registered		
Rating	Unsecured	Secured	Government		Providers		
AAA	£2.5m	£4m	£4m	£2.5m	£4m		
AAA	5 years	20 years	50 years	10 years	20 years		
AA+	£2.5m	£4m	£4m	£2.5m	£4m		
ААТ	5 years	10 years	25 years	7 years	10 years		
AA	£2.5m	£4m	£4m	£2.5m	£4m		
AA	4 years	5 years	15 years	5 years	10 years		
AA-	£2.5m	£4m	£4m	£2.5m	£4m		
AA-	3 years	4 years	10 years	4 years	10 years		
A+	£2.5m	£4m	£4m	£2.5m	£4m		
Ат	2 years	3 years	5 years	3 years	5 years		
Α	£2.5m	£4m	£4m	£2.5m	£4m		
A	13 mons	2 years	5 years	2 years	5 years		
Λ	£2.5m	£4m	£4m	£2.5m	£4m		
A-	6 mons	13 months	5 years	1 year	5 years		
None	£1m	n/a	n/a	£50,000	£2m		
None	6 months	II/a	II/a	5 years	1 year		
UK Govt	K Govt Central government £unlimited 50 years UK Local Authority £4m 10 years						
Pooled			£5m per Fund				
funds							

This table must be read in conjunction with the notes below.

- 5.5 **Credit Rating**: Investment limits are set with reference to the lowest published long-term credit rating from Fitch, Moody's or Standard & Poor's. Where available, the credit rating relevant to the specific investment or class of investment is used, otherwise the counterparty credit rating is used. However, investment decisions are never made solely based on credit ratings, and all other relevant factors including external advice will be taken into account.
- 5.6 **Banks Unsecured**: Accounts, deposits, certificates of deposit and senior unsecured bonds with banks and building societies, other than multilateral development banks. These investments are subject to the risk of credit loss via a bail-in should the regulator determine that the bank is failing or likely to fail. See below for arrangements relating to operational bank accounts.
- 5.7 **Banks Secured**: Covered bonds, reverse repurchase agreements and other collateralised arrangements with banks and building societies. These investments are secured on the bank's assets, which limits the potential losses in the unlikely event of insolvency, and means that they are exempt from bail-in. Where there is no investment specific credit rating, but the collateral upon which the investment is secured has a credit rating, the highest of the collateral credit rating and the counterparty credit rating will be used to determine cash and time limits. The combined secured and unsecured investments in any one bank will not exceed the cash limit for secured investments.

- 5.8 **Building Societies:** Although the regulation of building societies is no longer any different to that of banks the Council takes additional comfort from building societies' business model. The Council will therefore consider investing with unrated building societies where independent credit analysis shows them to be suitably creditworthy. A minimum asset size of £250m applies and limits of £1m per Society and £8m in total apply for unrated societies.
- Government: Loans, bonds and bills issued or guaranteed by national governments, regional and local authorities and multilateral development banks. These investments are not subject to bail-in, and there is an insignificant risk of insolvency. Investments with the UK Central Government may be made in unlimited amounts for up to 50 years and with a UK local government body up to £4m for up to 10 years.
- 5.10 **Corporates**: Loans, bonds and commercial paper issued by companies other than banks and registered providers. These investments are exposed to the risk of the company going insolvent. Loans to unrated companies will only be made either following an external credit assessment or to a maximum of £50,000 per company as part of a diversified pool in order to spread the risk widely.
- 5.11 **Registered Providers:** Loans and bonds issued by, guaranteed by or secured on the assets of Registered Providers of Social Housing, formerly known as Housing Associations. These bodies are tightly regulated by the Homes and Communities Agency and, as providers of public services; they retain the likelihood of receiving government support if needed.
- 5.12 Pooled Funds: Shares in diversified investment vehicles consisting of the any of the above investment types, plus equity shares and property. These funds have the advantage of providing wide diversification of investment risks, coupled with the services of a professional fund manager in return for a fee. Short-term Money Market Funds that offer same-day liquidity and very low or no volatility will be used as an alternative to instant access bank accounts, while pooled funds whose value changes with market prices and/or have a notice period will be used for longer investment periods.
- 5.13 Bond, equity and property funds offer enhanced returns over the longer term, but are more volatile in the short term. These allow the Council to diversify into asset classes other than cash without the need to own and manage the underlying investments. Because these funds have no defined maturity date, but are available for withdrawal after a notice period, their performance and continued suitability in meeting the Council's investment objectives will be monitored regularly. These types of funds were introduced in 2016/17 and are subject to their own specific limits which remain unchanged in the coming year.
- 5.14 **Operational bank accounts:** The Council may incur exposure though its current accounts to any UK bank with credit ratings no lower than BBB- and with assets greater than £25 billion. These are not classed as investments, but still subject to the risk of a bank bail-in. Balances will be kept as low as possible without affecting operations. The Bank of England has stated that in the event of failure, banks with assets greater than £25 billion are more likely to be bailed-in than made insolvent, increasing the chance of the Council maintaining operational continuity. The Council currently banks with NatWest rated BBB+.

- 5.15 **Long Term investments**: Alongside pooled funds the Council may use long term investments when they are appropriately secure over the term of the investment. Currently the balance between security and yield is not thought to make this type of investment superior to pooled funds but there may be suitable investments so the Council sets a limit of £12m on the total long term (over a year) investments.
- 5.16 **Risk Assessment and Credit Ratings**: Credit ratings are monitored by the Council's treasury advisors, who will notify changes in ratings as they occur. Where an entity has its credit rating downgraded so that it fails to meet the approved investment criteria then:
  - no new investments will be made,
  - any existing investments that can be ended at no cost will be, and
  - full consideration will be given to the recall or sale of all other existing investments with the affected counterparty.
- 5.17 Where a credit rating agency announces that a rating is on review for possible downgrade (also known as "rating watch negative" or "credit watch negative") so that it may fall below the approved rating criteria, then no investments other than call investments will be made with that organisation until the outcome of the review is announced. This policy will not apply to negative outlooks, which indicate a long-term direction of travel rather than an imminent change of rating.
- 5.18 Other Information on the Security of Investments: The Council understands that credit ratings are good, but not perfect, predictors of investment default. Full regard will therefore be given to other available information on the credit quality of the organisations in which it invests, including credit default swap prices, financial statements and reports in the quality financial press. No investments will be made with an organisation if there are substantive doubts about its credit quality, even though it may meet the Council's credit rating criteria.
- 5.19 When financial market conditions affect the creditworthiness of all organisations, as in 2008 and 2011, this is not generally reflected in credit ratings, but can be seen in other market measures. In these circumstances, the Council will restrict its investments to those organisations of higher credit quality and reduce the maximum duration of its investments. If these restrictions mean that no commercial organisations of "high credit quality" are available, then the Council will use the UK Government or other local authorities although this will cause a reduction in the level of investment income earned.

#### **Specified and Non-specified Investments**

- 5.20 The DCLG Guidance, that the Council have regard to under statute, uses the terms "specified" and "non-specified" investments. The guidance defines specified investments as:
  - denominated in pound sterling,
  - due to be repaid within 12 months of arrangement,
  - not defined as capital expenditure by legislation, and
  - invested with one of:
    - the UK Government,
    - o a UK local authority, parish council or community council, or
    - a body or investment scheme of "high credit quality".

- 5.21 The Council defines "high credit quality" organisations and securities as those having a credit rating of A- or higher that are domiciled in the UK or a foreign country with a sovereign rating of AA+ or higher. For money market funds and other pooled funds "high credit quality" is defined as those having a credit rating of A- or higher.
- 5.22 Any investment not meeting the definition of a specified investment is classed as "non-specified". The Council does not intend to make any investments in foreign currencies, nor any that are defined as capital expenditure by legislation, such as company shares. "Non-specified" investments will therefore be limited to long-term investments, i.e. those that are due to mature 12 months or longer from the date of arrangement and investments with bodies and schemes not meeting the definition on "high credit quality". The limits on "non-specified" investments are:

Non-Specified Investment Limits	Cash limit
Total long-term investments	£12m
Total investments without credit ratings or rated	
below A- (except UK Government and local	£28m
authorities)	
Total investments with institutions domiciled in	£10m
foreign countries rated below AA+	£IUIII
Total "Non-specified"	£50m

#### **Investment limits**

5.23 In order that to reduce risk in the case of a single default, the maximum that will be lent to any one organisation (other than the UK Government) will be £4m. A group of banks under the same ownership funds will be treated as a single organisation for limit purposes. Limits will also be placed on pooled funds, fund managers, investments in brokers' nominee accounts, foreign countries and industry sectors as below. Investments in pooled funds and multilateral development banks do not count against the limit for any single foreign country, since the risk is diversified over many countries. The limits are:

	Cash limit
Any single organisation, except the UK Central Government	£4m each
UK Central Government	Unlimited
Any group of organisations under the same ownership	£4m per group
Any group of pooled funds under the same management	£10m per manager
Money Market Funds	£30m in total
Pooled Bond fund with rating Minimum AA	£15m in total
Property Invested Pooled Fund	£5m in total
Other Pooled Funds incl. Equity, Unrated Bond Funds, Diversified assets funds.	£12m in total
Negotiable instruments held in a broker's nominee account	£20m per broker
Foreign countries	£10m per country
Registered Providers	£8m in total
Unsecured investments with Building Societies	£8m in total

#### **Cash flow management**

5.24 The Council's officers maintain a detailed cash flow forecast for each coming year revising it as more information is available. This informs the short term investments such as those to cover precept payments. The forecast is compiled on a prudent basis, with receipts under-estimated and payments over-estimated to minimise the risk of the Council being forced to borrow on unfavourable terms to meet its financial commitments. Long term investment strategy is based on the Council's medium term financial strategy.

## **Non-Treasury Investments**

5.25 Although not classed as treasury management activities and therefore not covered by the CIPFA Code or the DCLG Guidance, the Council may also purchase property for investment purposes and may also make loans and investments for service purposes. Such loans and investments will be subject to the Council's normal approval processes for revenue and capital expenditure and need not comply with this treasury management strategy. The prospective changes in CIPFA Codes and the DCLG Guidance imply these investments will be included in future annual investment strategies although exactly what detail is required is not certain until final versions are published. When the final versions are available a revised report including the extra detail may be required. To give some context the Council's existing non-treasury investments are mostly its commercial properties which at the last valuations totalled around £50m.

## **6** Treasury Management Indicators

#### Security benchmark: average credit rating

6.1 The Council has adopted a voluntary measure of its exposure to credit risk by monitoring the value-weighted average credit rating of its investment portfolio. This is calculated by applying a score to each investment (AAA=1, AA+=2, etc.) and taking the arithmetic average, weighted by the size of each investment. Unrated investments are assigned a score based on their perceived risk. The benchmark for 2018/19 will be an average credit rating of A which is one notch up from last year.

#### Liquidity benchmark

6.2 The Council has adopted a voluntary measure of its exposure to liquidity risk by monitoring the amount of cash available to meet unexpected payments within a rolling three month period, without additional borrowing. The liquidity benchmark for 2018/19 is an amount of cash available to meet unexpected payments within a rolling three month period, without additional borrowing. For 2018/19 the benchmark amount available will be £3m.

#### Yield benchmark

6.3 The Council has adopted the voluntary yield benchmark of the 7 day London Interbank bid rate.

#### **Interest rate exposures**

6.4 This indicator is set to control the Council's exposure to interest rate risk. The upper limits on fixed and variable rate interest rate exposures, expressed as an amount of net principal borrowed are shown below. Fixed rate investments and borrowings are defined here as those where the rate of interest is fixed for the whole financial year. Instruments that mature during the financial year are classed as variable rate. Investments count as negative borrowing.

						2018/19	2019/20	2020/21
Upper	limit	on	fixed	interest	rate	£15m	£15m	£15m
exposu	res							
Upper	limit	on	variable	interest	rate	£0m	£0m	£0m
exposu	res							

## Maturity structure of borrowing

6.5 This indicator is set to control the Council's exposure to refinancing risk and is really most useful for councils with a portfolio of loans. The upper and lower limits on the maturity structure of fixed rate borrowing are shown below. The Council only has one such debt at present and envisages only one more in 2018/19 so will set limits to allow flexibility of term and maturity date for any new borrowing.

	Upper	Lower
Under 12 months	100%	0%
12 months and within 24 months	100%	0%
24 months and within five years	100%	0%
Five years and within 10 years	100%	0%
10 years and above	100%	0%

## Principal sums invested for periods longer than 364 days

6.6 The purpose of this indicator is to control the Council's exposure to the risk of incurring losses by seeking early repayment of its investments. The limits on the total principal sum invested to final maturities beyond the period end will be:

	2018/19	2019/20	2020/21
Limit on investment over a year	£12m	£12m	£12m

## 7 Other Treasury Management issues

7.1 There are a number of additional items that the Council is obliged by CIPFA or CLG to include in its Treasury Management Strategy.

## Policy on use of financial derivatives

7.2 Local authorities have previously made use of financial derivatives embedded into loans and investments both to reduce interest rate risk (e.g. interest rate collars and forward deals) and to reduce costs or increase income at the expense of greater risk (e.g. LOBO loans and callable deposits). The general power of competence in Section 1 of the Localism Act 2011 removes much of the

- uncertainty over local authorities' use of standalone financial derivatives (i.e. those that are not embedded into a loan or investment).
- 7.3 The Council will only use standalone financial derivatives (such as swaps, forwards, futures and options) where they clearly reduce the overall level of risk. Additional risks presented, such as credit exposure to derivative counterparties, will be taken into account when determining the overall level of risk. Embedded derivatives, including those present in pooled funds and forward starting transactions, will not be subject to this policy, although the risks they present will be managed in line with the overall treasury risk management strategy.
- 7.4 Financial derivative transactions may be arranged with any organisation that meets the approved investment criteria. The current value of any amount due from a derivative counterparty will count against the counterparty credit limit and the relevant foreign country limit.

#### **Treasury Management advisors**

7.5 The Council's treasury management advisor is Arlingclose Limited. Arlingclose provide advice and information on the Council's investment, borrowing and capital financing activities. However, responsibility for final decision making remains with the Council and its officers. The quality of service will be monitored by the Director of Corporate Resource and officers using the services. The Director of Corporate Resources and the Head of Finance meet with a representative of the advisor at least twice a year.

#### Staff training

7.6 The needs of the Council's treasury management staff for training in investment management are assessed regularly as part of the staff appraisal process, and additionally when the responsibilities of individual members of staff change. Staff regularly attend training courses, seminars and conferences provided by Arlingclose, CIPFA and other expert bodies. Staff are also encouraged to study relevant professional qualifications.

## Investment of money borrowed in advance of need

- 7.7 The Council may, from time to time, borrow in advance of spending need, where this is expected to provide the best long term value for money. Since amounts borrowed will be invested until spent, the Council is aware that it will be exposed to the risk of loss of the borrowed sums, and the risk that investment and borrowing interest rates may change in the intervening period. These risks will be managed as part of the Council's overall management of its treasury risks.
- 7.8 The total borrowed will not exceed the authorised borrowing limit which is £15m. The maximum period between borrowing and expenditure is expected to be two years, although the Council does not link loans with items of expenditure.

## 8 Other courses of action considered but rejected

8.1 The DCLG Investment Guidance and the CIPFA Code of Practice do not prescribe any particular treasury management strategy for local authorities to adopt. Having consulted the Cabinet Member for Finance and Assets, the above strategy represents an appropriate balance between risk management and cost effectiveness. Some alternative strategies, with their financial and risk management implications, are listed below:

Alternative	Impact on income and expenditure	Impact on risk management
Invest in a narrower range of counterparties and/or for shorter times	Interest income will be lower	Lower chance of losses from credit related defaults, but any such losses will be greater
Invest in a wider range of counterparties and/or for longer times	Interest income will be higher	Increased risk of losses from credit related defaults, but any such losses will be smaller
Borrow additional sums at long-term fixed interest rates using less internal funds	Debt interest costs will rise; this is unlikely to be offset by higher investment income	Higher investment balance leading to a higher impact in the event of a default; however long-term interest costs may be more certain

# 9 Staffing consequences

9.1 There are no staffing consequences apart from the need for appropriate training set out in paragraph 7.6.

# 10 Financial consequences

10 .1 The budget for investment income in 2018/19 is £0.70m (2017/18 £0.59m), based on an average investment portfolio of £24m at an interest rate of 2.9%. The budget for debt interest paid in 2018/19 is £0.19m, based on a projected average debt portfolio of £7m at an average interest rate of 2.7%.

#### 11 Other considerations

11.1 Risks such as security of funds, liquidity, and interest rate risk are considered in the report. There are no consequences of any action proposed in respect of Crime & Disorder; Human Rights; Equality & Diversity and Sustainability.

# Appendix A Economic background and interest rate forecast

## **Economic background**

The major external influence on the Council's treasury management strategy for 2018/19 will be the UK's progress in negotiating a smooth exit from the European Union and agreeing future trading arrangements. The domestic economy has remained relatively robust since the surprise outcome of the 2016 referendum, but there are indications that uncertainty over the future is now weighing on growth. Transitional arrangements may prevent a cliff-edge, but will also extend the period of uncertainty for several years. Economic growth is therefore forecast to remain subdued throughout 2018/19.

Consumer price inflation reached 3.0% in September 2017 as the post-referendum devaluation of sterling continued to feed through to imports. Unemployment continued to fall and the Bank of England's Monetary Policy Committee judged that the extent of spare capacity in the economy seemed limited and the pace at which the economy can grow without generating inflationary pressure had fallen over recent years. With its inflation-control mandate in mind, the Bank of England's Monetary Policy Committee raised official interest rates to 0.5% in November 2017.

In contrast, the US economy is performing well and the Federal Reserve is raising interest rates in regular steps to remove some of the emergency monetary stimulus it has provided for the past decade. The European Central Bank is yet to raise rates, but has started to taper its quantitative easing programme, signalling some confidence in the Eurozone economy.

#### Credit outlook

High profile bank failures in Italy and Portugal have reinforced concerns over the health of the European banking sector. Sluggish economies and fines for pre-crisis behaviour continue to weigh on bank profits, and any future economic slowdown will exacerbate concerns in this regard.

Bail-in legislation, which ensures that large investors including local authorities will rescue failing banks instead of taxpayers in the future, has now been fully implemented in the European Union, Switzerland and USA, while Australia and Canada are progressing with their own plans. In addition, the largest UK banks will ring-fence their retail banking functions into separate legal entities during 2018. It's unclear how these changes will impact upon the credit strength of the residual legal entities.

The credit risk associated with making unsecured bank deposits has therefore increased relative to the risk of other investment options available to the Council; returns from cash deposits however remain very low.

#### **Interest rate forecast**

The Council's treasury adviser Arlingclose's central case is for UK Bank Rate to remain at 0.50% during 2018/19, following the rise from the historic low of 0.25%. The Monetary Policy Committee re-emphasised that any prospective increases in Bank Rate would be expected to be at a gradual pace and to a limited extent.

Future expectations for higher short term interest rates are subdued and on-going decisions remain data dependent and negotiations on exiting the EU cast a shadow over monetary policy decisions. The risks to Arlingclose's forecast are broadly balanced on both sides. The Arlingclose central case is for gilt yields to remain broadly stable across the medium term. Upward movement will be limited, although the UK government's seemingly deteriorating fiscal stance is an upside risk.

Below is a more detailed interest rate forecast provided by Arlingclose.

	Dec-17	Mar-18	Jun-18	Sep-18	Dec-18	Mar-19	Jun-19	Sep-19	Dec-19	Mar-20	Jun-20	Sep-20	Dec-20	Average
Official Bank Rate														
Upside risk	0.00	0.00	0.00	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.19
Arlingclose Central Case	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50
Downside risk	0.00	0.00	0.00	0.00	0.00	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.15
3-month LIBID rate														
Upside risk	0.10	0.10	0.10	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.22
Arlingclose Central Case	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50
Downside risk	-0.10	-0.10	-0.15	-0.15	-0.15	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.20
1-yr LIBID rate														
Upside risk	0.15	0.15	0.20	0.30	0.30	0.30	0.30	0.30	0.30	0.30	0.30	0.30	0.30	0.27
Arlingclose Central Case	0.70	0.70	0.70	0.70	0.80	0.80	0.80	0.80	0.80	0.80	0.80	0.80	0.80	0.77
Downside risk	-0.15	-0.20	-0.30	-0.30	-0.30	-0.30	-0.30	-0.30	-0.30	-0.30	-0.30	-0.15	-0.15	-0.26
5-yr gilt yield														
Upside risk	0.20	0.25	0.25	0.25	0.30	0.35	0.35	0.35	0.35	0.35	0.35	0.35	0.40	0.32
Arlingclose Central Case	0.75	0.75	0.80	0.80	0.80	0.85	0.90	0.90	0.95	0.95	1.00	1.05	1.10	0.89
Downside risk	-0.20	-0.20	-0.25	-0.25	-0.25	-0.35	-0.40	-0.40	-0.40	-0.40	-0.40	-0.40	-0.40	-0.33
10-yr gilt yield														
Upside risk	0.20	0.25	0.25	0.25	0.30	0.35	0.35	0.35	0.35	0.35	0.35	0.35	0.40	0.32
Arlingclose Central Case	1.25	1.25	1.25	1.25	1.25	1.30	1.30	1.35	1.40	1.45	1.50	1.55	1.55	1.36
Downside risk	-0.20	-0.25	-0.25	-0.25	-0.25	-0.30	-0.35	-0.40	-0.40	-0.40	-0.40	-0.40	-0.40	-0.33
20-yr gilt yield														
Upside risk	0.20	0.25	0.25	0.25	0.30	0.35	0.35	0.35	0.35	0.35	0.35	0.35	0.40	0.32
Arlingclose Central Case	1.85	1.85	1.85	1.85	1.85	1.90	1.90	1.95	1.95	2.00	2.05	2.05	2.05	1.93
Downside risk	-0.20	-0.30	-0.25	-0.25	-0.30	-0.35	-0.40	-0.45	-0.50	-0.50	-0.50	-0.50	-0.50	-0.38
EO um mile unio lal														
50-yr gilt yield Upside risk	0.20	0.25	0.25	0.25	0.30	0.35	0.35	0.35	0.35	0.35	0.35	0.35	0.40	0.32
	0.20		1.70	1.70					1.90					1.82
Arlingclose Central Case	1.70	1.70	-	-	1.70	1.75	1.80	1.85		1.95	1.95	1.95	1.95	
Downside risk	-0.30	-0.30	-0.25	-0.25	-0.30	-0.35	-0.40	-0.45	-0.50	-0.50	-0.50	-0.50	-0.50	-0.39

# Appendix B Changes to codes and guidance relating to treasury management

## **CIPFA Codes**

CIPFA is reviewing both the Prudential Indicator and Treasury Management Codes and will be issuing the new codes in late December. CIPFA has stated the time was right for a general review of the Codes and at the same time has reacted to discussions about concerns that local authorities have greatly increased investments in properties and were using increased borrowing to fund this and this should be subject to the same framework as traditional treasury management.

The consultation suggested a new 'capital strategy' including the capital spending plans overall approach to investment and borrowing and the government's arrangements to be approved by the full Council allowing more detailed strategy to be delegated by the Council to another committee..

Significantly the new suggested Codes bring a wider set of investments into the annual strategy including commercial property investments. It asks local authorities to make clear its process of governance and analysis of potential investments.

## **DCLG** guidance

Department for Communities and Local Government (DCLG) issued revised guidance on local authority investments in March 2010. DCLG is now consulting on new guidance with a deadline of late December 2017 and will issue final guidance by late January 2018. The DLCG has also expressed concerns that local authorities were funding increased investments in properties with increased borrowing and have suggested changes to make this more transparent.



## **Report to Audit Committee**

Date of meeting 13 December 2017
By the Director of Corporate Resources
INFORMATION REPORT



Not exempt

# Treasury Management and Prudential Indicators mid-year report 2017/18

# **Executive Summary**

This report covers treasury activity and prudential indicators for the first half of 2017/18. During the period the Council complied with its legislative and regulatory requirements and the statutory borrowing limit, the Authorised Limit, was not breached.

At 30 September 2017, the Council's external debt was £9m (£4m at 31 March 2017) and its investments totalled £56.3m (£50.1m at 31 March 2017).

During the first half of 2017/18, the Council's cash balances were invested in accordance with the Council's treasury management strategy. Interest of £0.45m was earned on investments at an average return of 0.8% (1.2% full year 2016/17).

#### Recommendations

The Committee is recommended to:

- i) Note the treasury management stewardship report at the mid-year 2017/18
- ii) Note the mid-year prudential indicators for 2017/18

## **Reasons for Recommendations**

- i) This mid-year report is a requirement of the Council's reporting procedures
- ii) This report meets the requirements of the relevant CIPFA Codes of Practice for Treasury Management and Prudential Indicators in Capital Finance.

## **Background Papers**

"Treasury Management Strategy 2017-18" – Audit Committee 4 January 2017

"Budget 2017/18 and Medium Term Financial Strategy" - Cabinet 26 January 2017

"Medium Term Financial Strategy 2018/19 to 2021/22" - Cabinet 23 November 2017

Consultation: Arlingclose Limited. Council's Treasury management advisors

Wards affected: All

Contact: Julian Olszowka, Group Accountant, Technical 01403 215310

# **Background Information**

## 1 Introduction

## The purpose of this report

1.1 This report covers treasury management activity and prudential indicators for the first half of 2017/18. It meets the requirements of both the CIPFA Code of Practice on Treasury Management and the CIPFA Prudential Code for Capital Finance in Local Authorities. The Council is required to comply with both Codes through Regulations issued under the Local Government Act 2003. The Code recommends that Members are informed of Treasury Management activities at least twice a year.

## **Background**

- 1.2 In line with the CIPFA Prudential Code for Capital Finance in Local Authorities the Council adopts prudential indicators for each financial year and reports on performance relative to those indicators. This requirement is designed to show that capital spending is prudent, affordable and sustainable and that treasury practices adequately manage risk. The original indicators for 2017/18 together with Treasury Management Strategy 2017/18 were approved by Council on 15 February 2017. The Treasury Management Strategy 2017/18 had been recommended for approval by this Committee on 4 January 2017.
- 1.3 The economic background to treasury management remains challenging with concerns over Brexit, inflation, indebtedness, productivity and growth weighing on the economy and financial system which has still not fully recovered from the financial crisis. Arlingclose Limited, the Council's treasury management advisors have provided a commentary on the year so far in Appendix A.
- 1.4 There are also a number of regulatory changes that affect the operation of treasury management under way and Arlingclose have provided a commentary in Appendix B. The Director of Corporate Resources will monitor the development of the regulations in order to mitigate any risks to the Council's treasury operations.
- 1.5 At the end of 2016/17 the Council's underlying need to borrow for capital purposes as measured by the Capital Financing Requirement (CFR) was £16.0m, while usable reserves and working capital which are the underlying resources available for investment were £62m. The Council had £4m of borrowing and £50m of investments reflecting its use of internal resources rather than borrowing.

#### 2 Treasury management

#### **Borrowing Activity**

2.1 During the period in question £10m of short term loans were taken out towards the end of July 2017 at an average rate of 0.21%. This was necessary to fund the purchase of the Forum retail units at the end of July. £5m of the short term loans were repaid towards the end of September 2017 as the net inflow of tax collected and returning investments build up cash resources. On 30 September 2017 the Council's borrowing comprised its £4m long term PWLB loan at 3.38% and the remaining short term borrowing of £5m at average rate of 0.24%.

2.2 The remaining £5m of short term loans were repaid in October 2017. It is expected that there will be a significant net cash outflow in the rest of the financial year. This is caused by the usual tailing off of cash as the tax inflows are weighted towards the first ten months of the years and the spending on new waste collection vehicles and the Broadbridge Heath Leisure centre. As a consequence, the Council will need to constantly review its investment position in the rest of the year. This may well involve a combination of cashing in longer term money market funds and further short term borrowing. Short term rates have edged up since the rate change so it is expected that the Council would be paying in the range 0.4% to 0.5%. The yields from longer term money market funds are likely to be in a similar range so the Director of Corporate Resources will monitor the position closely.

#### **Investment Activity**

2.3 The treasury management position at 30 September 2017 is shown below. This is a snapshot rather than the cumulative returns. The cumulative returns are markedly lower at 0.8%. In general the Council holds more liquid balances in the first half of the year which force down yields. The cumulative yield would also have been reduced as the Council held the £15m meant for the Forum purchase in liquid form in the time running up to the final settlement which extended to about a month before final terms were agreed.

	Principal £m	Average Interest Rate %
Call accounts	1.2	0.01
Money Market Funds	27.4	0.50
Short-term deposits	6.0	0.47
Long-term deposits	5.8	1.58
Pooled Funds	15.9	3.90
Total Investments	56.3	1.56
Long-term PWLB loans	4.0	3.38
Short term borrowing	5.0	0.24
Total Borrowing	9.0	1.50
Net Investments	47.3	1.57

- 2.4 Short term rates were extremely low in the period. They should pick up slightly in the second half of the year as the effect of the BoE increasing the base rate from 0.25% to 0.5% in November 2017 feeds through.
- 2.5 Investment income was £0.45m against the budget of £0.31m. The average return was 0.8% against a budget of 0.76% and the adopted yield benchmark 7 day LIBID of 0.11%. Cash balances ranged from £40m to £67m averaging £54m against a budgeted average balance of £41m. Part of the difference would be capital programme lagging behind the budget including the Bridge leisure centre which was budgeted to be further into construction by the middle of the financial year. It is estimated the full year income could be in the region of £0.77m compared to budget of £0.59m. The extra income reflects increased use of pooled funds approved in the annual strategy but not in the original budget which was calculated before the 2017/18 strategy was agreed.

- 2.6 Pooled funds comprising equity, bonds and property are a relatively new part of the strategy and they introduce a risk to the capital value of the investments falling as the underlying asset values can be volatile in the short term. At the end of the first half of the year the value of the investments was £40,000 below the initial investment. However, it should be remembered that these investments are longer term so the current small capital loss should not be overemphasised.
- 2.7 Security of capital has remained the Council's main investment objective. Key to this is the counterparty policy as set out in its treasury management strategy. Counterparty credit quality was assessed and monitored with reference to credit ratings, credit default swap prices, financial statements, information on potential government support and reports in the quality financial press.
- 2.8 **Security benchmark** The Council set a security benchmark rating of A-, which is the average credit rating for the investment portfolio. The average rating was above the benchmark at either A+ or AA-.
- 2.9 **Liquidity benchmark** The Council sets a benchmark to maintain a minimum of liquidity. The benchmark set was that £3m is available within a rolling three month period without additional borrowing. The Director of Corporate Resources can report that liquidity arrangements were well within benchmark during the year to date with overnight cash alone not falling below £4m.
- 2.10 **Counterparty Update** Arlingclose Limited, the Council's treasury management advisors, monitor the quality of potential counterparties and have provided a commentary on the developments in the first part of the year in Appendix C.

## **Compliance with Prudential Indicators**

2.11 The Council confirms compliance with its Prudential Indicators for 2017/18, which were set out in January 2017 as part of the Council's Treasury Management Strategy.

## **Treasury Management Indicators**

2.12 Interest rate exposures - This indicator is set to control the Council's exposure to interest rate risk. The exposures to fixed and variable rate interest rates, expressed as an amount of net principal borrowed, were as the table below. Fixed rate investments and borrowings are those where the rate of interest is fixed for the whole financial year. Instruments that mature during the financial year are classed as variable rate. As investments count as negative borrowing the variable rate figure was negative during the period.

	Limit	Actual	Met?
Upper limit on fixed rate exposures	£15m	£4m	✓
Upper limit on variable rate exposures	£0m	£-30m	✓

2.13 **Maturity Structures Of Borrowing** – These gross limits are set in order to reduce the Council's exposure to large fixed rate loans - those instruments which carry a fixed interest rate for the duration of the instrument - falling due for refinancing. As the Council only has one such debt it has freedom to refinance the debt. The table below shows the estimates and current position.

	Upper	Lower	Actual	Met?
	Limit	Limit		
Under 12 months	100%	0	0	✓
12 months and within 24 months	100%	0	100%	✓
24 months and within five years	100%	0	0	✓
Five years and within 10 years	100%	0	0	✓
10 years and above	100%	0	0	✓

2.14 Principal sums invested for periods longer than 364 days – The purpose of this indicator is to control the Council's exposure to the risk of incurring losses by seeking early repayment of its long-term investments. The total principal sums invested to final maturities beyond the period end were:

	Original	Maximum
	Indicator	Position
Maximum principal sums invested > 364 days	£12m	£5.8m

#### 3 Prudential Indicators 2017/18

- 3.1 The Local Government Act 2003 requires the Council to have regard to CIPFA's Prudential Code for Capital Finance in Local Authorities (the Prudential Code) when determining how much it can afford to borrow. The objectives of the Prudential Code are to ensure that capital investment plans are affordable, prudent and sustainable. To demonstrate that the Council meets these objectives, the Prudential Code sets out the following indicators that must be set and monitored each year.
- 3.2 **The Council's Capital Expenditure and Financing 2017/18 -** This is one of the required prudential indicators and shows total capital expenditure for the year and how this is financed. The estimated indicator is shown below.

2017/18	Original Estimate £000	Current projection £000
Total capital expenditure	26,310	30,524
Resourced by:		
Capital receipts and contributions	(8,603)	(7,695)
Capital grants	( 513)	( 750)
Revenue reserves	(2,953)	(6,773)
Unfinanced capital expenditure (additional need to borrow)	14,241	15,306

3.3 The estimated capital spend in 2017/18 is over the original budget. An underspend as compared to the original budget set in February for 2017/18 has been offset by the Forum Retail Unit purchase which was £12m over the original £3m budget. The revenue reserves financing has also been increased in line with the "Medium Term Financial Strategy 2018/19 to 2021/22" report to the Cabinet on 23 November. The final unfinanced expenditure is only slightly over the original estimate as the increase due to the Forum purchase is offset by the extra use of revenue reserves.

- 3.4 **The Council's overall borrowing need -** The Council's underlying need to borrow is termed the Capital Financing Requirement (CFR). It represents the accumulated net capital expenditure which has not been financed by revenue or other resources. Part of the Council's treasury activities is to address this borrowing need, either through borrowing from external bodies, or utilising temporary cash resources within the Council.
- 3.5 The Council is required to make an annual revenue charge, the Minimum Revenue Provision (MRP), to reduce the CFR effectively a repayment of the borrowing need. The Council's 2017/18 MRP Policy was approved on 15 February 2017 within the 2017/18 Budget report.
- 3.6 The Council's CFR for the year is shown below, and represents a key prudential indicator. There is a small increase in the expected CFR mainly due to the unfinanced capital spend being more than expected as discussed above. No increase in long term borrowing is now projected in this financial year.

Capital Financing Requirement and External Debt Year end 2017/18	Original estimate £000	Current projection £000
CFR	29,276	30,371
External debt	4,000	4,000

- 3.7 External borrowing should not, except in the short term, exceed the total of CFR in the preceding year plus the estimates of any additional CFR for 2017/18 and next two financial years. No difficulties are envisaged for the current or future years in complying with this Prudential Indicator.
- 3.8 **Borrowing limits** The Council approved these Prudential Indicators as part of the 2017/18 Budget report.
- 3.9 Operational boundary for external debt: The operational boundary is based on the Authority's estimate of most likely, i.e. prudent, but not worst case scenario for external debt.
- 3.10 Authorised limit for external debt: The authorised limit is the affordable borrowing limit determined in compliance with the Local Government Act 2003. It is the maximum amount of debt that the Council can legally owe. The authorised limit provides headroom over and above the operational boundary for unusual cash movements.

	Limit	Actual	Met?
Operational boundary – borrowing	£4m	£4m	✓
Operational boundary – other long-term liability	<u>£0m</u>	<u>£0m</u>	✓
Operational boundary – TOTAL	£4m	£4m	<b>  ✓</b>
Authorised limit – borrowing	£14m	£4m	✓
Authorised limit – other long-term liability	£1m	£0m	✓
Authorised limit – TOTAL	£15m	£4m	✓

3.11 The ratio of financing costs to net revenue stream - This indicator identifies the trend in the cost of capital (financing costs net of interest and investment income) against the net revenue stream. The indicator for the year was 2% and the current estimate is approximately 3% as the estimate of financing costs has shaded upwards.

#### 4 Outcome of consultations

4.1 Arlingclose Limited, the Council Treasury management advisors, have made comments which have been incorporated into the report.

## 5 Staffing consequences

5.1 There are no direct staff resourcing consequences. However, the risks in the investment environment highlights the continuing need for staff training and staff will take advantage of courses run by its advisors Arlingclose Limited.

## 6 Financial consequences

6.1 Interest earned is expected to be above budget improving the current year's financial performance. The outturn is forecast to be £0.2m above budget as a result of having higher cash balances and the return from the pooled funds investment amounts that were not in the 2017/18 budget but subsequently approved in the strategy. Extra borrowing costs will be incurred but they will not be material against the £0.135m current budget

#### 7 Other considerations

7.1 There are no consequences of any action proposed in respect of Risk; Crime & Disorder; Human Rights; Equality & Diversity and Sustainability.

# Appendix A

## Economic background to the midpoint of 2017/18

**Economic backdrop**: Commodity prices fluctuated over the period with oil falling below \$45 a barrel before inching back up to \$58 a barrel. UK Consumer Price Inflation (CPI) index rose with the data print for August showing CPI at 2.9%, its highest since June 2013 as the fall in the value of sterling following the June 2016 referendum result continued to feed through into higher import prices. The new inflation measure CPIH, which includes owner occupiers' housing costs, was at 2.7%.

The unemployment rate fell to 4.3%, its lowest since May 1975, but the squeeze on consumers intensified as average earnings grew at 2.5%, below the rate of inflation. Economic activity expanded at a much slower pace as evidenced by Q1 and Q2 GDP growth of 0.2% and 0.3% respectively. With the dominant services sector accounting for 79% of GDP, the strength of consumer spending remains vital to growth, but with household savings falling and real wage growth negative, there are concerns that these will be a constraint on economic activity in the second half of calendar 2017.

The Bank of England made no change to monetary policy at its meetings in the first half of the financial year. The vote to keep Bank Rate at 0.25% narrowed to 5-3 in June highlighting that some MPC members were more concerned about rising inflation than the risks to growth. Although at September's meeting the Committee voted 7-2 in favour of keeping Bank Rate unchanged, the MPC changed their rhetoric, implying a rise in Bank Rate in "the coming months". The Council's treasury advisor Arlingclose was not convinced the UK's economic outlook yet justified a rise, but the Bank's interpretation of the data seemed to have shifted and in the second half of the year the Bank did move.

In contrast to the UK, near-term global growth prospects improved. The US Federal Reserve increased its target range of official interest rates in June for the second time in 2017 by 25bps (basis points) to between 1% and 1.25% and, despite US inflation hitting a soft patch with core CPI at 1.7%, a further similar increase is expected in its December 2017 meeting. The Fed also announced confirmed that it would be starting a reversal of its vast Quantitative Easing programme and reduce the \$4.2 trillion of bonds it acquired by initially cutting the amount it reinvests by \$10bn a month.

Geopolitical tensions escalated in August as the US and North Korea exchanged escalating verbal threats over reports about enhancements in North Korea's missile programme. The provocation from both sides helped wipe off nearly \$1 trillion from global equity markets but benefited safe-haven assets such as gold, the US dollar and the Japanese yen. Tensions remained high, with North Korea's threat to fire missiles towards the US naval base in Guam, its recent missile tests over Japan and a further testing of its latent nuclear capabilities.

Prime Minister Theresa May called an unscheduled General Election in June, to resolve uncertainty but the surprise result has led to a minority Conservative government in coalition with the Democratic Unionist Party. This clearly results in an enhanced level of political uncertainty. Although the potential for a so-called hard Brexit is diminished, lack of clarity over future trading partnerships, in particular future customs agreements with the rest of the EU block, is denting business sentiment and investment. The reaction from the markets on the UK election's outcome was fairly muted, business confidence now hinges on the progress (or not) on Brexit negotiations, the ultimate 'divorce bill' for the exit and

whether new trade treaties and customs arrangements are successfully concluded to the UK's benefit.

In the face of a struggling economy and Brexit-related uncertainty, Arlingclose expects the Bank of England to take only a very measured approach to any monetary policy tightening; any increase will be gradual and limited as the interest rate backdrop will have to provide substantial support to the UK economy through the Brexit transition

**Financial markets:** Gilt yields displayed significant volatility over the six-month period with the appearing change in sentiment in the Bank of England's outlook for interest rates, the push-pull from expectations of tapering of Quantitative Easing (QE) in the US and Europe and from geopolitical tensions, which also had an impact. The yield on the 5-year gilts fell to 0.35% in mid-June, but then rose to 0.80% by the end of September. The 10-year gilts similarly rose from their lows of 0.93% to 1.38% at the end of the quarter, and those on 20-year gilts from 1.62% to 1.94%.

The FTSE 100 nevertheless powered away reaching a record high of 7548 in May but dropped back to 7377 at the end of September. Money markets rates have remained low: 1-month, 3-month and 12-month LIBID rates have averaged 0.25%, 0.30% and 0.65% over the period from January to 21st September 2017.

## Appendix B

## **Regulatory Updates**

MiFID II: Local authorities are currently treated by regulated financial services firms as professional clients who can "opt down" to be treated as retail clients instead. But from 3rd January 2018, as a result of the second Markets in Financial Instruments Directive (MiFID II), local authorities will be treated as retail clients who can "opt up" to be professional clients, providing that they meet certain criteria. Regulated financial services firms include banks; brokers, advisers, fund managers and custodians, but only where they are selling, arranging, advising or managing designated investments. In order to opt up to professional, the authority must have an investment balance of at least £10 million and the person authorised to make investment decisions on behalf of the authority must have at least one year's relevant professional experience. In addition, the firm must assess that that person has the expertise, experience and knowledge to make investment decisions and understand the risks involved.

The main additional protection for retail clients is a duty on the firm to ensure that the investment is "suitable" for the client. However, local authorities are not protected by the Financial Services Compensation Scheme nor are they eligible to complain to the Financial Ombudsman Service whether they are retail or professional clients. It is also likely that retail clients will face an increased cost and potentially restricted access to certain products including money market funds, pooled funds, treasury bills, bonds, shares and to financial advice. The Authority has declined to opt down to retail client status in the past as the costs were thought to outweigh the benefits.

The Authority meets the conditions to opt up to professional status and intends to do so in order to maintain their current MiFID status.

**CIPFA Consultation on Prudential and Treasury Management Codes:** In February 2017 CIPFA canvassed views on the relevance, adoption and practical application of the Treasury Management and Prudential Codes and after reviewing responses launched a further consultation on changes to the codes in August with a deadline for responses of 30th September 2017. The Council responded to the consultation after taking advice from Arlingclose.

The proposed changes to the Prudential Code include the production of a new high-level Capital Strategy report to full council which will cover the basics of the capital programme and treasury management. The prudential indicators for capital expenditure and the authorised borrowing limit would be included in this report but other indicators may be delegated to another committee. There are plans to drop certain prudential indicators, however local indicators are recommended for ring fenced funds (including the HRA) and for group accounts. Other proposed changes include applying the principles of the Code to subsidiaries.

Proposed changes to the Treasury Management Code include the potential for non-treasury investments such as commercial investments in properties in the definition of "investments" as well as loans made or shares brought for service purposes. Another proposed change is the inclusion of financial guarantees as instruments requiring risk management and addressed within the Treasury Management Strategy. Approval of the technical detail of the Treasury Management Strategy may be delegated to a committee

rather than needing approval of full Council. There are also plans to drop or alter some of the current treasury management indicators.

CIPFA intends to publish the two revised Codes towards the end of 2017 for implementation in 2018/19, although CIPFA plans to put transitional arrangements in place for reports that are required to be approved before the start of the 2018/19 financial year.

The Department of Communities and Local Government (DCLG) has at various forums stated a wish to have a more rigorous framework in place for the treatment of commercial investments as soon as is practical. The DCLG has issued a revision to its Investment and MRP Guidance for local authorities in England. It is open for consultation until 22<sup>nd</sup> December 2017 with final version expected at the end of January 2018.

## Appendix C

#### **Counterparty issues**

**Credit background:** UK bank credit default swaps continued their downward trend, reaching three-year lows by the end of June. Bank share prices have not moved in any particular pattern.

There were a few credit rating changes during the half year. The significant change was the downgrade by Moody's to the UK sovereign rating in September from Aa1 to Aa2 which resulted in subsequent downgrades to sub-sovereign entities including local authorities. Moody's downgraded Standard Chartered Bank's long-term rating to A1 from Aa3 on the expectation that the bank's profitability will be lower following management's efforts to de-risk their balance sheet. The agency also affirmed Royal Bank of Scotland's and NatWest's long-term ratings at Baa1, placed Lloyds Bank's A1 rating on review for upgrade, revised the outlook of Santander UK plc, and Nationwide and Coventry building societies from negative to stable but downgraded the long-term rating of Leeds BS from A2 to A3. The agency downgraded long-term ratings of the major Canadian banks on the expectation of a more challenging operating environment and the ratings of the large Australian banks on its view of the rising risks from their exposure to the Australian housing market and the elevated proportion of lending to residential property investors.

S&P also revised Nordea Bank's outlook to stable from negative, whilst affirming their long-term rating at AA-. The agency also upgraded the long-term rating of ING Bank from A to A+.

Ring-fencing, which requires the larger UK banks to separate their core retail banking activity from the rest of their business, is expected to be implemented within the next year. In May, following Arlingclose's advice, the Authority reduced the maximum duration of unsecured investments with Bank of Scotland, HSBC Bank and Lloyds Bank from 13 months to 6 months as until banks' new structures are finally determined and published, the different credit risks of the 'retail' and 'investment' banks cannot be known for certain.

The new EU regulations for Money Market Funds were finally approved and published in July and existing funds will have to be compliant by no later than 21st January 2019. The key features include Low Volatility NAV (LVNAV) Money Market Funds which will be permitted to maintain a constant dealing NAV, providing they meet strict new criteria and minimum liquidity requirements. MMFs will not be prohibited from having an external fund rating (as had been suggested in draft regulations). Arlingclose expects most of the short-term MMFs it recommends to convert to the LVNAV structure and awaits confirmation from each fund.

# **Report to Audit Committee**

13th December 2017 By the Director of Corporate Resources **INFORMATION REPORT** 



Not Exempt

# Risk Management ~ Quarterly Report

# **Executive Summary**

This report includes an update on the Corporate Risk Register for consideration and provides an update on progress with the quarterly departmental risk register reviews.

#### Recommendations

That the Committee is recommended to:

i) Note the contents of this report.

## **Reasons for Recommendations**

As part of good governance, it is important that this document is considered by Members.

# **Background Papers**

Covalent Performance Management System / Corporate Risk Register

Wards affected: All

Contact: Julie McKenzie, Project Assurance Manager 01403-215306

## **Background Information**

# 1 Introduction and Background

- 1.1 The Audit Committee is charged with responsibility for monitoring the effectiveness of the Council's risk management arrangements.
- 1.2 The report provides details of key changes to the Council's Corporate Risk Register, and an update on progress regarding the departmental risk registers (see 3.1 and 3.2 below).

# 2 Relevant Council Policy

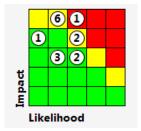
- 2.1 The Council's Risk Management Policy is detailed in the Council's Risk Management Toolkit. The Council's Risk Management Strategy is a component part of the Policy, and this document sets out to achieve the following objectives:
  - Fully integrate risk management into the culture of the Council and its strategic and service planning processes;
  - Ensure that the risk management framework is understood and that ownership and accountability for managing risks is clearly assigned;
  - Ensure the benefits of risk management are realised through maximising opportunities and minimising threats;
  - Ensure consistency throughout the Council in the management of risk.

## 3 Details

#### 3.1 Corporate Risk Register

The Senior Leadership Team has reviewed the Corporate Risk Register and comments have been updated to reflect the current position for each risk (see Appendix 1).

The Corporate Risk profile is shown in the following heat map which shows the total number of risks in each segment. The red / amber / green zones are in accordance with the Council's risk appetite.



There is one risk which is currently considered to be high, eight medium risks and six low risks. The high risk area relates to the following:

Funding from Government is less generous than assumed in the Medium Term Financial Strategy (MTFS) from 2020

Please see the risk register in Appendix 1 which provides full details of all risks on the "live" register together with details of the control actions and responsible officers.

#### 3.2 Departmental Risk Registers

Departmental risk registers have been reviewed and updated.

#### 4 Outcome of Consultations

4.1 Officers who are responsible for control actions and the Senior Leadership Team have been consulted in updating the Corporate Risk Register.

## 5 Other Courses of Action Considered but Rejected

5.1 Not applicable.

### 6 Financial Consequences

6.1 There are no financial consequences.

## 7 Legal Consequences

7.1 There are no legal consequences.

## 8 Staffing Consequences

8.1 There are no staffing consequences.

#### 9 Risk Assessment

9.1 The report provides an update on the Council's corporate risks and how these are being managed by the Senior Leadership Team. See Appendix 1 for the latest version of the Council's Corporate Risk Register.

#### 10 Other Considerations

10.1 Risk management encompasses all risks within the organisation, including strategic, operational, and project/change risks. This includes consideration of Crime & Disorder; Human Rights; Equality & Diversity; and Sustainability as appropriate.



## **Appendix 1 Corporate Risk Report November 2017**

**Generated on:** 29 November 2017



Risk Code & Description	Effect	Risk Owner	Current Risk Matrix	Control Action	Control Action Owner	Status	Target Risk Matrix	Quarterly Update
			1	CRR.01.1 Review current budgets in preparation for the 2018/19 budget (October Annually)	Dominic Bradley			A balanced budget for 2017/18 was approved at Cabinet on 26 January 2017 and Council on 15 February 2017. This incorporated many of the efficiency and additional income plans worked on during the year.  The MTFS update in Nov 2017 forecasts small surpluses through to 2019/20 on the expectation that central funding from the government's four year settlement is delivered and that the proposed plans to deliver further efficiencies and income are implemented. The Council's acceptance of the 2015/16 four year settlement during 2016 has helped to provide a degree of certainty for the next three years, in as much as the Revenue Support Grant and the baseline Business Rates funding reduction from £2.2m in 2017/18 to £1.4m in 2019/20 should not get any worse during this period.
				CRR.01.2 Develop options to deal with pressure for consideration by Members	Dominic Bradley			
	Reductions in funding			CRR.01.3 Implement the Medium Term Plan	Dominic Bradley			
CRR01a Financial Cause: The Council is reliant on Central Controlled Government funding (e.g. Business Rates).	Adverse effect on morale	Jane Eaton		CRR.01.4 Ongoing monitoring under the Service Efficiency Board (Future Horsham)	Dominic Bradley		Likelihood	
k: (i) Failure to achieve the juired level of savings and income in the MTFS to 2019/20				CRR.01.5 Productivity & commercialisation projects reviews being undertaken, each of which will provide recommendations (programme of reviews to be completed by 30/09/18)	Chris Lyons			
CRR01b Financial Cause: The Council is reliant on Central Controlled Government funding (eg. Business Rates).  Risk: (ii) Funding from Government is less generous than assumed in the MTFS from 2020	Reductions in funding  Adverse effect on morale  Financial  Failure to achieve agreed objectives		Likelihood	CRR.01b.1 Continue to keep a watching brief	Dominic Bradley		Likelihood	November 2017 Update:  Uncertainty beyond 2019/20, especially with regards to the localisation (100%) retention of business rates remains a significant area of concern. This will be reviewed as information and guidance on how the scheme will work is released. An updated MTFS will be brought back to Members as soon as more is known.  A West-Sussex bid for a county

Risk Code & Description	Effect	Risk Owner	Current Risk Matrix	Control Action	Control Action Owner	Status	Target Risk Matrix	Quarterly Update
								wide pilot scheme for the localisation of Business Rates has been submitted for 2018/19; currently awaiting further information on the outcome of this.
CRR02 Managerial / Professional Cause: The Council has a legal obligation to protect personal			Likelihood	CRR.02.1 Develop appropriate processes & procedures which underpin the IT Security Policy	Andrea Curson			November 2017 Update:  CRR02.2 GDPR project set up with Reps from every department meeting regularly and working within departments to prepare for new regulations in May 2018.  Strategy is evolving as guidance and best practice becomes available.
data. The Information Commissioner has the power to levy significant financial penalties up to £500k for data breaches. These powers are much more far reaching when they change in	People and businesses come to harm and suffer loss that might not otherwise have			CRR.02.2 Develop Strategy for implementation of General Data Protection Regulations (GDPR) (to follow)	Jane Eaton			
May 2018.  Risk 1: Major data breach or leak of sensitive information to a third party.  Rick 2: Risk of significant ICO fine	occurred Complaints / claims / litigation	ed aints / / on Jane		CRR.02.3 Provide a programme of training on Information Security to all staff.	Robert Laban		0	CRR02.3 HDC's e-learning module on data protection is mandatory for all staff. New training for the new GDPR is now available and has been shared with the Project Board and GDPR department representatives. This will be rolled out to all staff by end Dec 17.  As Councillors have individual responsibility for complying with GDPR, HDC will be assisting by providing appropriate GDPR training.  CRR02.4 PSN accredited for
non-compliance with new eneral Data Protection Regulations (GDPR) Some contraventions will be subject to administrative fines of up to 100,000,000 or, in the case of undertakings, 2% of global turnover, whichever is the higher. Others will be subject to administrative fines of up to €20,000,000 or, in the case of undertakings, 4% of global	consumed in defending claims Financial losses Fines from regulators Adverse publicity Reputation damage	Eaton		CRR.02.4 Annual PSN Accreditation	Andrea Curson		Likelihood	
turnover, whichever is the higher. CRR03				CRR.03.1 Update corporate				2017/18, next due Mar/April 18.  November 2017 Update:
Legal Cause: The Civil Contingencies Act				business continuity plan and regular review.	Trevor Beadle			CRR.03.01 – Full review due in
places a legal obligation upon the Council, with partners, to assess the risk of, plan, and exercise for emergencies, as well as undertaking emergency and	come to harm and suffer loss that might not otherwise have occurred	Trevor Beadle	5	CRR.03.2 Update departmental business continuity plans and regular review.	Trevor Beadle		5	February 2018  CRR.03.02 – All managers advised to update departmental BCP's in September/October. Full audit to be
business continuity management. The Council is also responsible for warning and informing the public in relation to emergencies, and for advising local businesses.	Complaints / claims /	-53310	Likelihood		Trevor Beadle		Likelihood	conducted by EPO in November.  CRR.03.04 – No IT Disaster Recovery plan in place. Further work required with IT services and SLT.

Risk Code & Description	Effect	Risk Owner	Current Risk Matrix	Control Action	Control Action Owner	Status	Target Risk Matrix	Quarterly Update	
Risk: The Council is found to have failed to fulfil its obligations under the Act in the event of a civil contingency.	consumed in defending claims Financial losses Censure by			CRR.03.5 Bitesize workshops in 2017 and 2018 to address new procedures and processes and all SLT and heads of service will be invited to attend.	Trevor Beadle			CRR.03.05 – booked in and now taking place.  CRR.03.06 – changes have been	
	regulators Reputation damaged			CRR.03.6 Pick up Emergency Planning changes due to changes to Heads of Service (e.g. Mark Pritchard, Paul Cummins leaving)	Trevor Beadle			accounted for.	
	Failure of			CRR.05.1 Officer training	Jane Eaton				
CRR05 Geyernance Gause: Managers are responsible	business objectives Health & Safety Financial			CRR.05.2 Raise the profile of risk and control by incorporating them into the performance management framework (e.g. integrate into appraisal process).	Jane Eaton	<b>&gt;</b>		November 2017 Update:  Risk complete, retain on register to keep in view	
ensuring that controls to retigate risks are consistently applied.  Risk: Officers are either unaware of expected controls or do not comply with control procedures.	Service Delivery  Compliance with Regulations  Personal Privacy Infringement  Reputation damage	Jane Eaton	Likelihood	CRR.05.3 All Service Managers required to sign an Assurance Statement. (By 30th June Annually) (Cyclical)	Jane Eaton	<b>©</b>	Likelihood		
CRR06 Physical Cause: The Council is responsible for the health & safety of its clients, staff and other	People come to harm Complaints/clai ms/ litigation			CRR.06.2 Develop and implement a corporate inspection strategy (By 30/06/16).	Robert Laban / Health & Safety Officer			November 2017 Update:  CRR.06.2 -Corporate H&S Adviser continues to inspect HDC premises; ongoing.	
stakeholders, owns and maintains significant assets, and also has responsibility for H&S in some partner organisations where it does not have operational control.	Financial losses Censure by audit / inspection Reputation	Jane Eaton	Likelihood	CRR.06.3 Clarity of responsibilities and implementation of a training programme	Robert Laban		Likelihood	CRR.06.3 - H&S responsibilities are set out in the Corporate H&S Policy and H&S subject policies. Directorate H&S Working Groups	
Risk: A health & safety failure	damage Adverse effect			CRR.06.4 Implement a central repository for risk	Robert Laban /			are responsible for implementing these policies. Team self-audits to	

Risk Code & Description	Effect	Risk Owner	Current Risk Matrix	Control Action	Control Action Owner	Status	Target Risk Matrix	Quarterly Update
occurs.	on morale Stress and absenteeism			assessments	Health & Safety Officer			commence from 2018/19.  H&S Training matrix has been published as part of the corporate competencies framework.  E-learning courses for H&S key topics are accessible via Horsham LAB.  CRR.06.04 - The introduction of a central repository for risk assessments remains deferred until the introduction of Office 365 in 2017/18.
CRR07 Managerial / Professional Cause: There is a lack of	Failure of business			CRR.07.1 Specific contract management guidelines will be developed.	Jane Eaton			
morate consistency in terms of the way in which contracts are managed, and contract management is inadequate in some areas.  Risk: Failure of contract / poor service delivery / failure to achieve value for money.	objectives Financial Service delivery Compliance with regulations Personal Privacy Infringement Reputation damage	Jane Eaton		CRR.07.2 A contract management training programme will be designed and implemented.	Jane Eaton		Likelihood	November 2017 update:  SLT have agreed to remove this risk.
CRR12 Partnership / Supplier / Contractual				CRR.12.1 Staff training	Jo Newton- Smith			
<u>Cause:</u> The Council is subject to EU procurement rules and regulations, is putting more services out to tender, and	Financial losses			CRR.12.2 Up-to-date procedures (by 31/7/17).	Jo Newton- Smith			
contractors are increasingly challenging contract awards.	Censure by audit / inspection Reputation	Jane Eaton	Impact	CRR.12.3 Reference to Procurement Team for advice (ongoing)	Jo Newton- Smith		t O	November 2017 Update:  SLT have agreed to remove this
Risk: A contractor successfully challenges an award (e.g. on inflexible price:quality ratios).	ard (e.g. on Adverse offset		Likelihood	CRR.12.4 Proactive monitoring by the Procurement Team.	Jo Newton- Smith			risk.

Risk Code & Description	Effect	Risk Owner	Current Risk Matrix	Control Action	Control Action Owner	Status	Target Risk Matrix	Quarterly Update	
				CRR.14.1 Ensure that leisure priorities are understood within the CIL schedule process and keep under review	Trevor Beadle			November 2017 Update: The CIL Charging Schedule was implemented on 1 October 2017.	
CRR14					Barbara Childs			CIL Procedures Working Group continues to meets regularly to ensure that implementation issues can be considered.  The Planning Obligations and Affordable Housing SPD was adopted on 1 October 2017.  Note: Housing White Paper of 7 February 2017 indicates there is likelihood that Government will change CIL system in the Autumn Statement 2017, based on the CIL Report that was published alongside White Paper. There is likely to be a two year transition period to any new system when CIL can then be reviewed alongside the Local Plan Review. No further update has been provided on the timetable for any change.  SLT have agreed to remove this risk.	
Customer/Citizen Cause: The negotiation of Section 106 and CIL (Community Infrastructure Levy) are essential for ensuring necessary level of infrastructure provision for residents.  Risk: Failure to negotiate the optimum outcome. Failure to deliver the infrastructure needs of the District D O O O O O O O O O O O O O O O O O O	Reduced funding to deliver outcomes for the community	Chris Lyons	Likelihood	CRR.14.3 Update the Planning Obligations SPD (Supplementary Planning Document) and CIL charging schedule.	Barbara Childs		Likelihood		
CRR17 Cause: The External Auditors audit the				CRR.17.1 Increase / improve the level of quality control checking.	Peter Stuart	<b>②</b>			
HDC Benefits Grant Subsidy return to the Department for Work and Pensions (DWP) on an annual basis to identify errors. Targeted sample testing is	Reputation	Jane	5	CRR.17.2 Continued implementation of the Census Quality Plan which came out of the 2013/14 audit.	Peter Stuart		5	November 2017 Update:  SLT have agreed to remove this risk.	
undertaken to ensure that housing benefit claims have been correctly administered, and extended sample testing is carried out should errors be identified. The amount of the error is then		Eaton	Likelihood	CRR.17.3 A reassessment of all "Working Age In Work" cases will be undertaken by the end of May 2017.	Peter Stuart	<b>②</b>	Likelihood		
extrapolated across the entire population (for that particular cell)				CRR.17.4 Explore options for future service provision	Jane Eaton	<b>②</b>			

Risk Code & Description	Effect	Risk Owner	Current Risk Matrix	Control Action	Control Action Owner	Status	Target Risk Matrix	Quarterly Update
to produce an estimate of the total error amount. Our Subsidy Claim was qualified in 2015/16 and financial penalties occurred.  Risk: Errors may be made which are not identified by quality control checking. This may result in the Benefit Subsidy claim being qualified and/or financial losses.  Refer to new risk CRR25				CRR.17.6 Complete successful transfer to new provider	Jane Eaton			
				CRR.18.1 Staff Training	Claire Oliver / Robert Laban			November 2017 Update:
₽ <b>2</b> R 18	ter and recovery of systems. Fraud/theft. Loss of the integrity of Council Records. Exposure of sensitive/perso nal data			CRR.18.2 Awareness of current threats	Andrea Curson		Likelihood	
Cause: Council services are increasingly reliant on IT systems				CRR.18.3 An effective ICT Service delivery team	Andrea Curson			
atime when there are greater opportunities for malicious attackers to exploit security weaknesses.				CRR.18.4 Effective patching and updates to mitigate known vulnerabilities	Andrea Curson			
Risk 1: A malicious attacker exploits a known or unknown		Jane Eaton	Impact	CRR.18.5 Compliance with expected security standards. (PSN, PCI-DSS)	Andrea Curson			PSN submission complete. Remediation ongoing Patching of devices ongoing
security weakness to penetrate the Council's ICT systems.  Risk 2: IT not working due to environmental problems: fire,			Likelihood	CRR.18.6 Effective policies in place which outline security requirements for users of ICT	Andrea Curson			devices origoning
flood, power cut		r		CRR.18.7 Effective back-up and recovery processes in place for Council ICT systems.	Andrea Curson			
				CRR.18.8 The CenSus Cloud will transfer the risks to the cloud provider	Andrea Curson			

Risk Code & Description	Effect	Risk Owner	Current Risk Matrix	Control Action	Control Action Owner	Status	Target Risk Matrix	Quarterly Update
CRR19 <u>Cause</u> : Uncertainty in the UK and World economy. The Government			Likelihood	CRR19.2 Monitor the external environment	Dominic Bradley			
has spoken about an additional 5% reduction in local government funding, and further cuts in years to come.	Financial Service			CRR19.3 Monitor internal indicators, particularly income generation	Dominic Bradley		Likelihood	November 2017 Update:  The uncertain economic environment is being continually monitored and changes will be reported in any MTFS update and regular quarterly budget and performance monitoring to Overview and Scrutiny Committee.
Risk: The impact on the financial markets and the pound could bring forward the next recession and cause a slowdown in the housing market. This may result in a reduction in planning fees; reduced car parking income; increased homelessness; and increased housing benefit claims.	Delivery Compliance with Regulations	Jane Eaton		CRR19.4 Future Horsham focuses on productivity and commercialisation reviews; these will provide recommendations going forward. (Programme of reviews to be completed by 30.09.2018)	Chris Lyons			
_	Incorrect data migration Data inaccuracies Inaccurate reporting and decision-		CRR.20.1 Monitor and control Joint tender process (with A&WDC) in line with procurement requirements.	Dominic Bradley	<b>Ø</b>		November 2017 Update:  The new FMS went live on 5 September 2017.	
Page CRR20		n cies te g and		CRR.20.2 Training and implementation for finance users. Parallel running of old and new system.	Dominic Bradley	<b>Ø</b>		The migration of data went relatively smoothly, with few discrepancies, but took longer than anticipated due to the volumes involved.  The basic transactional processes are working ok, although progress is a little slow as users get to grips
Technological Cause: There is an inherent risk when significant financial systems change. Current contract for Financial Management System				CRR.20.3 Training and implementation for all Council users to enable access and self-service usage of new system.	Dominic Bradley		Likelihood	
(FMS) expires November 2017.  Risk: System that has not been adequately tested or is without the right level of functionality goes live. Lack of integration with other systems that requires significant systems re-processing.	making Failure to achieve agree objectives and		Likelihood	CRR.20.4 Project management and sufficient testing time incorporated into plan.	Dominic Bradley			with new processes and ways of working. Learning is ongoing. Small improvements to the system are also being made as issues are identified.
	deliver statutory services • Poor VfM	oor		CRR.20.5 Ensure procedure notes for new system and skills are maintained.	Dominic Bradley			The full functionality of budgeting and reporting has been slightly delayed as a consequence of
				CRR.20.6 Providing effective systems support	Dominic Bradley			focussing on the transactional side.  The Council has extended access to the asset module in the old system for a further year before this is transferred across.

Risk Code & Description	Effect	Risk Owner	Current Risk Matrix	Control Action	Control Action Owner	Status	Target Risk Matrix	Quarterly Update
CRR24 Cause: The implementation of alternate weekly collections is a major change of service delivery with a high level of complexity that affects all residents Risk: Failure to successfully roll out the Alternate Weekly Collections project. There are multiple risks around late delivery; cost impact and reputation	Failure of business objectives Financial Service Delivery Reputation Environmental	Adam Chalmers	Likelihood	CRR.24.1 Control actions identified in project risk register	Adam Chalmers		Likelihood	New risk
CRR25 <u>Cause</u> : The transition from Mid	Service Jane Delivery Eaton			CRR.25.1 Effective project delivery teams at HDC and LGSS	Jane Eaton			
Sussex DC (who currently host the service for HDC residents) to new provider (LGSS) is complex, with many inter-related dependencies including HR matters and potential data / and technology issues.  Risk: that transfer of Revenues and Benefits service cannot be completed and / or does not go smoothly by 1 April 2018.		1	Impact	CRR.25.2 Continue to work collaboratively with MSDC to ensure each council has effective teams in place for the future delivery of their service	Jane Eaton		Impact	New Risk
	Reputation		Likelihood	CRR.25.3 Ensure successful transfer of customer data - HDC has good in-house skills and will benefit from LGSS's experience transferring other LA's data	Jane Eaton		崖 <mark>〇</mark> Likelihood	

## **Report to Audit Committee**

13<sup>th</sup> December 2017 By the Chief Internal Auditor

#### **INFORMATION REPORT**

Not Exempt



## Internal Audit - Quarterly Update Report

## **Executive Summary**

This report summarises the work completed by the Internal Audit Section since July 2017.

#### Recommendations

The Committee is recommended to:

i) Note the summary of audit and project work undertaken since July 2017.

#### **Reasons for Recommendations**

- i) To comply with the requirements set out in the Public Sector Internal Audit Standards 2013 (amended April 2017).
- ii) The Audit Committee is responsible for reviewing the effectiveness of the Council's system of internal control.

## **Background Papers**

Internal Audit Reports and Correspondence

Wards affected: All.

**Contact:** Paul Miller, Chief Internal Auditor, 01403-215319

## **Background Information**

## 1 Introduction and Background

- 1.1 The purpose of this report is to provide a summary of work undertaken by the Internal Audit Team since July 2017.
- 1.2 The Accounts and Audit (England) Regulations 2015 state that "A relevant authority must undertake an effective internal audit to evaluate the effectiveness of its risk management, control and governance processes, taking into account public sector internal auditing standards or guidance." This responsibility is discharged through the Council's Internal Audit Section.

## 2 Relevant Policy / Professional Standards

- 2.1 Internal Audit follows the mandatory standards set out in the Public Sector Internal Audit Standards (PSIAS) published by the Chartered Institute of Public Finance and Accountancy (CIPFA) and the Chartered Institute of Internal Auditors.
- 2.2 Internal Audit is conducted in accordance with the Council's Constitution. Financial Procedure Rule 4e 32 states that: "the Chief Finance Officer, as determined by the Council, will ensure that the Council has appropriate arrangements in place to maintain an adequate and effective internal audit". The terms of reference for Internal Audit are detailed in the Council's Internal Audit Charter which is approved and reviewed by the Audit Committee.

## 3 Summary of Audit Findings

3.1 Use of Consultants

OVERALL AUDIT OPINION: REASONABLE ASSURANCE (1)1

The Council obtains great benefit from the use of consultants, and it was noted that some departments (for example, Strategic Planning & Development) regularly engage consultants to obtain advice and skills that would not ordinarily be available from the Council's permanent employees.

The Council's "Consultancy Agreement" template produced by the Legal and Democratic Services team is a particularly well written document and helps to ensure that appropriate conditions are included within the contract.

The main finding from the audit was that there has been some general confusion concerning the difference between consultants, agency workers, interim managers and other temporary staff. As a consequence of this, it has been difficult to identify accurate records for consultancy expenditure. The lack of a clear definition and the

(1) = Improved.

( = No change.

( Reduced.

If blank ~ No previous opinion

<sup>&</sup>lt;sup>1</sup> The symbols in brackets indicate the movement in the level of assurance when the area was last audited.

shortcomings in the coding of expenditure has meant that a significant amount of temporary worker and interim management costs have been inadvertently charged to the consultancy expenditure code. This not only over-inflates the reported cost of consultancy to the Council; it is also hides the true cost of covering for vacant posts and/or long-term sickness.

It was agreed that the Procurement Intranet pages would be updated to show the Central Government (Cabinet) definition of a consultant. In addition, it was agreed that officers would be reminded of the importance of accurately coding expenditure as part of the user training provided during the implementation of the new Technology One (Finance) system. Officers are encouraged to seek assistance from the Procurement team as appropriate.

#### 3.2 Forward Plan

#### **OVERALL AUDIT OPINION: REASONABLE ASSURANCE**

Monthly e-mails are sent to service managers reminding them that they should notify the Democratic Services Manager of any "Key Decisions" which the Cabinet or Cabinet Member intend to make. The Monitoring Officer has provided training to Heads of Service about the importance of the Forward Plan, and the Senior Leadership Team reviews the Forward Plan regularly as part of their routine weekly meetings.

The Forward Plan is easily accessed via the Council's website and the up-to-date version is attached to each Cabinet agenda as a standard item. Contact details for members of the public wishing to make representations are printed on the document.

Audit testing did not identify any specific key decision taken since June 2016 which had not been included on the Forward Plan. However, it has been agreed that the Procurement Officer will now routinely inform the Democratic Services Manager of any major contracts and tenders being advertised. This is an enhancement to the current process and will help to ensure that the Forward Plan is accurate and up to date.

#### 3.3 Commercial Rents

#### OVERALL AUDIT OPINION: REASONABLE ASSURANCE (

The auditor was satisfied that officers within the Property team routinely liaise with local and specialist agents to ensure all property deals contribute the best possible return, taking into account market conditions, council strategic priorities and any relevant risk factors. The Council monitors the percentage of its commercial estate that is occupied as a key performance indicator. The level of voids is low and the performance has exceeded the target for a number of years.

Property valuations are updated on a five year rolling programme in line with Council policy. The valuations are reviewed by experienced Council surveyors to ensure they are reasonable and follow professional guidance. The resulting

valuations are used to calculate the rate of return on property that is published as a key performance indicator.

The auditor raised two main concerns:

- (i) The Council had engaged a management agent to deal with the tenancies on its three industrial estates (Oakhurst Business Park, Blatchford Close and Lintot Square). The contract commenced on 1 February 2017 but, at the time of the audit, the formal contract had not been signed and procedures for managing the contract were still under development. Regular meetings (at least quarterly) are now being held with the Management Agents to update actions needed to deliver the contract.
- (ii) The auditor noted that rent arrears on accounts that are managed by the Management Agents had increased from £26,675 (as at 20 April 2017) to £95,373 (as at 31 August 2017). The increase in arrears had come about in part because of the loss of direct debit as a means of rent collection. It has been agreed that the level of rent arrears will be reviewed with the Management Agents at the quarterly contract management meetings as a standing agenda item.

#### 3.4 New Finance System ~ Data Migration

OVERALL AUDIT OPINION: REASONABLE ASSURANCE

On 4<sup>th</sup> September, the Council's Finance system (TOTAL) was replaced by a new system (Technology One) which is a cloud hosted system and can be accessed remotely. The primary benefit of having a cloud hosted system is that it provides the Council with an element of resilience in terms of business continuity planning and disaster recovery.

Internal Audit had some early involvement in the FMS Replacement project, but this was restricted to commenting on the system specification and evaluation criteria for the selection of a preferred solution. At the time, the Council was working together with Adur/Worthing Councils. In order to retain independence Internal Audit was not involved during the procurement and selection stages of the project.

It was agreed that Internal Audit would carry out further work during the implementation stage for the purposes of providing assurance on the acceptance testing and deployment of Technology One as the project reached its conclusion. The decision to adopt a "Big Bang<sup>2</sup>" approach to implementing Technology One (rather than running the two systems in parallel) meant that much of the user acceptance testing would be carried out on the live system after implementation. For this reason Internal Audit's work was focused on supporting the data migration process and providing independent assurance that balances transferred from the old system to the new were correct.

The auditor was able to provide "Reasonable Assurance" that effective arrangements and controls were in place for ensuring that data was migrated to the

<sup>&</sup>lt;sup>2</sup> With the "big bang" approach, the switch between using the old system and using the new system happens on one single date, the so-called "instant changeover" of the system.

new system completely and accurately. It was agreed that the Systems Accountant would take such action as required in order to establish the reason for the discrepancies highlighted in the reports supplied by Internal Audit and make the required adjustments.

Internal audit raised concerns in the audit report that the Council had placed significant reliance on the technical expertise of one individual (i.e. the Systems Accountant) to implement the new Finance system. It was agreed that the Head of Finance would discuss, with the Director of Corporate Resources, the need to identify a second Systems Administrator (within Finance or IT) to provide support to the Systems Accountant, and to cover periods of absence.

#### 3.5 Taxi Licenses

OVERALL AUDIT OPINION: REASONABLE ASSURANCE

The auditor concluded that there is a sound system of control in place for the administration of the Hackney & Private Hire Licences system.

A few weaknesses were identified which are outlined below:

- It was identified that inspections of vehicle registration documents, bill of sale forms and vehicle service records were not always being evidenced. It was agreed that evidence will be recorded in future.
- There is no formal inspection programme for Private Hire Operators. It has been agreed that all Private Hire Operators will be subject to a formal inspection at least every three years and the notes of these will be recorded within the "Notes" facility within the Diamond Licensing system.

#### 3.6 Community Link

OVERALL AUDIT OPINION: REASONABLE ASSURANCE ( )

The Community Link Service is accredited to the TSA (Telecare Services Association) Quality Standards Framework following an audit carried out in May 2017. Community Link Advisors are all trained to advise and install the correct equipment to customers. All staff have been subject to enhanced DBS (Disclosure and Barring Service) checks.

The auditor confirmed that the monitoring of customer accounts is timely and the level of arrears is low. The Service maintains detailed customer records including information on the equipment installed. Budget monitoring of income and expenditure is undertaken on a monthly basis in accordance with Council procedures. Policies and procedure notes are in place covering all aspects of the Community Link service. These are reviewed and updated regularly.

A few concerns were raised which are summarised as follows:

- The basis of the procurement arrangements for the equipment and devices used by the service has not been reviewed recently and work is needed to ensure that the Council's own Procurement regulations have been followed. It has been agreed that advice will be sought from the Council's Procurement Team.
- The Community Link records are currently maintained on an Access database and there are no direct links between the 'customer' records and the 'stock' records. The provision of a new 'bespoke' IT platform to provide enhanced functionality with improved links was underway but progress was slow. A target completion date of the 31st December has now been agreed with the Council's Technology Services department.

#### 4. Other Audit Work

- 4.1 Internal Audit has been involved in a number of activities since the last report to the Committee:
  - DFG Grant Certification work.
  - Duplicate Creditors Testing.
  - Review and update of the Council's risk management toolkit.
  - Risk management training / mentoring to the new Director and new Heads of Service.
  - Advice provided to Members on the workings of the Housing Benefits subsidy.
  - Provision of support to the Policy and Performance team for the 2016/17 Annual Governance Statement.
  - Active participation in GDPR Project Board meetings.
  - Active participation in Corporate Governance Group meetings (held guarterly).

#### 4.2 Orbis Internal Audit

A significant amount of time has been spent in preparing for the transfer of the Council's Internal Audit Service to Orbis<sup>3</sup>. The Orbis Partnership has its own programme of work, and the Horsham Internal Audit team has contributed towards many of the various work streams (for example: Audit Processes; Committee Report Template; Audit Management System and Data analytics).

There is a separate project plan for the Horsham integration work stream, and everything is currently on track for implementation on 1<sup>st</sup> April 2018. A Partnership Agreement has been drafted and this is currently being vetted by the East Sussex C.C and Horsham D.C Legal teams. The TUPE consultation is scheduled to commence on 12<sup>th</sup> January 2018. Orbis internal audit templates and processes for

<sup>&</sup>lt;sup>3</sup> The Orbis Partnership comprises three sovereign authorities: Surrey County Council, East Sussex County Council and Brighton and Hove City Council.

audit field work have already been adopted as part of the transition work so that integration is as seamless as possible.

## 5 Audit Plan ~ Progress Update

- 5.1 The audit plan for 2017/18 is progressing (see Appendix 2 for the current status). 7/24 pieces of work have been completed (29%) and 8 other work streams are currently in progress.
- 5.2 It is important that there is an element of flexibility built into the annual audit plan to respond to emerging risks and changing priorities.

The following amendments were reported to the Committee in the July report:

- (i) The Parking Enforcement audit has been replaced by the "consultancy" review of the ANPR system.
- (ii) The audit of mobile devices has been replaced by an audit of cyber controls (following the recent well-publicised ransomware attacks).

With the agreement of the Director of Corporate Resources, and taking into account the current level of resources, it has been agreed that "Cloud Computing" and "Rural Car Parking" will be dropped so that the team can focus on the delivery of the remainder of the plan. The Cloud Computing project has not evolved in accordance with our original expectations, and Rural Car Parking is not considered to be sufficiently high risk compared to other areas on the plan.

It was originally planned that we would undertake a formal audit follow up of the security of the Council's buildings, but this has been substituted for a formal follow up of special collections (bulky waste) following our "No Assurance" opinion of this area earlier this year. Outstanding agreed actions from our security audit continues to be monitored through our action tracking process.

The team is still aiming to achieve 85% of the audit plan which was the target set at the beginning of the year.

## 6 Next Steps

6.1 The Committee will be kept informed about progress in terms of the audit plan and integration into Orbis.

#### 7 Outcome of Consultations

7.1 Service managers are consulted during each audit. At the end of each review, audit findings and recommendations are discussed with the service manager at a final meeting, and actions are agreed. An action plan is incorporated into the final report including details of responsible officers and agreed implementation dates. There are occasions when a director may also be consulted, particularly for audits which span a number of departments.

## 8 Other Courses of Action Considered but Rejected

8.1 Not applicable.

## 9 Resource Consequences

9.1 This report summarises information about the work undertaken by Internal Audit, and therefore there are no direct financial or HR consequences.

## 10 Legal Consequences

10.1 There are no legal consequences. Where compliance issues are identified during audit fieldwork, the Head of Legal & Democratic Services (or relevant legal specialist) will be consulted.

#### 11 Risk Assessment

11.1 All Internal Audit work is undertaken using a risk based approach and as part of this process, audit findings are risk assessed prior to being reported. The risk assessment then determines the order in which control weaknesses are reported and informs the overall audit assurance opinion. See Appendix 1 for the Orbis audit report assurance definitions which have now been adopted.

#### 12 Other Considerations

12.1 Internal Audit is a reporting function and there are no consequences in respect of Crime & Disorder; Human Rights; Equality & Diversity; or Sustainability. However these areas are considered where appropriate during audit fieldwork.

## Appendix 1

Opinion	Definition
Substantial Assurance	Controls are in place and are operating as expected to manage key risks to the achievement of system or service objectives.
Reasonable Assurance	Most controls are in place and are operating as expected to manage key risks to the achievement of system or service objectives.
Partial Assurance	There are weaknesses in the system of control and/or the level of non-compliance is such as to put the achievement of the system or service objectives at risk.
Minimal Assurance	Controls are generally weak or non-existent, leaving the system open to the risk of significant error or fraud. There is a high risk to the ability of the system/service to meet its objectives.



## APPENDIX 2 ANNUAL AUDIT PLAN 2017/18 ~ PROGRESS UPDATE

Key:
Current Status
Deferred

	Annual Audits ~ Key Financial Systems	Planning	Fieldwork	Draft Report	Report Issued
1	Ernst & Young Key Financial Controls (ISA)				
2	Cash & Bank				
3	Council Tax (CenSus Partnership)				
4	Creditors				
5	Debtors				
	Housing Benefits (to be undertaken by the Crawley Internal Audit Team)				
6	N.N.D.R. (CenSus Partnership)				
7	Payroll				
8	Treasury Management				
	Annual Audits ~ Other	Planning	Fieldwork	Draft Report	Report Issued
9	Contract Management				
0	Computer Audit ~ Cyber Controls				
1	Governance ~ Council's Forward Plan				
2	Ethics, Culture & Behaviours (B/F from 2016/17)				
	4 Year Cycle	Planning	Fieldwork	Draft Report	Report Issued
3	Use of Consultants (B/F from 2016/17)				
4	Casual Workers (including the new IR35 Regulations)				
5	Parking ~ ANPR System ~ Consultancy assignment				
6	Commercial Rents				
7	Community Link / Alarm				
8	Taxi Licenses				
9	Specific follow up (Special Collections - Bulky Waste)				
	Other Work	Planning	Fieldwork	Draft Report	Report Issued
20	Annual Governance Statement ~ Audit Input				
21	Rural Car Parks ~ Annual Charging (New Process)				
22	General Data Protection Regulations ~ Project Assurance Work				
23	FIS Replacement ~ Project Assurance Work				
24	Cloud Computing				
	Unscheduled Work	Planning	Fieldwork	Draft Report	Report Issued
	Special Investigation ~ Printing				
	Duplicate Payments Testing				
	Bulky Waste follow up				



# Agenda Item 13

By virtue of paragraph(s) 3 of Part 1 of Schedule 12A of the Local Government Act 1972.

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By virtue of paragraph(s) 3 of Part 1 of Schedule 12A of the Local Government Act 1972.

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