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Horsham District Council

Audit Committee

Wednesday, 12th December, 2018 at 5.30 pm
Conference Room, Parkside, Chart Way, Horsham

Councillors: Stuart Ritchie (Chairman)
Paul Marshall (Vice-Chairman)
John Chidlow
Paul Clarke
Brian Donnelly
Tim Lloyd
Godfrey Newman

You are summoned to the meeting to transact the following business

Glen Chipp
Chief Executive

Agenda

		Page No.
1.	**Apologies for absence**	
2.	**Minutes** To approve as correct the minutes of the meeting held on 10th October 2018. *(Note: If any Member wishes to propose an amendment to the minutes they should submit this in writing to committeeservices@horsham.gov.uk 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 - 6
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.	**Audit Plan 2018/19**	7 - 34
6.	**Annual Governance Statement - 6 Month Review**	35 - 40
7.	**Treasury Management and Prudential Indicators mid-year report 2018/19**	41 - 50
8.	**Capital Strategy 2019/20 incorporating Investment and Treasury Management Strategy**	51 - 80
9.	**Risk Management - Quarterly Update**	81 - 92

Audit Committee
10 OCTOBER 2018

Present: Councillors: Stuart Ritchie (Chairman), Paul Marshall (Vice-Chairman), Paul Clarke, Brian Donnelly and Godfrey Newman

Apologies: Councillors: John Chidlow and Tim Lloyd

AAG/18 **MINUTES**

There was a small typographical change to be made to minute AAG/6. The word 'they' would be changed to the word 'he'.

Following the above amendment, the minutes of the meeting held on 12th July 2018 were approved as a correct record and signed by the Chairman.

AAG/19 **DECLARATIONS OF MEMBERS' INTERESTS**

There were no declarations of interest.

AAG/20 **ANNOUNCEMENTS**

The Chairman announced that a forward plan for Audit Committee had been created. It would be included on future Agendas.

The vast majority of previously restricted items i.e. 'Internal Audit – Quarterly Update on Audit Follow-Ups' would now be available to the public going forward.

AAG/21 **ANNUAL AUDIT LETTER**

The external audit manager presented the Annual Audit Letter with the purpose of identifying key issues arising from the 2017/18 audit.

The letter detailed potential impacts regarding new accounting standards coming in to effect in the financial years 2018/19 and 2019/20

Members noted the contents of the letter and the potential impacts of the incoming IFRS 9, IFRS 15, and IFRS 16.

AAG/22 **RISK MANAGEMENT - QUARTERLY UPDATE**

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

Two new risks had been added to the register since the publication of the previous update:

- CRR28 – Systems not fully operational on resumption of power supply forcing need for HDC Disaster Recovery Implementation.
- CRR30 – Increase in costs of homelessness, housing services, recycling, transport and anti-social behaviour.

Risk CRR30 was considered to be high risk. There was only one other high risk on the register: CRR01b – Funding from Government is less generous than assumed in the Medium Term Financial Strategy (MTFS) from 2020. CRR28 – the shutdown had taken place without incident and the risk would be removed at the next review.

Members asked the Director of Corporate Resources to provide an indicative cost for the provision of a replicate site for Disaster Recovery.

RESOLVED

That the report be noted.

REASON

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

AAG/23 **INTERNAL AUDIT - QUARTERLY UPDATE REPORT**

The Chief Internal Auditor presented Members with the Internal Audit Progress Report for quarter 1 2018/19.

A number of audits had been completed during quarter 1, however, they related to the previous financial year and the outcomes were included in the annual audit report at the previous committee meeting.

Orbis had established the Orbis Counter Fraud Team in April 2018 and there had been a focus in quarter 1 to ensure a consistent approach be adopted across the Orbis partnership. Implementation of an integrated Fighting Fraud Plan across Orbis partners in quarter 2 would be taking place and internal audit had been liaising with relevant departments in preparation for the forthcoming National Fraud Initiative data matching exercise.

All high and medium priority actions agreed with management as part of individual audit reviews are subject to action tracking. As at the end of quarter 1, 95% of high priority actions due had been implemented within agreed timescales. Internal Audit would continue to work with senior management to ensure that sufficient attention be given, and regular updates would continue to be given at Audit Committee meetings.

Members noted the progress of ongoing and recently completed individual audit reviews.

Three new reviews had been added to the audit plan:

- Housing Benefits Subsidy - Lessons Learnt
- Review of bomb / lockdown procedures for Parkside and buildings owned by Horsham D.C.
- Input to the review of the Council's Constitution

One audit had been removed from the audit plan:

- Contracts (Procurement)

Members noted that all previously agreed performance indicators had been met by Internal Audit.

RESOLVED

That the Audit Committee noted the report.

REASONS

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 systems of internal control.

AAG/24 **URGENT BUSINESS**

The External Auditor, Paul King, announced that he would no longer be the Ernst & Young representative for HDC and his colleague, Andrew Brittain, would be replacing him. He also thanked the Finance team for their hard work and cooperation during the last five years.

The Chairman thanked Paul for his hard work and dedication throughout the previous years.

The meeting closed at 6.21 pm having commenced at 5.30 pm

CHAIRMAN

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Horsham District Council

Audit planning report

Year ended 31 March 2019

December 2018

EY

Building a better working world

Members of the Audit Committee

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

December 2018

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 2018/19 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 12 December 2018 as well as understand whether there are other matters which you consider may influence our audit.

Yours faithfully

Andrew Brittain

For and on behalf of Ernst & Young LLP

Contents

Public Sector Audit Appointments Ltd (PSAA) issued the "Statement of responsibilities of auditors and audited bodies". It is available from the PSAA website (https://www.psaa.co.uk/audit-quality/statement-of-responsibilities/).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 and further guidance (updated April 2018)" 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 2018/19 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 of 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. In addition to our overall response, we consider where these risks may manifest themselves and identify separate fraud risks as necessary below.
Risk of fraud in revenue recognition Inappropriate capitalisation of revenue expenditure	Fraud risk	More focused risk this year.	Under ISA240 there is a presumed risk that revenue may be misstated due to improper recognition of revenue. In the public sector, this requirement is modified by Practice Note 10, issued by the Financial Reporting Council, which states that auditors should also consider the risk that material misstatements may occur by the manipulation of expenditure recognition. Our judgement is the significant risk at the Council relates to the improper capitalisation of revenue expenditure.
Pension Liability Valuation	Inherent 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. 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 2018/19 audit strategy

Risk / area of focus	Risk identified	Change from PY	Details
Valuation of Land and Buildings	Inherent risk	No change in risk or focus.	The fair value of Property, Plant and Equipment (PPE) represents a significant balance in the Council's accounts and are subject to valuation changes, impairment reviews and depreciation charges. Management is required to make material judgements and apply estimation techniques to calculate the year-end balances recorded in the balance sheet.
New Accounting Standards	Inherent risk	New risk identified this year.	IFRS 9 (Financial Instruments) and IFRS 15 (Revenue from contracts) applies from 1 April 2018 and IFRS 16 (Leases) applies from 1 April 2019. We will assess the impact of these new standards to determine whether they have been appropriately implemented by the Council.

Materiality

Planning materiality
£1,553k

Materiality has been set at £1,553k, which represents 2% of the prior years gross expenditure on provision of services.

Performance materiality
£1,165k

Performance materiality has been set at £1,165k, which represents 75% of materiality.

Audit differences
£78k

We will report all uncorrected misstatements relating to the primary statements (comprehensive income and expenditure statement, balance sheet, movement in reserves statement, cash flow statement and collection fund) greater than £78k. Other misstatements identified will be communicated to the extent that they merit the attention of the Audit Committee.

Overview of our 2018/19 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 2019 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.

When 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.

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.

	What is the risk?	What will we do?
Misstatements due to fraud or error	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.	▸ 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. Performing mandatory procedures regardless of specifically identified fraud risks, including: ▸ Testing the appropriateness of journal entries recorded in the general ledger and other adjustments made in the preparation of the financial statements ▸ Assessing accounting estimates for evidence of management bias, and ▸ Evaluating the business rationale for significant unusual transactions. In addition to our overall response, we consider where these risk may manifest themselves and identify separate fraud risks as necessary below.

Our response to significant risks

We have set out the significant risks 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.

Risk of fraud in revenue recognition - inappropriate capitalisation of revenue expenditure

Financial statement impact

Inappropriate capitalisation of revenue expenditure would decrease the net expenditure from the general fund, and increase the value of non-current assets.

What is the risk?

Under ISA 240 there is a presumed risk that revenue may be misstated due to improper revenue recognition. In the public sector, this requirement is modified by Practice Note 10 issued by the Financial Reporting Council, which states that auditors should also consider the risk that material misstatements may occur by the manipulation of expenditure recognition.

From our risk assessment, we have assessed that the risk manifests itself solely through the inappropriate capitalisation of revenue expenditure to improve the financial position of the general fund.

Capitalised revenue expenditure can be funded through borrowing with only minimal MRP charges recorded in the general fund, deferring the expenditure for 30+ years when the borrowing is repaid.

What will we do?

Our approach will focus on:

► For significant additions we will examine invoices, capital expenditure authorisations, leases and other data that support these additions. We review the sample selected against the definition of capital expenditure in IAS 16.

► We will extended our testing of items capitalised in the year by lowering our testing threshold. We will also review a larger random sample of capital additions below our testing threshold.

► Journal testing – we will use our testing of Journals to identify high risk transactions, such as items originally recorded as revenue expenditure and subsequently capitalised.

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?
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 estimated balance and the Code requires that this asset be disclosed on the Council's balance sheet. At 31 March 2018 this totalled £10,313k. 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.	We will: ▸ Liaise with the auditors of West Sussex Pension Fund to obtain assurances over the information supplied to the actuary in relation to West Sussex County 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.
Valuation of Land and Buildings The fair value of Property, Plant and Equipment (PPE) represents a significant balance in the Council's accounts and are subject to valuation changes, impairment reviews and depreciation charges. Management is required to make material judgements and apply estimation techniques to calculate the year-end balances recorded in the balance sheet.	We will: ▸ Consider the work performed by the Council's valuer, including the adequacy of the scope of the work performed, their professional capabilities and the results of their work; ▸ Sample test key asset information used by the valuers in performing their valuation (e.g. floor plans to support valuations based on price per square metre) and challenge the key assumptions used by the valuer; ▸ 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. ▸ Review assets not subject to valuation in 2018/19 to confirm that the remaining asset base is not materially misstated; and ▸ Test accounting entries have been correctly processed in the financial statements.

Other areas of audit focus (continued)

What is the risk/area of focus?	What will we do?
IFRS 9 Financial instruments This new accounting standard is applicable for local authority accounts from the 2018/19 financial year and will change: ▸ How financial assets are classified and measured; ▸ How the impairment of financial assets are calculated; and ▸ The disclosure requirements for financial assets. There are transitional arrangements within the standard; and the 2018/19 Cipfa Code of practice on local authority accounting provides guidance on the application of IFRS 9. However, until the Guidance Notes are issued and any statutory overrides are confirmed there remains some uncertainty on the accounting treatment.	We will: ▸ Assess the authority's implementation arrangements that should include an impact assessment paper setting out the application of the new standard, transitional adjustments and planned accounting for 2018/19; ▸ Consider the classification and valuation of financial instrument assets; ▸ Review new expected credit loss model impairment calculations for assets; and ▸ Check additional disclosure requirements.
IFRS 15 Revenue from contracts with customers This new accounting standard is applicable for local authority accounts from the 2018/19 financial year. The key requirements of the standard cover the identification of performance obligations under customer contracts and the linking of income to the meeting of those performance obligations. The 2018/19 Cipfa Code of practice on local authority accounting provides guidance on the application of IFRS 15 and includes a useful flow diagram and commentary on the main sources of LG revenue and how they should be recognised. The impact on local authority accounting is likely to be limited as large revenue streams like council tax, non domestic rates and government grants will be outside the scope of IFRS 15. However where that standard is relevant, the recognition of revenue will change and new disclosure requirements introduced.	We will: ▸ Assess the authority's implementation arrangements that should include an impact assessment paper setting out the application of the new standard, transitional adjustments and planned accounting for 2018/19; ▸ Consider application to the authority's revenue streams, and where the standard is relevant test to ensure revenue is recognised when (or as) it satisfies a performance obligation; and ▸ Check additional disclosure requirements.

Other areas of audit focus (continued)

What is the risk/area of focus?	What will we do?
IFRS 16 Leases This new accounting standard is applicable for local authority accounts from the 2019/20 financial year and will change: ▸ How operating leases are recognised (as lessee); and ▸ The disclosure requirements for operating leases (as lessee). The 2019/20 Cipfa Code of practice on local authority accounting has not yet been issued. However, the Code requires the disclosure of information relating to the impact of an accounting change that will be required by a new accounting standard, but one which has not yet been implemented.	We will: ▸ Assess the authority's implementation arrangements that should include an impact assessment paper setting out the application of the new standard, transitional adjustments and planned accounting for 2019/20; and ▸ Check additional disclosure requirements.

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 2018/19 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.

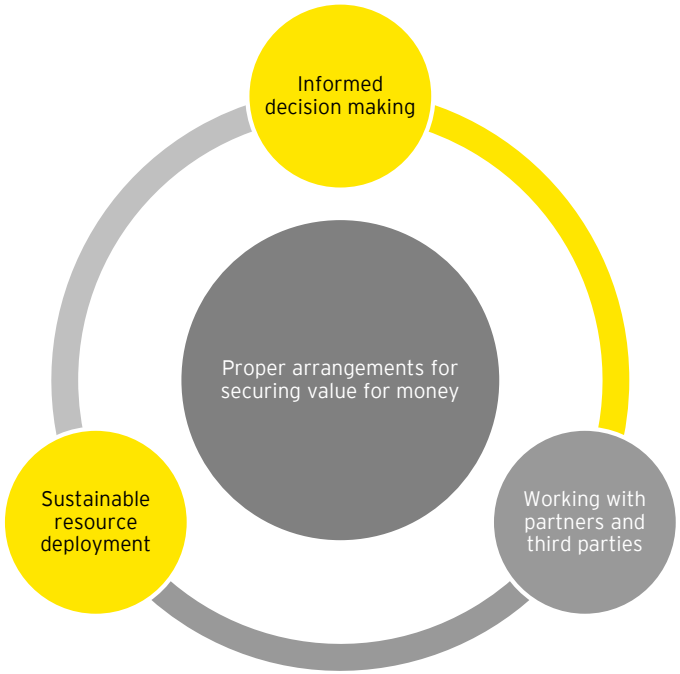
In considering your proper arrangements, we will draw on the requirements of the CIPFA/SOLACE framework for local government to ensure that our assessment is made against a framework that you are already required to have in place and to report on through documents such as your annual governance statement.

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. We consider business and operational risks insofar as they relate to proper arrangements at both sector and organisation-specific level. In 2018/19 this has included consideration of the steps taken by the Council to consider the impact of Brexit on its future service provision, medium-term financing and investment values. Although the precise impact cannot yet be modelled, we anticipate that Authorities will be carrying out scenario planning and that Brexit and its impact will feature on operational risk registers.

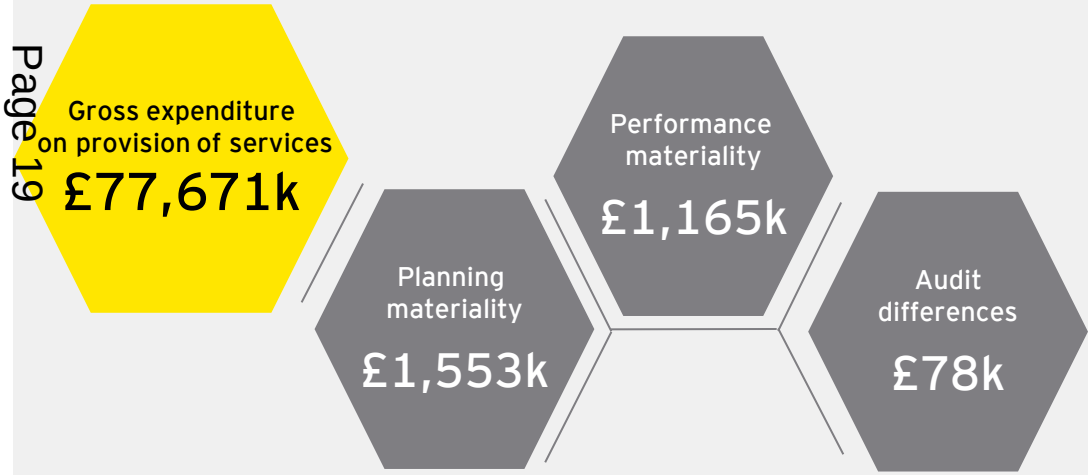
Our risk assessment has therefore considered both the potential financial impact of the issues we have identified, and also the likelihood that the issue will be of interest to local taxpayers, the Government and other stakeholders. This has resulted in the identification of no significant risks at the planning stage of our audit, but we will keep this assessment under review and update the Audit Committee as soon as possible if risks are identified during the remainder of our audit.



Materiality

Materiality

For planning purposes, materiality for 2018/19 has been set at £1,553k. 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 C.



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 £1,165k which represents 75% of planning materiality.

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.

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).

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

- 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 Statement; and
- Reviewing and reporting on the Whole of Government Accounts return, in line with the instructions issued by the NAO

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.

For 2018/19 we plan to follow a substantive approach to the audit 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.

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 Chief Internal Auditor, 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 and the use of specialists

The core audit team is lead by Andrew Brittain, Associate Partner and Jack Dunkley as Manager. John Darlison, Senior, will lead the fieldwork.

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 area where either EY or third party specialists provide input for the current year audit is:

Area	Specialists
Pensions IAS 19 entries	Hymans Robertson, PwC Actuaries and EY Actuaries
Property valuation	Wilks Head & Eve, and EY Real Estates

In accordance with Auditing Standards, we will evaluate each specialist's professional competence and objectivity, considering their qualifications, experience and available resources, together with 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 2018/19.

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.

Audit phase	Timetable	Audit committee timetable	Deliverables
Planning: Risk assessment and setting of scopes.	November		
Walkthrough of key systems and processes	December	Audit Committee	Audit Planning Report
	January		
Testing of routine processes Interim audit testing	February		
	March		
	April	Audit Committee	Interim Audit Update report
	May		
Year end audit Audit Completion procedures	June	Audit Committee	Audit Results Report Audit opinions and completion certificates
	July		
	August		
	Autumn	Audit Committee	Annual Audit Letter

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	**Final 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 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	▸ 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 Andrew Brittain, 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.

None 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 your policy on pre-approval. The ratio of non audit fees to audits fees is not permitted to exceed 70%.

At the time of writing, we have not undertaken any non-audit work, therefore no additional safeguards are required.

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.

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 2018

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 2018 and can be found here:

http://www.ey.com/uk/en/about-us/ey-uk-transparency-report-2018

09 Appendices

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.

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 requirements of the Code of Audit Practice and supporting guidance published by the National Audit Office, the financial reporting requirements set out in the Code of Practice on Local Authority Accounting published by CIPFA/LASAAC, and the professional standards applicable to auditors' work.

	Planned fee 2018/19	Scale fee 2018/19	Final Fee 2017/18
	£	£	£
Total Fee – Code work (1)	38,572	38,572	57,094
Total audit	38,572	38,572	57,094
Other non-audit services not covered above (Housing Benefits)	13,172	13,172	12,383
Total other non-audit services	13,172	13,172	12,383
Total fees	51,744	51,744	69,477

All fees exclude VAT

Note:

(1) the 17/18 Code work includes an additional fee of £7,000 in relation to the change in financial management system; the additional value for money areas that the Audit Committee requested us to review and our work on the valuation of the Forum, which included the involvement of EY Real Estate as an auditor's expert. We are currently in discussions with PSAA over the approval of the additional fee.

The agreed fee presented is based on the following assumptions:

- Officers meeting the agreed timetable of deliverables;
- Our accounts opinion and value for money conclusion being unqualified;
- Appropriate quality of documentation is provided by the Council; and
- The Council has an effective control environment.

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.

Appendix B

Required communications with the Audit Committee

We have detailed the communications that we must provide to the Audit Committee .

Required communications	What is reported?	Our Reporting to you When and where
Terms of engagement	Confirmation by the Audit Committee of acceptance of terms of engagement as written in the engagement letter signed by both parties.	The statement of responsibilities serves as the 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 approach	Communication of the planned scope and timing of the audit, any limitations and the significant risks identified.	Audit planning report
Significant findings from the audit	▸ Our view about the significant qualitative aspects of accounting practices including accounting policies, accounting estimates and financial statement disclosures ▸ 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	Audit results report
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
Misstatements	▸ Uncorrected misstatements and their effect on our audit opinion, unless prohibited by law or regulation ▸ The effect of uncorrected misstatements related to prior periods ▸ A request that any uncorrected misstatement be corrected ▸ Corrected misstatements that are significant ▸ Material misstatements corrected by management	Audit results report

Required communications with the Audit Committee (continued)

		Our Reporting to you
Required communications	**What is reported?**	**When and where**
Fraud	▸ Enquiries of the Audit Committee to determine whether they have knowledge of any actual, suspected or alleged fraud affecting the entity ▸ Any fraud that we have identified or information we have obtained that indicates that a fraud may exist ▸ A discussion of any other matters related to fraud	Audit results report
Related parties	▸ Significant matters arising during the audit in connection with the entity's related parties including, when applicable: ▸ Non-disclosure by management ▸ Inappropriate authorisation and approval of transactions ▸ Disagreement over disclosures ▸ Non-compliance with laws and regulations ▸ Difficulty in identifying the party that ultimately controls the entity	Audit results report
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 Audit Results Report
External confirmations	▸ Management's refusal for us to request confirmations ▸ Inability to obtain relevant and reliable audit evidence from other procedures	Audit results report

Appendix B

Required communications with the Audit Committee (continued)

		Our Reporting to you
Required communications	**What is reported?**	**When and where**
Consideration of laws and regulations	▸ 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 ▸ 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	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	▸ Any circumstances identified that affect the form and content of our auditor's report	Audit results report
Fee Reporting	▸ Breakdown of fee information when the audit plan is agreed ▸ Breakdown of fee information at the completion of the audit ▸ Any non-audit work	Audit planning report 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.	
Our responsibilities required by auditing standards	▸ 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 financial statements. Reading other information contained in the financial statements, 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.

Additional audit information (continued)

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 locations at which we conduct audit procedures to support the opinion given on the financial statements; and
- 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.

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Report to Audit Committee

12th December 2018

By the Director of Corporate Resources

INFORMATION REPORT

Not exempt

Annual Governance Statement – Action Plan 2018/19 Six Month Review

Executive Summary

The six month 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 2017/18. This review included information and assurance gathering processes to ensure that the published Annual Governance Statement is correct as well as a review of the Council's Governance framework against the best practice framework devised by CIPFA/SOLACE.

The aim of the review process is to ensure that the Council has effective governance, risk management and internal control processes in place to assist with accountability and the delivery of objectives. Additionally, the review process has identified any shortfalls in these arrangements to enable them to be addressed.

Recommendations

That the Committee is recommended:

i) To note the contents of this report.

Reasons for Recommendations

i) As part of good governance, it is important that the Audit Committee reviews progress against the Annual Governance Statement action plan.

Background Papers: Supporting evidence, Head of Service Assurance Statements, and the Annual Internal Audit Report.

Consultation: The Senior Leadership Team, Monitoring Officer, Head of Community & Culture, Head of Finance, Head of HR & OD, Head of Technology Services and the Chief Internal Auditor.

Wards affected: All

Contact: Julie McKenzie Project Assurance Manager, 01403-215306

Attachments:

Appendix A: AGS Action Plan 2018/19 Six Month Review

Background Information

1 Introduction and Background

1.1 The Accounts and Audit (England) Regulations 2015 require the Council to approve the Annual Governance Statement, ensuring that this properly reflects the control environment, and to review actions required for improvement. The six month review the 2018/19 Action Plan is attached as Appendix A of this report.

1.2 Senior officers have been consulted and supporting documentation has been updated to reflect the current position.

2 Relevant Council Policy

The Audit Committee is responsible for approving the Annual Governance Statement in accordance with the Committee's terms of reference.

3 Details

3.1 The six month review of the 2018/19 Action Plan is attached as Appendix A of this report.

4 Next Steps

4.1 The Committee is asked to note this report.

5 Outcome of Consultations

5.1 Key officers have been consulted when compiling the Annual Governance Statement, including the Senior Leadership Team; Monitoring Officer; Head of Community & Culture; Head of Finance; Head of Human Resources and Organisational Development; and the Chief Internal Auditor.

6 Other Courses of Action Considered but Rejected

6.1 None.

7 Resource Consequences

7.1 There are no direct staffing consequences arising from this report.

8 Legal Consequences

8.1 Regulation 6 of The Accounts and Audit (England) Regulations 2015 requires that:-

6.—(1) A relevant authority must, each financial year—

(a) conduct a review of the effectiveness of the system of internal control required by regulation 3; and
(b) prepare an annual governance statement;

(2) If the relevant authority referred to in paragraph (1) is a Category 1 authority, following the review, it must—

(a) consider the findings of the review required by paragraph (1)(a)—

(i) by a committee; or
(ii) by members of the authority meeting as a whole; and

(b) approve the annual governance statement prepared in accordance with paragraph (1)(b) by resolution of—

(i) a committee; or
(ii) members of the authority meeting as a whole.

8.2 In 2016 CIPFA/SOLACE published a revised framework for Corporate Governance: "Delivering Good Governance in Local Government Framework". This framework provides a useful and practical update and follows seven core principles of good governance. The Framework urges local authorities to review and report on the effectiveness of the governance arrangements.

9 Risk Assessment

9.1 There are no risks associated with this report.

10 Other Considerations

10.1 This report has no effect on Crime & Disorder; Human Rights; Equality & Diversity or Sustainability.

APPENDIX A: ANNUAL GOVERNANCE STATEMENT ~ ACTION PLAN 2018/19 SIX MONTH REVIEW

No.	Area for Improvement	Actions	Responsible Officer	Target Date	Six Month Progress Update
1	Information security policies	Review and rewrite information security policies	Head of Technology Services	30/9/18	Complete
2	S151 and Monitoring Officer sign off of decision reports	Roll out of tracking and sign off through Modern.gov	Democratic Services Manager	31/3/20	Target date has been moved to 31/3/20.
3	Officer/Member protocol	Reintroduce an officer/member protocol	Head of Legal & Democratic Services	30/6/18	Complete
4	Revenues and Benefits disaster recovery	Move of all Horsham and Mid Sussex based revenues and benefits systems to Milton Keynes Council	Head of Revenues and Benefits (LGSS)	17/12/18	Full migration date moved to 17/12/18 due to external Tech provider being unable to meet earlier date.
5	Verto Project Management system	Review and redesign of the Verto Project Management system	Project Assurance Manager	31/7/18	Complete
6	Reliability of power supply at the depot	Purchase and implementation of a generator	Head of Property Services	1/12/18	Cost/benefit assessment decision taken not to purchase a generator as impact likelihood of power outages at Hop Oast are much reduced.
7	Horsham in-house technology disaster recovery plan	Complete the Disaster Recovery Plan for the in house technology	Head of Technology Services	31/3/19	Process is always an ongoing process.

8	Legal Services' case management & disaster recovery	Implement the new Legal Services Case Management System	Legal Services Business Manager	1/12/18	Target date moved to 1/12/18. Training currently taking place.
9	Plan for major power outage in the District	Prepare a plan for dealing with this type of emergency	Well-being/ Community Safety Manager	31/3/19	This is being investigated and a plan is to be produced by 31/3/19.
10	Contract for the production of the Horsham Pantomime	Review of the arrangements for the Horsham Pantomime to ensure financial probity, value for money and transparency.	Head of Community Services	30/11/18	Complete
11	Software and technology support contracts	Review all software and technology support contracts ensuring their value for money and fitness for purpose	Head of Technology Services	31/12/18	Always an ongoing process for all of the software and technology support contracts.
12	Access to HR records in a civil emergency, disaster recovery of HR and budgetary control of salaries information	Implementation of the HR module of Technology One (Cloud based finance system)	Head of HR and OD	31/12/18	On target
13	Mandatory governance training courses	Ensure all mandated governance courses are complete by the deadlines	Heads of Service	31/3/19	On target. Service Managers will ensure all courses are completed by 31/3/19.
14	Improve disaster recovery and reliability of email systems	Roll out of office 365	Head of Technology Services	31/12/18	On target for 31/12/18

Report to Audit Committee
Date of meeting 12 December 2018
By the Director of Corporate Resources
INFORMATION REPORT

Not exempt

Treasury Management and Prudential Indicators mid-year report 2018/19

Executive Summary

This report covers treasury activity and prudential indicators for the first half of 2018/19. 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 2018, the Council's external debt was £4m (£4m at 31 March 2018) and its investments totalled £44.6m (£56.3m at 30 September 2017).

During the first half of 2018/19, the Council's cash balances were invested in accordance with the Council's treasury management strategy although in one instance the exposure in the Council's own bank exceeded the level that strategy would allow as an investment in that bank. Interest of £0.4m was earned on investments at an average return of 1.0% (0.8% full year 2017/18).

Recommendations

The Committee is recommended to:

i) Note the treasury management stewardship report at the mid-year 2018/19
ii) Note the mid-year prudential indicators for 2018/19

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 2018-19" – Audit Committee 13 December 2017
"Budget 2018/19 and Medium Term Financial Strategy to 2021/22" – Cabinet 25 January 2018

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 2018/19. 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 2018/19 together with Treasury Management Strategy 2018/19 were approved by Council on 21 February 2018. The Treasury Management Strategy 2018/19 had been recommended for approval by this Committee on 13 December 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.

Local Context

1.4 At the end of 2017/18 the Council's underlying need to borrow for capital purposes as measured by the Capital Financing Requirement (CFR) was £30.4m, while usable reserves and working capital which are the underlying resources available for investment were £63m. The Council had £4m of borrowing and £37m of investments reflecting its use of internal resources rather than borrowing in order to reduce risk and keep interest costs low.

1.5 The treasury management position at 30 September 2018 and the change during the period is show in table below.

	31.3.18 Balance £m	**Movement £m**	**30.9.18 Balance £m**	**30.9.18 Rate %**
Long-term borrowing	0	0	0	
Short-term borrowing	4	0	4	3.4
Total borrowing	**4**	**0**	**4**	**3.4**
Long-term investments	17.6	-0.7	16.9	3.4
Short-term investments	14.2	5.7	19.9	0.8
Cash and cash equivalents	5.7	2.1	7.8	0.6
Total investments	**37.6**	**7.1**	**44.6**	**1.8**

2 Treasury management

Borrowing Activity

2.1 During the period in question there was no change in borrowing with only the single £4m PWLB loan at 3.38% which is now classed as short term as it matures on 31 March 2019.

Investment Activity

2.2 The treasury management position at 30 September 2018 is shown below. This is a snapshot rather than the cumulative returns. The cumulative returns are markedly lower at 1%. In general the Council holds more liquid balances in the first half of the year which force down yields so the final average yield for the year is expected to be closer to the present value.

	31.3.18 Balance £m	Movement £m	30.9.18 Balance £m	30.9.18 Rate %
Call accounts	0.7	0.1	0.8	0.1
Money Market Funds – call	5.0	2.0	7.0	0.7
Money Market Funds – longer term	9.4	0.0	9.4	0.6
Short-term deposits	4.8	5.7	10.5	1.1
Long-term deposits	2.0	-2.0	0.0	-
Pooled Funds	15.7	1.3	16.9	3.4
Total Investments	**37.6**	**7.1**	**44.6**	**1.8**

2.3 Short term rates picked up a little after the bank rate rise in August 2018 but they remain comparatively low when compared to historic levels. The prediction of rates is a slow increase in the medium term, although current events around Brexit make any prediction uncertain.

2.4 Investment income in the period was £0.43m against the budget of £0.29m. The average return was 1.0% against a budget of 1.1% and the adopted yield benchmark 7 day LIBID of 0.43%. Cash balances ranged from £33m to £49m averaging £42m against a budgeted average balance of £27m. The major part of the difference is the fact that the capital programme is lagging behind the budget. The current forecast of the full year income is in the region of £0.82m compared to budget of £0.71m reflecting cash balances exceeding the budget.

2.5 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 above the initial investment. However, it should be remembered that these investments are longer term so any capital gain or loss should not be overemphasised. The returns from pooled funds continue to be significantly higher than any other investment type.

Compliance

2.6 The Director of Corporate Resources reports that all treasury management activities undertaken during the first half of 2018/19 complied with the CIPFA Code of Practice and the Council's approved Treasury Management Strategy apart from one instance where exposure to the Council's own bank exceeded the £2.5m that was set as an investment limit. Although this is not an investment as envisaged in the strategy it creates a credit exposure so it is reported here.

2.7 On 29 June 2018 the Council's bank balance had climbed to £2.4m during the day. As this was within the £2.5m limit there was no transfer of cash to other counterparties. However, at 16.30 in the afternoon the Council was credited with an unexpectedly high amount of £150,000 of rents. The usual credits are in the £1,000s or low £10,000s. The rent amount was received after the deadline for investing in other counterparties. As a result the total in the bank went £70,000 over the £2.5m that we would invest with our bank as an investment counterparty. Although this is not an investment as envisaged in the strategy it creates a credit exposure so it is reported here. In retrospect the bank balance should have been reduced to leave headroom for any unexpected credits, although this only happens infrequently.

2.8 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.

Treasury Management Indicators

2.9 The Council measures and manages its exposures to treasury management risks using the following indicators.

2.10 **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 at above the benchmark at either A+ or AA- during the first half of the year.

2.11 **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 £2m and a further £9m available within a week's notice.

Compliance with Prudential Indicators

2.12 The Council confirms compliance with its Prudential Indicators for 2018/19, which were set out in December 2017 as part of the Council's Treasury Management Strategy.

Treasury Management Indicators

2.13 **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	£-31m	✓

2.14 **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 Limit	Lower Limit	Actual	Met?
Under 12 months	100%	0	100%	✓
12 months and within 24 months	100%	0	0	✓
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	✓

2.15 **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 Indicator	Maximum Position
Maximum principal sums invested > 364 days	£12m	£2m

3 **Prudential Indicators 2018/19**

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 2018/19 -** 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.

2018/19	**Original Estimate £000**	**Current projection £000**
Total capital expenditure	24,296	18,229
Resourced by:		
Capital receipts and contributions	(6,496)	(4,028)
Capital grants	(713)	(1,250)
Revenue reserves incl New Homes	(7,201)	(6,564)
Unfinanced capital expenditure (additional need to borrow)	9,886	6,387

3.3 The estimated capital spend in 2018/19 is under the original budget with financing similarly lower than expected and less unfinanced spend than originally planned.

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 2018/19 MRP Policy was approved on 21 February 2018 within the 2018/19 Budget report.

3.6 The Council's CFR for the year is shown below, and represents a key prudential indicator. There is a decrease in the expected CFR is mainly due to the unfinanced capital spend being more than expected. No increase in long term borrowing is now projected in this financial year.

Capital Financing Requirement and External Debt Year end 2018/19	**Original estimate £000**	**Current projection £000**
CFR	39,877	35,970
External debt	9,000	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 2018/19 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 2018/19 Budget report.

3.9 **Operational boundary for external debt:** The operational boundary is based on the Council'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	£9m	£4m	✓
Operational boundary – other long-term liability	£0m	£0m	✓
Operational boundary – TOTAL	£9m	£4m	✓
Authorised limit – borrowing	£17m	£4m	✓
Authorised limit – other long-term liability	£1m	£0m	✓
Authorised limit – TOTAL	£18m	£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 3% and the current estimate is approximately 2% as the interest paid is lower than budgeted and the interested received is over the budget.

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 £110,000 above 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 2018/19

Economic background: Oil prices rose by 23% over the six months to around $82/barrel. UK Consumer Price Inflation (CPI) for August rose to 2.7% year/year, above the consensus forecast and that of the Bank of England's in its August Inflation Report, as the effects of sterling's large depreciation in 2016 began to fade. The most recent labour market data for July 2018 showed the unemployment rate at 4%, its lowest since 1975. The 3-month average annual growth rate for regular pay, i.e. excluding bonuses, was 2.9% providing some evidence that a shortage of workers is providing support to wages. However real wages (i.e. adjusted for inflation) grew only by 0.2%, a marginal increase unlikely to have had much effect on households.

The rebound in quarterly GDP growth in Q2 to 0.4% appeared to overturn the weakness in Q1 which was largely due to weather-related factors. However, the detail showed much of Q2 GDP growth was attributed to an increase in inventories. Year/year GDP growth at 1.2% also remains below trend. The Bank of England made no change to monetary policy at its meetings in May and June, however hawkish minutes and a 6-3 vote to maintain rates was followed by a unanimous decision for a rate rise of 0.25% in August, taking Bank Rate to 0.75%.

Having raised rates in March, the US Federal Reserve again increased its target range of official interest rates in each of June and September by 0.25% to the current 2%-2.25%. Markets now expect one further rise in 2018.

The escalating trade war between the US and China as tariffs announced by the Trump administration appeared to become an entrenched dispute, damaging not just to China but also other Asian economies in the supply chain. The fallout, combined with tighter monetary policy, risks contributing to a slowdown in global economic activity and growth in 2019.
The EU Withdrawal Bill, which repeals the European Communities Act 1972 that took the UK into the EU and enables EU law to be transferred into UK law, narrowly made it through Parliament. With just six months to go when Article 50 expires on 29th March 2019, neither the Withdrawal Agreement between the UK and the EU which will be legally binding on separation issues and the financial settlement, nor its annex which will outline the shape of their future relationship, have been finalised, extending the period of economic uncertainty.

Financial markets: Gilt yields displayed marked volatility during the period, particularly following Italy's political crisis in late May when government bond yields saw sharp moves akin to those at the height of the European financial crisis with falls in yield in safe-haven UK, German and US government bonds. Over the period, despite the volatility, the bet change in gilt yields was small. The 5-year benchmark gilt only rose marginally from 1.13% to 1.16%. There was a larger increase in 10-year gilt yields from 1.37% to 1.57% and in the 20-year gilt yield from 1.74% to 1.89%. The increase in Bank Rate resulted in higher in money markets rates. 1-month, 3-month and 12-month LIBID rates averaged 0.56%, 0.70% and 0.95% respectively over the period.

Credit background: Reflecting its perceived higher risk, the Credit Default Swap (CDS) spread for non-ringfenced bank NatWest Markets plc rose relatively sharply over the period to around 96bps. The CDS for the ringfenced entity, National Westminster Bank plc, has held steady below 40bps. Although the CDS of other UK banks rose marginally over the period, they continue to remain low compared to historic averages.
The ringfencing of the big four UK banks - Barclays, Bank of Scotland/Lloyds, HSBC and RBS/Natwest Bank plc – is complete, the transfer of their business lines into retail (ringfenced) and investment banking (non-ringfenced) is progressing and will need to be completed by the end of 2018.

There were a few credit rating changes during the period. Moody's downgraded Barclays Bank plc's long-term rating to A2 from A1 and NatWest Markets plc to Baa2 from A3 on its view of the credit metrics of the entities post ringfencing. Upgrades to long-term ratings included those for Royal Bank of Scotland plc, NatWest Bank and Ulster Bank to A2 from A3 by Moody's and to A- from BBB+ by both Fitch and Standard & Poor's (S&P). Lloyds Bank plc and Bank of Scotland plc were upgraded to A+ from A by S&P and to Aa3 from A1 by Moody's.

Our treasury advisor Arlingclose will henceforth provide ratings which are specific to wholesale deposits including certificates of deposit, rather than provide general issuer credit ratings. Non-preferred senior unsecured debt and senior bonds are at higher risk of bail-in than deposit products, either through contractual terms, national law, or resolution authorities' flexibility during bail-in. Arlingclose's creditworthiness advice will continue to include unsecured bank deposits and CDs but not senior unsecured bonds issued by commercial banks.

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Report to Audit Committee

12 December 2018

By the Director of Corporate Resources

DECISION REQUIRED

Not exempt

Horsham District Council

Capital Strategy 2019/20 incorporating Investment and Treasury Management Strategy

Executive Summary

This report is a new report for 2019/20, required by changes in CIPFA and the Ministry of Housing, Communities and Local Government (MHCLG) guidance. It combines an overview of how capital expenditure, capital financing, treasury and other investment activity contribute to the provision of local public services along with an overview of how associated risk is managed and the implications for future financial sustainability. The strategies set limits and indicators that embody the risk management approach that the Council believes to be prudent. The strategies are set against the mid-term financial strategy, the context of the UK economy and projected interest rates.

The new report sets treasury investment criteria and limits which are largely unchanged. The investment strategy in section 5 pulls together information on commercial property to explicitly show the Councils risk management approach in that area.

Recommendations

The Committee is asked to:

i) approve the Capital Strategy as an appropriate overarching strategy for the Council while leaving the full Council to approve the updated capital strategy that will accompany the 2019/20 budget to Council in early 2019.

ii) recommend that the full Council approve the Treasury Management Strategy for 2019/20 and the associated limits and specific indicators included in section 4 and appendix B of this report.

iii) recommend that the full Council approve the Investment Strategy for 2019/20 and the associated limits and specific indicators included in section 5 and appendix C of this report.

Reasons for Recommendations

i) The Council has is required to have regard to the Chartered Institute of Public Finance and Accountancy's Treasury Management in the Public Services: Code of Practice 2017 Edition (the CIPFA Code) and Prudential Code which requires the Council to approve Capital strategy, investment strategy and a treasury management strategy before the start of each financial year.

ii) The Ministry for Housing Communities and Local Government (MHCLG) issued revised guidance on local authority investments in 2017 that the Council is required to have regard to.

Background Paper
"Medium Term Financial Strategy 2019/20 to 2021/22" – Cabinet 22 November 2018

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 This is a new report responding to a revised set of Codes and guidance that the Council must, by statue, have regard to. Section 3 gives a high-level overview of:
- how capital expenditure, capital financing and treasury management activity contribute to the provision of local public services
- how associated risk is managed and;
- the implications for future financial sustainability.

1.2 The Treasury Management Strategy at section 4 is the usual report that this Committee has traditionally considered. It covers management of the Council's cash flows, borrowing and investments, and the associated risks. The investment strategy at section 5 is a new requirement for 2019/20 and covers investments held for service purposes or for commercial profit which were not included in the Treasury Management Strategy.

1.3 The changes to guidance are designed to bring together areas which CIPFA and MHCLG consider should be regarded in the round. They are also a response to the increasing commercialisation of local government and especially the increasing investment in commercial property. The guidance requires the capital and investment strategies to be approved by the full Council while the treasury management strategy can now be approved by a subcommittee of the Council although here we follow the Council's existing Constitution that this Committee recommends the Treasury Management Strategy be approved by the full Council (Constitution 4e 30).

2 Background

Economic background

2.1 The Council's strategies must take account of expectations for the economy and specifically the finance sector. The Council receives advice on this from its advisors Arlingclose Ltd. Appendix A is a commentary by them on the current economic background, the outlook for creditworthiness and interest rates.

2.2 The forecast for the Bank Rate is that it rises gradually in the medium term but stays at levels that are below the historical average. For the purpose of the interest 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 still reduced in the aftermath of the financial crisis of 2008 with no return to pre-crisis rates in sight. Governments and regulators have put in place measures prompted by the crisis that restrict any government bail-out of individual financial institutions. This means an institution in difficulty may have to use its own resources and its deposits to continue to operate, exposing any depositor's capital.

Statutory background

2.4 This report is part of the Council's legal obligation under the Local Government Act 2003 to have regard to both the CIPFA Code and the Ministry for Housing, Communities and Local Government (MHCLG) Guidance.

2.5 The regulatory background has been complicated by the revision by both CIPFA and MHCLG codes and guidance. Both CIPFA and the MHCLG state they do not seek to prescribe precisely how councils invest but they clearly have concerns that some councils are taking increasing commercial risks using borrowed money. This approach means that Members are asked to look at a more extensive strategy so that more of the risks that the Codes and guidance highlight are apparent to Members.

Relevant Council policy

2.6 The Council's constitution requires that the Council approve Prudential Code indicators and Treasury Management Strategy. The Investment Strategy covering commercial property has been split from the traditional Treasury Management Strategy here for ease of understanding as it deals with a different type of investment but it can be considered to be encompassed in the definition of the Treasury Management Strategy as used by the Constitution.

2.7 The existing Treasury Management Strategy 2018/19 and Prudential indicators were approved by the Council on 21 February 2018 the former having been approved by the Audit Committee on 13 December 2017.

3 Capital Expenditure and Financing

3.1 Capital expenditure is where the Council spends money on assets, such as property or vehicles that will be used for more than one year. In local government this includes spending on assets owned by other bodies, and loans and grants to other bodies enabling them to buy assets. All capital expenditure must be financed, either from external sources (government grants and other contributions), the Council's own resources (revenue, reserves and capital receipts) or debt (borrowing or leasing).

3.2 Service managers bid annually in October to include projects in the Council's capital programme. Bids are collated by Finance who calculate the financing cost (which can be nil if the project is fully externally financed). The Senior Leadership Team appraises all bids based on a comparison of service priorities against financing costs and makes recommendations to the informal cabinet. The final capital programme is then presented to Cabinet in January and to Council in February each year.

3.3 The current projected capital programme and financing is shown below. It includes current estimates for capital bids for 2019/20 and beyond. The use of reserves is in line with the Medium Term Financial Strategy report to the Cabinet of 22 November 2018. It will be revised if necessary as the 2019/20 budget process develops and the final figures appear alongside the Budget in February 2019 will constitute one of the prudential indicators required by the CPIFA Prudential Code.

£millions	2017/18 Actual £000	2018/19 Revised £000	2019/20 Revised £000	2020/21 Revised £000	2021/22 Estimate £000
Projected Capital Expenditure	28.2	18.2	15.6	10.8	11.8
Financed by:					
External resources	1.7	3.9	2.8	6.3	5.3
Internal Resources *	11.1	7.9	11.5	3.9	4.0
Debt	15.4	6.4	1.3	0.6	2.5
Total Financing	28.2	18.2	15.6	10.8	11.8

* Includes use of New Homes Bonus

3.4 The term Debt used above does not automatically lead to external borrowing as the Council may be able to use cash it holds in reserves and as working capital which is usually termed internal borrowing. Over time all debt whether it be internal or external borrowing must be repaid, and this is therefore replaced over time by other financing, usually from revenue which is known as minimum revenue provision (MRP). The Council is required to make an annual MRP statement and this will be included in the Budget report in January 2019 and the methodology will be on the same basis as 2018/19. The current planned MRP payments are as follows:

£millions	2017/18 actual	2018/19 forecast	2019/20 budget	2020/21 budget	2021/22 budget
MRP	0.924	0.870	0.881	0.941	0.940

3.5 The Council's cumulative outstanding amount of debt finance is measured by the capital financing requirement (CFR). This increases with new debt-financed capital expenditure and reduces with MRP and any capital receipts used to replace debt. The CFR is expected to increase by £1.3m during 2019/20. The Council's estimated CFR is as follows:

£millions	31.3.2018 actual	31.3.2019 forecast	31.3.2020 budget	31.3.2021 budget	31.3.2022 budget
CFR	30.4	36.0	36.3	36.0	37.5

3.6 **Asset disposals:** When a capital asset is no longer needed, it may be sold so that the proceeds, known as capital receipts, can be spent on new assets. Repayments of capital grants, loans and investments also generate capital receipts. The Council projects capital receipts as follows:

	2017/18 actual	2018/19 forecast	2019/20 budget	2020/21 budget	2021/22 budget
Asset sales	1.719	1.350	1.625	3.300	5.775
Loans repaid	0	0.053	0.028	0.029	0.030
TOTAL	**1.719**	**1.403**	**1.653**	**3.329**	**5.805**

4 Treasury Management

4.1 Treasury management is concerned with keeping sufficient but not excessive cash available to meet the Council's spending needs, while managing the risks involved. Surplus cash is invested until required, while a shortage of cash will be met by borrowing, to avoid excessive credit balances or overdrafts in the bank current account. The Council is typically cash rich in the short-term as revenue income is received before it is spent, but cash poor in the long-term as capital expenditure is incurred before being financed. The revenue cash surpluses are offset against capital cash shortfalls to reduce overall borrowing. The Council currently has £4m borrowing at an average interest rate of 3.4% and £46.4m treasury investments at an average rate of 1.9%.

4.2 **Borrowing strategy**: The Council's only borrowing is £4m which is being repaid on 31 March 2019. No further borrowing is planned next financial year but the Council could find itself in a position which calls for some borrowing. In that circumstance the main objectives when borrowing would be to achieve a low but certain cost of finance while retaining flexibility. These objectives are often conflicting, and the Council therefore would seek to strike a balance between cheap short-term loans (currently available at around 0.75%) and long-term fixed rate loans where the future cost is known but higher (currently 2.0% to 3.0%).

4.3 Projected levels of the Council's total outstanding debt (which comprises borrowing and leases) are shown below, compared with the Capital Financing Requirement. Statutory guidance is that debt should remain below the Capital Financing Requirement, except in the short-term. As can be seen from the table the Council expects to comply with this in the medium term.

£millions	**31.3.2018 actual**	**31.3.2019 forecast**	**31.3.2020 budget**	**31.3.2021 budget**	**31.3.2022 budget**
Debt (incl. leases)	4	4	2	2	2
CFR	30.4	36.0	36.3	36.0	37.5

4.4 The table above demonstrates that the Council is relying on internal borrowing i.e. using reserves and other cash resources that it holds rather than borrow from external sources. From projections of the capital programme and use of reserves this strategy is seen as sustainable in the medium term although the Director of Corporate Resources will monitor the actual position against the projections in order to be ready to respond should external borrowing become advisable. In this the Council will use advice from Arlingclose as to the best course of action.

4.5 **Affordable borrowing limit**: Irrespective of plans to borrow or not the Council is legally obliged to set an affordable borrowing limit (also termed the authorised limit for external debt) each year. In line with statutory guidance, a lower "operational boundary" is also set as a warning level should debt approach the limit. The increase in lease figures from 2019/20 reflects the fact that the accounting treatment of leases changes from that year. Although no borrowing is planned, limits are set in case a need develops in 2019/20. Further details on borrowing are in appendix B.

£millions	2018/19 limit	2019/20 limit	2020/21 limit	2021/22 limit
Authorised limit – borrowing	17	15	15	15
Authorised limit – leases	1	3	3	3
Authorised limit – total external debt	18	18	18	18
Operational boundary – borrowing	9	0	0	0
Operational boundary – leases	0	2	2	2
Operational boundary – total external debt	9	2	2	2

4.6 **Investment strategy:** Treasury investments arise from receiving cash before it is paid out again. Investments made for service reasons or for pure financial gain are not generally considered to be part of treasury management and will be dealt with in the Investment Strategy in section 5 and Appendix C.

4.7 The Council's policy on treasury investments is to prioritise security and liquidity over yield, that is to focus on minimising risk rather than maximising returns. Cash that is likely to be spent in the near term is invested securely, for example with the government, other local authorities or selected high-quality banks, to minimise the risk of loss. Money that will be held for longer terms is invested more widely, including in bonds, shares and property, to balance the risk of loss against the risk of receiving returns below inflation. Both near-term and longer-term investments may be held in pooled funds, where an external fund manager makes decisions on which particular investments to buy and the Council may request its money back at short notice. The future longer term investments in the table below are strategic pooled funds that the council intends to hold for the longer term although they can be sold if required.

	31.3.2018 actual	31.3.2019 forecast	31.3.2020 budget	31.3.2021 budget	31.3.2022 budget
Near-term investments	20.0	12	2	4	12
Longer-term investments	17.6	17	17	17	17
TOTAL	**37.6**	**29**	**19**	**21**	**23**

4.8 The projections show cash balances increasing from 2020/21 as the major capital spends of the Bridge and Pirie's Place car park have finished and developers' contributions and New Homes Bonus flow in faster than they are spent. The New Homes Bonus projection used assumes that it reduces but does not end in the medium term. Further detail on treasury investments are in Appendix C including limits and indicators which the Committee is asked to consider.

4.9 **Governance:** Decisions on treasury management investment and borrowing are made daily and are therefore delegated to the Director of Corporate Resources and staff, who must act in line with the Treasury Management Strategy as approved by the Council following this committee's scrutiny and recommendation. The Audit Committee receives a midyear and full year report and is responsible for scrutinising treasury management decisions made.

5 Investment Strategy (loans, shares and property)

5.1 This section is the disclosure newly required by CIPFA and MHCLG guidance. Both bodies have concerns over the increasing risks that they see in the sector as councils start their own companies and make large commercial property purchases.

Investments for Service Purposes

5.2 The Council has the ability to makes investments to assist local public services, including making loans to local service providers and any Council subsidiaries that provide services although at the time of writing there are no subsidiaries. In light of the public service objective, the Council is willing to take more risk than with treasury investments. However it still plans for such investments to generate a profit after all costs to offset risk.

5.3 **Governance:** Decisions on service investments are made by the full Council after the relevant Head of Service has submitted a comprehensive analysis in consultation with the Director of Corporate Resources and must meet the criteria and limits. Most loans and shares are capital expenditure and purchases will therefore also be approved as part of the capital programme in the Budget report or by full Council. Further details on service investments are in appendix C with a new limit of £1m on the total exposure to loans for service purposes and no exposure permitted for shares being held.

Commercial Activities

5.4 With central government financial support for local public services declining, the Council invests in commercial property purely or mainly for financial gain. Total commercial investments are currently valued at £47m, with the largest being the Forum Retail Unit at £12m. These provide a net return after direct costs of 6.6% based on the last set of final accounts which value the assets at market value rather than historical value.

5.5 As financial return is the main objective, the Council recognises the higher risk on commercial investment compared with treasury investments. The principal risk exposures include individual vacancies, falls in market value, changes in the overall and local economy. Individual property risks are constantly monitored and managed by the Head of Property. In order that commercial investments remain proportionate to the financial capacity of the Council, these are subject to an overall maximum investment limit which is set at £60m. Should income not meet expectations the Council holds £6m of general reserves available to balance the revenue budget in the short term while the Head of Property reviews the performance of the portfolio.

5.6 **Governance:** Decisions on new commercial investments are made by the Cabinet after recommendation from the Cabinet Advisory Sub-Committee (Property Investment) in line with the criteria and limits approved by the Council in this strategy. Property and most other commercial investments are also capital expenditure and purchases will therefore also be approved as part of the capital programme. Further details on commercial investments and limits on their use are in appendix C.

Other Liabilities

5.7 The Council has set aside £1.8m to cover risks of Business Rates Appeals. The Council is also at risk of having to pay for historic insurance claims but has not put aside any money because there is no reasonable assessment of the amount required. The Council is also committed to making future payments to cover its pension fund deficit should it arise.

5.8 **Governance:** Decisions on incurring new discretional liabilities are taken by the relevant Director whose directorate budget would cover the crystallisation of a liability. These would be discussed at the quarterly corporate risk management meeting and final decisions as to recognition taken by the Director of Corporate Resources. New liabilities exceeding £1m are reported to full Council for approval or notification as appropriate. Further details on liabilities are in note 18 of the 2017/18 statement of accounts.

Revenue Budget Implications

5.9 Although capital expenditure is not charged directly to the revenue budget, interest payable on loans and MRP are charged to revenue, offset by any investment income receivable. The net annual charge is known as financing costs; this is compared to the net revenue stream i.e. the amount funded from Council Tax, business rates and general government grants. The table below shows the proportion is small.

	2017/18 actual	**2018/19 forecast**	**2019/20 budget**	**2020/21 budget**	**2021/22 budget**
Financing costs (£m)	0.1	0.25	0.01	0.06	-0.04
Proportion of net revenue stream	1%	2%	0%	1%	0%

5.10 **Sustainability:** Due to the long-term nature of capital expenditure and financing, the revenue budget implications of expenditure incurred in the next few years will extend for up to 40 years into the future. The Director of Corporate Resources is satisfied that the proposed capital programme is prudent, affordable and sustainable because the net budget demand on the Council and the risks in the programme have been reviewed and fall within the Council's tolerances.

Knowledge and Skills

5.11 The Council employs professionally qualified and experienced staff in senior positions with responsibility for making capital expenditure, borrowing and investment decisions. For example, the Director of Corporate Resources and S151 Officer is a qualified accountant with over 25 years' experience and the Head of Property is a fellow of RICS with over 30 years' of experience in commercial property. The Council will support junior staff to study towards relevant professional qualifications.

5.12 Where Council staff do not have the knowledge and skills required, use is made of external advisers that are specialists in their field. The Council currently employs Arlingclose Limited as treasury management advisers and for any

significant property investment would use property consultants with specialist knowledge of the appropriate property sector. This approach ensues access to right knowledge and skills and can be more cost effective than employing such staff directly. The overarching requirement is that the Council has access to knowledge and skills commensurate with its risk appetite.

6 Other courses of action considered but rejected

6.1 The MHCLG Investment Guidance and the CIPFA Codes of Practice do not prescribe any particular strategies for local authorities to adopt. 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
Invest more in service loans	Interest income will be higher and service benefits will accrue	Increased risk of losses from credit related defaults or service body being unable to pay loan and provide service
Reduce investment in property	Income will be lower	Lower chance of losses from non-paying tenants or falling property values.
Invest additional sums in property	income will be higher	Increased chance of losses from vacancies or falling property values. Reputational and regulatory risk if Council incurs large loss

7 Staffing consequences

7.1 There are no staffing consequences apart from the need for appropriate training.

8 Financial consequences

8 .1 The budgeted treasury investment income in 2019/20 is £0.89m (2018/19 £0.7m), which is equivalent to an average investment portfolio of £40m at an interest rate of 2.2%. The budget for debt interest paid in 2019/20 is £0.02m which is a contingency for possible short term borrowing. The budget for commercial property net income is £3.5m which is a yield of 7% from an investment portfolio of £47m.

9 Other considerations

9.1 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 UK's progress negotiating its exit from the European Union, together with its future trading arrangements, will continue to be a major influence on the Authority's treasury management strategy for 2019/20.

Following a weak reading in the first quarter of 2018 attributed to weather-related factors, UK GDP growth rebounded in the second quarter to 0.4%, but at an annual rate of only 1.2% this remains below trend. As economic growth had evolved broadly in line with its May Inflation Report forecast, the Bank of England's Monetary Policy Committee (MPC) voted unanimously for a rate rise of 0.25% in August, taking Bank Rate to 0.75%. In November 2018 the MPC maintained Bank Rate at 0.75% while the Inflation Report showed that compared to the August report further interest rate increases may be required to bring inflation down to the 2% target over the forecast horizon.

The headline rate of UK Consumer Price Inflation fell back to 2.4% year-on-year in September 2018 from 2.7% in August, as higher import and energy prices continued to hold inflation above the BoE target. Labour market data is positive. The ILO (International Labour Organization) unemployment rate fell to 4%, its lowest level since 1975. The 3-month average annual growth rate for pay excluding bonuses rose to 3.1% in August providing some evidence that a shortage of labour is supporting wages. However, adjusting for inflation this means real wages were only up by 0.7% and only likely to have a moderate impact on household spending.

While external inflationary pressures from energy costs and import prices are expected to subside, domestic pressures are projected to build over the forecast horizon with the balance of these effects likely to keep inflation above the Bank of England's target throughout most of their forecast horizon, meaning that strong real income growth is unlikely to materialise any time soon.

As the US economy has continued to perform well, the Federal Reserve maintained its monetary tightening stance and pushed up its target range for the Fed Funds Rate in September 2018 by 0.25% to 2% - 2.25%. One further rise is expected in 2018 and two more in 2019.

The fallout from the US-China trade war continues which, combined with tighter monetary policy, risks contributing to a slowdown in global economic activity in 2019. Despite slower growth in the region, the European Central Bank has started conditioning markets for the end of quantitative easing as well as the timing of the first interest rate hike, currently expected in 2019, and the timing and magnitude of increases thereafter.

Credit outlook

The big four UK banking groups have now divided their retail and investment banking divisions into separate legal entities under ring-fencing legislation. Bank of Scotland, Barclays Bank UK, HSBC UK Bank, Lloyds Bank, National Westminster Bank, Royal Bank of Scotland and Ulster Bank are the ring-fenced banks that now only conduct lower risk retail banking activities. Barclays Bank, HSBC Bank, Lloyds Bank Corporate Markets and NatWest Markets are the investment banks. Credit rating agencies have adjusted the ratings of some of these banks with the ring-fenced banks generally being better rated than their non-ring-fenced counterparts.

European banks are considering their approach to Brexit, with some looking to create new UK subsidiaries to ensure they can continue trading here. The credit strength of these new banks remains unknown, although the chance of parental support is assumed to be very high if ever needed. The uncertainty caused by protracted negotiations between the UK and EU is weighing on the creditworthiness of both UK and European banks with substantial operations in both jurisdictions.

Interest rate forecast:

Following the increase in Bank Rate to 0.75% in August 2018, the Authority's treasury management adviser Arlingclose is forecasting two more 0.25% hikes during 2019 to take official UK interest rates to 1.25%. The Bank of England's MPC has maintained expectations for slow and steady rate rises over the forecast horizon. The MPC continues to have a bias towards tighter monetary policy but is reluctant to push interest rate expectations too strongly. Arlingclose believes that MPC members consider both that ultra-low interest rates result in other economic problems, and that higher Bank Rate will be a more effective policy weapon should downside Brexit risks crystallise when rate cuts will be required.

The UK economic environment remains relatively soft, despite seemingly strong labour market data. Arlingclose's view is that the economy still faces a challenging outlook as it exits the European Union and Eurozone growth softens. Whilst assumptions are that a Brexit deal is struck and some agreement reached on transition and future trading arrangements before the UK leaves the EU, the possibility of a "no deal" Brexit still hangs over economic activity (at the time of writing this commentary in early November). As such, the risks to the interest rate forecast are considered firmly to the downside.

Gilt yields and hence long-term borrowing rates have remained at low levels but some upward movement from current levels is expected based on Arlingclose's interest rate projections, due to the strength of the US economy and the ECB's forward guidance on higher rates. 10-year and 20-year gilt yields are forecast to remain around 1.5% and 2% respectively over the interest rate forecast horizon, however volatility arising from both economic and political events are likely to continue to offer borrowing opportunities.

A more detailed economic and interest rate forecast provided by Arlingclose is shown below.

For the purpose of setting the budget, it has been assumed that new investments will be made at the prevailing central case forecasted bank rate.

	Dec-18	Mar-19	Jun-19	Sep-19	Dec-19	Mar-20	Jun-20	Sep-20	Dec-20	Mar-21	Jun-21	Sep-21	Dec-21	Average
Official Bank Rate														
Upside risk	0.00	0.00	0.00	0.00	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	**0.17**
Arlingclose Central Case	**0.75**	**1.00**	**1.00**	**1.25**	**1.25**	**1.25**	**1.25**	**1.25**	**1.25**	**1.25**	**1.25**	**1.25**	**1.25**	**1.17**
Downside risk	0.00	0.50	0.50	0.75	0.75	0.75	0.75	0.75	0.75	0.75	0.75	0.75	0.75	**0.65**
3-mth money market rate														
Upside risk	0.10	0.10	0.10	0.10	0.15	0.20	0.20	0.20	0.20	0.20	0.20	0.20	0.20	**0.17**
Arlingclose Central Case	**0.80**	**1.00**	**1.10**	**1.20**	**1.30**	**1.30**	**1.25**	**1.20**	**1.20**	**1.20**	**1.20**	**1.20**	**1.20**	**1.17**
Downside risk	0.20	0.50	0.60	0.70	0.80	0.80	0.75	0.75	0.75	0.75	0.75	0.75	0.75	**0.68**
1-yr money market rate														
Upside risk	0.20	0.30	0.30	0.35	0.35	0.35	0.35	0.35	0.35	0.35	0.35	0.35	0.35	**0.33**
Arlingclose Central Case	**1.05**	**1.25**	**1.35**	**1.40**	**1.50**	**1.45**	**1.40**	**1.40**	**1.40**	**1.40**	**1.40**	**1.40**	**1.40**	**1.37**
Downside risk	0.35	0.50	0.60	0.75	0.75	0.75	0.75	0.75	0.75	0.75	0.75	0.75	0.75	**0.69**
5-yr gilt yield														
Upside risk	0.15	0.20	0.25	0.35	0.35	0.35	0.35	0.35	0.35	0.35	0.35	0.35	0.35	**0.32**
Arlingclose Central Case	**1.15**	**1.20**	**1.25**	**1.35**	**1.40**	**1.40**	**1.35**	**1.35**	**1.30**	**1.30**	**1.30**	**1.30**	**1.30**	**1.30**
Downside risk	0.30	0.35	0.45	0.50	0.60	0.60	0.60	0.60	0.60	0.60	0.60	0.60	0.60	**0.54**
10-yr gilt yield														
Upside risk	0.20	0.25	0.25	0.35	0.35	0.35	0.35	0.35	0.35	0.35	0.35	0.35	0.35	**0.32**
Arlingclose Central Case	**1.60**	**1.65**	**1.65**	**1.70**	**1.75**	**1.75**	**1.75**	**1.70**	**1.70**	**1.70**	**1.70**	**1.70**	**1.70**	**1.70**
Downside risk	0.30	0.45	0.50	0.55	0.60	0.60	0.60	0.60	0.60	0.60	0.60	0.60	0.60	**0.55**
20-yr gilt yield														
Upside risk	0.20	0.25	0.25	0.35	0.35	0.35	0.35	0.35	0.35	0.35	0.35	0.35	0.35	**0.32**
Arlingclose Central Case	**1.90**	**1.95**	**1.95**	**2.00**	**2.00**	**2.00**	**2.00**	**2.00**	**2.00**	**2.00**	**2.00**	**2.00**	**2.00**	**1.98**
Downside risk	0.30	0.40	0.45	0.45	0.45	0.45	0.45	0.45	0.45	0.45	0.45	0.45	0.45	**0.43**
50-yr gilt yield														
Upside risk	0.20	0.25	0.25	0.35	0.35	0.35	0.35	0.35	0.35	0.35	0.35	0.35	0.35	**0.32**
Arlingclose Central Case	**1.80**	**1.85**	**1.85**	**1.90**	**1.90**	**1.90**	**1.90**	**1.90**	**1.90**	**1.90**	**1.90**	**1.90**	**1.90**	**1.88**
Downside risk	0.30	0.40	0.45	0.45	0.45	0.45	0.45	0.45	0.45	0.45	0.45	0.45	0.45	**0.43**

PWLB Certainty Rate (Maturity Loans) = Gilt yield + 0.80%
PWLB Local Infrastructure Rate (Maturity Loans) = Gilt yield + 0.60%

Appendix B Treasury Management Strategy

Present position and forecast

1 On 31 October 2018 the Council held £4m of borrowing and £46.4m of investments at market value; broken down as follows:

	Principal £m	Average Interest Rate %
Call accounts	0.6	0.20
Money Market Funds	18.4	0.61
Short-term deposits	10.5	1.11
Pooled Funds	16.9	3.83
Total Investments	**46.4**	**1.9**
Long-term PWLB loans	4.0	3.38
Short term borrowing	0	0
Total Borrowing	**4.0**	**3.38**
Net Investments	**42.4**	**1.75**

2 Taking the forecasts within the capital strategy, the balance sheet of the Council can be projected to estimate the amounts available for investments. Below is the current projected analysis of the balance sheet to illustrate the trajectory of the Council's funds.

All figures at year-end £m	**Actual 17/18**	**Estimate 18/19**	**Estimate 19/20**	**Estimate 20/21**	**Estimate 21/22**
CFR	30.5	36.0	36.3	36.0	37.5
Less external borrowing	4.0	4.0	0	0	0
Internal borrowing	26.5	32.0	36.3	36.0	37.5
Useable reserves, receipts, contributions held	56.2	53.8	49.4	50.2	53.9
Working capital/other balances	7.9	6.7	6.3	6.4	6.4
Estimated Investments	37.6	28.5	19.4	20.6	22.8

3 The Council's strategy has been to maintain borrowing and investments below their underlying levels, sometimes known as internal borrowing. In spite of the continuation of this, the Council is projected to hold significant investment balances even at the end of the financial year which is the low point for cash.

Borrowing Strategy

4 As shown above the Council is not expecting to borrow long term funds although it may need short term money if short term cash flow issues require it.

5 **Sources of borrowing:** 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.

6 In addition, capital finance may be raised by the use of leases and hire purchase that are not borrowing, but may be classed as other debt liabilities.

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.

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.

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.

Investment Strategy

10 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 £33m and £60m 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 in the region of £20m for the next three years

11 Both the CIPFA Code and the MHCLG 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.

12 **Negative interest rates:** If the UK enters into a recession in 2019/20, there is a small chance that the Bank of England could set its Bank Rate at or below zero, which is likely to feed through to negative interest rates on all low risk, short-term investment options. This situation already exists in many other European countries. In this event, security will be measured as receiving the contractually agreed amount at maturity, even though this may be less than the amount originally invested.

13 Given the increasing risk and very low returns from short-term unsecured bank investments, the Council aims to further diversify into more secure and/or higher yielding asset classes during 2019/20. This is especially the case for the estimated £20m cash balances that are available for longer-term investment. This diversification will represent a continuation of the present strategy that has moved investment into pooled funds and other local authorities.

14 **Business models:** Under the new IFRS 9 standard, the accounting for certain investments depends on the Council's "business model" for managing them. The Council aims to achieve value from its internally managed treasury investments by a business model of collecting the contractual cash flows rather than buying and selling investments and therefore, where other criteria are also met, these investments will continue to be accounted for at amortised cost.

15 **Approved counterparties**: The Council may invest 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 2018/19 strategy):

Credit Rating	Banks Unsecured	Banks Secured	Government	Corporate	Registered Providers
AAA	*£2.5m 5 years*	*£4m 20 years*	*£4m 50 years*	*£2.5m 10 years*	*£4m 20 years*
AA+	*£2.5m 5 years*	*£4m 10 years*	*£4m 25 years*	*£2.5m 7 years*	*£4m 10 years*
AA	*£2.5m 4 years*	*£4m 5 years*	*£4m 15 years*	*£2.5m 5 years*	*£4m 10 years*
AA-	*£2.5m 3 years*	*£4m 4 years*	*£4m 10 years*	*£2.5m 4 years*	*£4m 10 years*
A+	*£2.5m 2 years*	*£4m 3 years*	*£4m 5 years*	*£2.5m 3 years*	*£4m 5 years*
A	*£2.5m 13 mons*	*£4m 2 years*	*£4m 5 years*	*£2.5m 2 years*	*£4m 5 years*
A-	*£2.5m 6 mons*	*£4m 13 months*	*£4m 5 years*	*£2.5m 1 year*	*£4m 5 years*
None	*£1m 6 months*	*n/a*	*n/a*	*£50,000 5 years*	*£2m 1 year*
UK Govt	*Central government £unlimited 50 years UK Local Authority £4m 10 years*				
Pooled funds and real estate investment trusts	*£5m per Fund or Trust*				

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

16 **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.

17 **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.

18 **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.

19 **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

20 **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. The Council is confident that as a sector local authorities are secure investments in the context of support from Central Government and the legal surcharging framework that guarantees debts will be paid. However, for any investment over six months the financial resilience of the relevant council will be assessed.

21 **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.

22 **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.

23 **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.

24 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 have provided increased yield although their capital value has shown some volatility requiring continued monitoring. This class of pooled funds are subject to their own specific limits and in view of the possible level of investments in the longer term they have been increased to give the Council reasonable investment options.

25 **Real estate investment trusts:** Shares in companies that invest mainly in real estate and pay the majority of their rental income to investors in a similar manner to pooled property funds. As with property funds, REITs offer enhanced returns over the longer term, but are more volatile especially as the share price reflects changing demand for the shares as well as changes in the value of the underlying properties. This is a new category that sits alongside Pooled Funds. It is added on the advice of Arlingclose to give the Council greater options in investment in property should it require it. The Council will carry out detail appraisal and take advice before any possible investment. As these trust are subject to volatility and are new instrument to the Council a limit of £2m is set for them.

26 **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 and balances will therefore be kept below £2.5m. 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 A-.

27 **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.

28 **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

29 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.

30 **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.

31 When deteriorating financial market conditions affect the creditworthiness of all organisations, as happened 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 to maintain the required level of security. The extent of these restrictions will be in line with prevailing financial market conditions. If these restrictions mean that insufficient commercial organisations of high credit quality are available to invest the Council's cash balances, then the surplus will be deposited with the UK Government via the Debt Management Office or invested in government treasury bills for example, or

with other local authorities. This will cause a reduction in the level of investment income earned, but will protect the principal sum invested.

32 **Investment limits**: The Council's revenue reserves available to cover investment losses are forecast to be in the region of £10m on 31 March 2019 but are set at a long term target of £6m. In order that no more than 2/3 of available reserves will be put at 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 will be treated as a single organisation for limit purposes. Limits will also be placed on 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. Where the limit has changed the new and old limits are shown

	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
Property Invested Pooled Fund	£7m in total was £5m
Other Pooled Funds incl. Equity, Unrated Bond Funds, Diversified assets funds	£15m in total was £12m
Real estate investment trusts (New category in 2019/20)	£2m 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
Loans to unrated corporates	£2m in total

Cash flow management

33 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.

Treasury Management Indicators

34 **Security benchmark: average credit rating** 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 2019/20 will be an average credit rating of A unchanged from last year.

35 **Liquidity benchmark 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. For 2019/20 the benchmark amount available will be £3m unchanged from 2018/19.

Interest rate exposures

36 This indicator is set to control the Council's exposure to interest rate risk. New CIPFA guidance has led to a change in this indicator which is now an upper limits on the one year revenue impact of a 1% rise or fall in interest rates. The impact of a change in interest rates is calculated on the assumption that maturing loans and investments will be replaced at current rates.

	Limit
Upper limit on one-year revenue impact of a 1% rise in interest rates	£200,000
Upper limit on one-year revenue impact of a 1% fall in interest rates	£200,000

Maturity structure of borrowing

37 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 is not planned to have any debt as 2019/20 begins but 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 a year

38 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 long-term principal sum invested to final maturities beyond the period end will be:

	2019/20	2020/21	2021/22
Limit on principal invested beyond year end	£12m	£10m	£8m

Other Treasury Management issues

39 The CIPFA Code requires the Council to include the following in its treasury management strategy.

40 **Financial Derivatives:** 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).

41 The Council will only use standalone financial derivatives (such as swaps, forwards, futures and options) where they can be clearly demonstrated to reduce the overall level of the financial risks that the Council is exposed to. 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.

42 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.

43 **Markets in Financial Instruments Directive**: The Council has opted up to professional client status with its providers of financial services, including advisers, banks, brokers and fund managers, allowing it access to a greater range of services but without the greater regulatory protections afforded to individuals and small companies. Given the size and range of the Council's treasury management activities, the Director of Corporate Resources believes this to be the most appropriate status.

Appendix C Investment Strategy

1. This Investment Strategy is a new report for 2019/20, meeting the requirements of statutory guidance issued by the Government in January 2018, and focuses on the support of local public services by lending to or buying shares in other organisations or its own subsidiaries (service investments) and commercial property investment income.

Service Investments: Loans

2. The Council can lend money to local bodies or its subsidiaries to support local public services and stimulate local economic growth. Historically the Council has only done this in very limited circumstances where a significant service outcome is expected. At present only one £300,000 loan is outstanding with a community run leisure centre for it to develop a specific local service.

3. There is no intention to increase the use of loans to local bodies and they are expected to be infrequent. The Council could lend to a potential subsidiary in its possible housing company but this has not been subject to Council approval so the Council report that approves the setting up of any subsidiary would also amend the Investment Strategy limit.

4. The main risk when making service loans is that the borrower will be unable to repay the principal lent and/or the interest due. In order to limit this risk, and ensure that total exposure to service loans remains proportionate to the size of the Council, upper limits on the outstanding exposure has been set at £1m.

5. Accounting standards require the Council to set aside loss allowance for loans, reflecting the likelihood of non-payment. The figures for loans in the Council's statement of accounts from 2018/19 onwards will be shown net of this loss allowance. However, the Council makes every reasonable effort to collect the full sum lent and has appropriate credit control arrangements in place to recover overdue repayments.

6. **Risk assessment**: The Council assesses the risk of loss before entering into service loans by assessing the counterparty's resilience, the service users' needs that the loan is designed to help meet and how theses will evolve over time. During the life of the loan any change in original assumptions will be monitored. The Council will use external advisors if felt appropriate by the Director of Corporate Resources. All loans will be subject to contract agreed by Head of Legal. All loans must be approved by full Council and will be monitored by Director of Corporate Resources.

Service Investments: Shares

7. The Council does not currently invest in any shares and has no agreed plans to do so. There have been discussions on the setting up of a local housing company which may mean that the Council would need to invest as the shareholder of its subsidiary. As details are not known the limit on investment in this type of share will be set at zero and any change to the limit would be addressed in the report to the Council to setting up any subsidiary.

8. **Security:** One of the risks of investing in shares is that they potentially fall in value meaning that the initial outlay may not be recovered. In order to limit this risk upper limits on the sum invested in local subsidiaries will be set at the lowest practical level if and when exposure is allowed.

9. **Risk assessment:** The Council would assess the risk of loss before entering into and whilst holding shares by going through an extensive process of risk analysis. The risk analysis will include an assessment of the market that the subsidiarity will be active in including the nature and level of competition, how the market/customer needs will evolve over time, the barriers to entry and exit and any ongoing investment requirements. The Council will use external advisors as thought appropriate by Director of Corporate Resources.

10. **Liquidity:** Although this type of investment is fundamentally illiquid, in order to limit this the Council, when it sets a limit in this area, will initially set out the maximum periods for which funds may prudently be committed and how the Council will ensure it stays within its stated investment limits.

11. **Non-specified Investments:** Shares are the only investment type that the Council has identified that meets the definition of a non-specified investment in the government guidance. The limits above on share investments are therefore also the Council's required upper limits on non-specified investments. The Council has not adopted any procedures for determining further categories of non-specified investment since none are likely to meet the definition.

Commercial Investments: Property

12. The Council invests in local commercial property with the intention of making a profit that will be spent on local public services. These include retail units, business centres, and commercial leisure facilities. They contributed £3.1m of net income in 2017/18 and provide a significant revenue stream to support the Council's finances.

13. The table below lists the property by major category and by whether they are 'legacy' properties, which is taken as having been on the Council's books on 31st March 2007, and the acquisitions and developments since then. The reason for the choice of 31st March 2007 is twofold: firstly, this was the date of the implementation of asset accounting under International financial reporting standard that required the Council to keep detail records of historic asset values and secondly it separates out the last decade where the recent purchases are reported. It is these more recent purchases which were made to provide commercial income to support the Council's budget as Central Government support reduced that is the main concern of the new guidance. For the recent purchases the cost records are available whereas the Council does not have comprehensive records of actual purchase costs so the 31st March 2007 values are used.

Property by type £millions	**Actual**	**31.3.2018 actual**		**31.3.2019 expected**	
	Purchase cost / 31st March 2007 value	**Gains or losses**	**Value in accounts**	**Gains or losses**	**Value in accounts**
Retail – legacy	2.6	1.5	4.1	1.5	4.1
Retail – Swan Walk	8.4	-6.2	2.2	-6.2	2.2
Light industrial - legacy	9.3	1.9	11.2	1.9	11.2
Healthcare – legacy	6.5	1.0	7.5	1.0	7.5
Office - legacy	1.0	0.3	1.3	0.3	1.3
Retail - recent	14.1	-0.3	13.8	-0.2	14.3
Light industrial – recent	4.1	-0.8	3.3	-0.8	3.3
Healthcare – recent	0.6	0.2	0.8	0.2	0.8
Education -recent	1.8	-0.3	1.5	-0.3	1.5
Leisure - recent	1.5	-0.6	0.9	-0.6	0.9
Total	**49.9**	**-3.3**	**46.6**	**-3.2**	**47.1**

14. In the table above the Swan Walk Centre has been taken out of the legacy retail category as it has a significant effect and has its own distinct history. The loss in value is due to the movement of the valuation of the Council's equity share in Swan Walk from £8.4m in 2007 to a current value of £2.2m. An authentic separable purchase price for the Swan Walk equity share is not available as the Swan Walk development was a complex set of multiparty arrangements rather than a simple purchase. The additions to commercial property in 2018/19 is a retail purchase of £0.5m.

15. **Security:** In accordance with government guidance, the Council considers a property investment to be secure if its accounting valuation is at or higher than its purchase cost including taxes and transaction costs.

16. The fair value assessment of the Council's investment property portfolio is below the purchase cost which, following the government guidance to the letter, expects the Council to provide detail of the mitigating actions that the local authority is taking or proposes to take to protect the capital invested. However, without the Swan Walk £6m reduction in value, which is not of a nature than the guidance was meant to apply to, the whole portfolio does provide security.

17. If we look only at 'recent' property the fair values are £1.8m below purchase price so the Head of Property has considered mitigating actions to take to protect the capital invested. The Head of Property concludes that the best course of action at the moment is to hold the assets as he believes the values will increase in the long term as they are sound assets with dependable income streams.

18. The commercial properties are revalued each year-end by external valuers so the Council will each year consider whether the underlying assets provide security i.e. are not below their purchase cost. Should this be the case the Head of Property will consider whether his current course of action of holding the assets is appropriate and bring any alternative actions to Council in an update to the Investment Strategy for that year.

19. **Risk assessment:** The Council assesses the risk of loss before entering into and whilst holding property investments by :
    a. assessing the relevant market sector including the level of competition, the barriers to entry and exit and future market prospects;
    b. using advisors if thought appropriate by the Director of Corporate Resources;
    c. consulting Council's Cabinet Advisory Subcommittee (Property Investment)
    d. taking final comprehensive report on all new investments to Cabinet
    e. continually monitoring risk in the whole portfolio and any specific assets

20. **Liquidity:** Clearly property is relatively difficult to sell and convert to cash at short notice, and can take a considerable period to sell in certain market conditions. To ensure that the invested funds can be accessed when they are needed the Head of Property ensures that at least £5m of commercial property could be sold as a going concern within a six month period.

Loan Commitments and Financial Guarantees

21. Although not strictly counted as investments, since no money has exchanged hands yet, loan commitments and financial guarantees carry similar risks to the Council and are included here for completeness. The Council does not provide

such commitments and guarantees and this strategy does not include them for 2019/20. As noted above there is a potential subsidiary which may, or may not, require commitments or guarantees dependent on its legal structure. Should they be required limits will be set as a part of the Council report on the setting up of a subsidiary.

Proportionality

22. The Council is dependent on profit generating investment activity to achieve a balanced revenue budget. The table below shows the extent to which the expenditure planned to meet the service delivery objectives is dependent on achieving the expected net profit from investments over the lifecycle of the Medium Term Financial Strategy. Should it fail to achieve the expected net profit, the Council has general reserves to cover the immediate shortfall in income and Head of Property would review the cause of any shortfall and identify any actions needed to ensure the income shortfall is remedied.

Proportionality of Investments £m	**2017/18 Actual**	**2018/19 Forecast**	**2019/20 Budget**	**2020/21 Budget**	**2021/22 Budget**
Gross service expenditure	33	33	33	33	34
Investment income	3.1	3.4	3.5	3.7	3.8
Proportion	9%	10%	11%	11%	11%

23. **Capacity, skills and culture**

Elected Members and statutory officers: The Council recognises that those elected Members and statutory officers involved in the investments decision making process must have appropriate capacity, skills and information to enable them to:

- take informed decisions as to whether to enter into a specific investment;
- to assess individual assessments in the context of the strategic objectives and risk profile of the Council; and
- to enable them to understand how new decisions have changed the overall risk exposure of the Council.

The Council will ensure that the relevant officers and the Members of Audit Committee and Cabinet Advisory Subcommittee (Property Investment) have appropriate skills, providing training and advisor support where there is a skills gap.

24. **Commercial deals**: The Council will ensure that the Audit Committee, Cabinet Advisory Subcommittee (Property Investment), Cabinet, and officers negotiating commercial deals are aware of the core principles of the prudential framework and of the regulatory regime within which local authorities operate.

25. **Corporate governance:** Any investment decisions will be scrutinised by Senior Leadership Team, Cabinet Advisory Subcommittee (Property Investment), and Cabinet before final approval. The Overview and Scrutiny committee review all decisions made by the Cabinet. Although after the event the Committee can make any recommendations to the Council if it sees fit.

Investment Indicators

26. The Council has set the following quantitative indicators to allow elected Members and the public to assess its total risk exposure as a result of its investment decisions.

27. **Total risk exposure:** The first indicator shows the total exposure to potential investment losses.

Total investment exposure	**31.03.2018 Actual**	**31.03.2019 Forecast**	**31.03.2020 Forecast**
Treasury management investments	37	29	19
Service investments: Loans	0.3	0.2	0.2
Service investments: Shares	0	0	0
Commercial investments: Property	46.6	47.1	50.1
TOTAL INVESTMENTS	83.9	76.3	69.3
Commitments to lend	0	0	0
Guarantees issued on loans	0	0	0
TOTAL EXPOSURE	83.9	76.3	69.3

28. **How investments are funded:** Government guidance is that these indicators should include how investments are funded. Since the Council does not normally associate particular assets with particular liabilities, this guidance is difficult to comply with. However, the following investments could be described as being funded by the borrowing. The remainder of the Council's investments are funded by usable reserves and income received in advance of expenditure.

Investments funded by borrowing	**31.03.2018 Actual**	**31.03.2019 Forecast**	**31.03.2020 Forecast**
Treasury management investments	0	0	0
Service investments: Loans	0	0	0
Commercial investments: Property*	3.2	3.1	0
Total funded by borrowing	3.2	3.1	0

**£4m borrowed reduced by MRP to date*

29. **Rate of return received**: This indicator shows the investment income received less the associated costs, including the cost of borrowing where appropriate, as a proportion of the sum initially invested. Note that due to the complex local government accounting framework, not all recorded gains and losses affect the revenue account in the year they are incurred.

Investments net rate of return	2017/18 Actual	2018/19 Forecast	2019/20 Forecast
Treasury management investments	1.6%	1.8%	2.2%
Service investments: Loans	3.0%	3.0%	3.0%
Service investments: Shares	0	0	0
Commercial investments: Property	6.6%	7.2%	7.0%
ALL INVESTMENTS	4.4%	5.1%	5.7%

30. The MHCLG guidance lists other indicators and the Council has selected the indicators below as appropriate.

Indicator	2017/18 Actual	2018/19 Forecast	2019/20 Forecast
Debt to net service expenditure ratio	37%	37%	0%
Commercial income to net service expenditure ratio	29%	32%	34%
Investment cover ratio – net income excl revaluation over interest expense	23	25	175
Benchmarking of returns – ratio of property income yield to IPD property yield index averaged over 5 year period	1.3	1.3	1.3
Net income return target	6.6%	7.2%	7.0%
Operating overheads of property section attributable to commercial property as a proportion of net property income	7.4%	6.8%	6.7%
Average Vacancy levels	0.8%	1%	2%
Tenant over 5%	5	5	5
Weighted Average Unexpired Lease Term (WAULT)	11y 5m	11yr 2m	11yr
Bad debts written off	£0	£10,000	£10,000

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Report to Audit Committee

12th December 2018
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 Appendix1).

Since the last report one new risk has been added:

CRR31	Unavailability of key officers, inadequate processes (including risk assessments and election project plan) leading to failure (including legal challenge).

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.

	CRR01a CRR02 CRR03 CRR06	CRR01b CRR18	CRR30	
		CRR01c CRR05 CRR19 CRR25 CRR26	CRR31	
		CRR17		

There are four risks which are currently considered to be high, nine medium risks and one low risks. The high risk area relates to the following:

CRR01b	Funding from Government is less generous than assumed in the Medium Term Financial Strategy (MTFS) from 2020
CRR18	A malicious attacker exploits a known or unknown security weakness to penetrate the Council's ICT systems.
CRR30	Increase in costs of homelessness, housing services, recycling, transport and anti-social behaviour
CRR31	Unavailability of key officers, inadequate processes (including risk assessments and election project plan) leading to failure (including legal challenge)

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 Register

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.

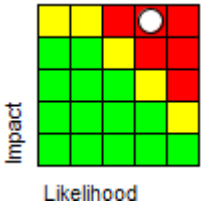
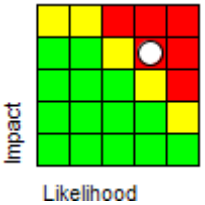
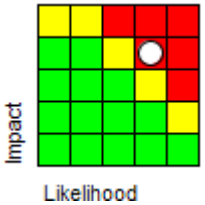
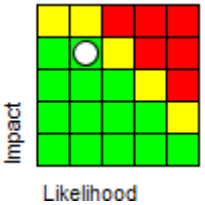
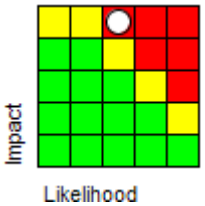
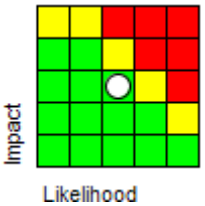
Appendix 1 Corporate Risk Report November 2018

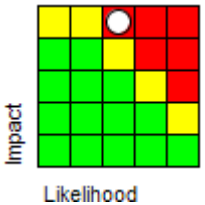
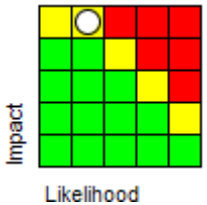
Risks ordered by RAG not numerically

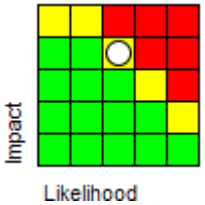
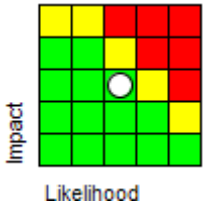
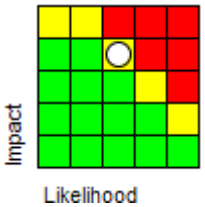
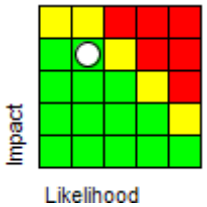
Generated on: 19 November 2018

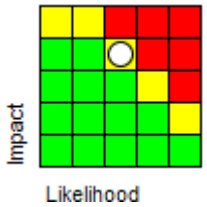
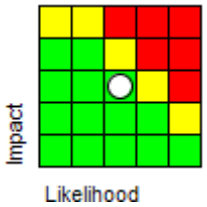
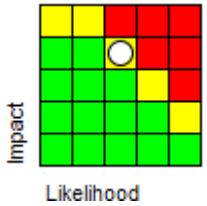
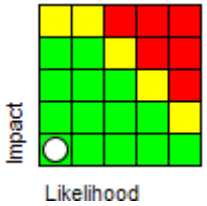
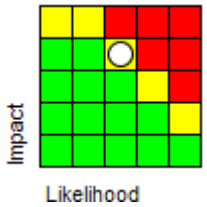
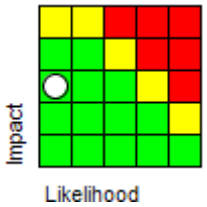
Assigned & in progress	Completed

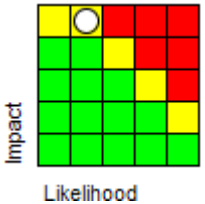
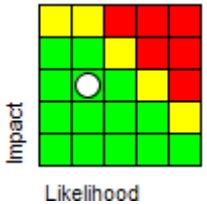
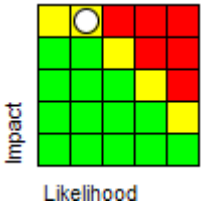
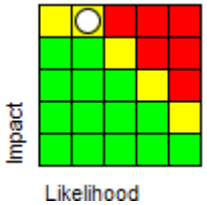
Horsham District Council

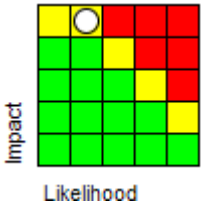
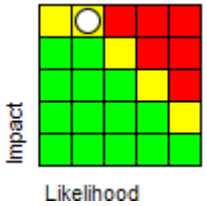
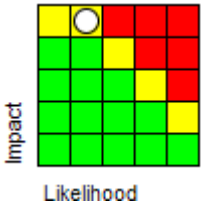
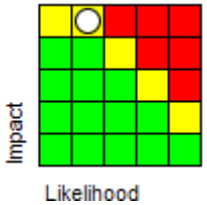
Risk Code & Description	Effect	Risk Owner	Current Risk Matrix	Control Action	Control Action Owner	Status	Target Risk Matrix	Quarterly Update
CRR30 Cause: WSCC have proposed some cuts to their budgets on the September 2018 forward plan. Risk: Increase in costs of homelessness, housing services, recycling and transport	Financial Service delivery in all services due to limited money	Glen Chipp		CRR.30.1 Work with other districts and voluntary organisations to seek ways to re-provide preventative services CRR.30.2 Provide evidence to county to inform their decision making CRR.30.3 Task and finish group set up with representatives from across Districts and Boroughs to feed into process	Glen Chipp Glen Chipp Clen Chipp			November 2018 Update: A County-wide project to review and manage the Housing risks, led by the Chief Executive of Arun DC is ongoing.
CRR31 Cause: The success of the election process is dependent upon adequate staffing, effective equipment (including IT) and proper processes (a separate risk assessment is undertaken to support the process. Risk: Unavailability of key officers, inadequate processes (including risk assessments and election project plan) leading to failure (including legal challenge).	Election Petition (challenge through the courts). Election would need to be re-run - potential for significant financial & resource implications. Results of election delayed and associated reputation risk			CRR31.1 Review risks as part of project planning process prior to an election CRR31.2 Training of staff CRR31.3 Review the adequacy of insurance cover for Returning Officers @ start of election process ~ ensure adequate protection against an Election Petition CRR31.4 Training of Elections staff to provide cover	Sharon Evans Sharon Evans Sharon Evans Sharon Evans			November 2018 Update: Potential Corporate Risk escalated from Department Risk Register. Unforeseen difficulties with staffing and the potential unavailability of key officers has increased likelihood of risk in the run up to election year. Measures are in place to try and mitigate this.
CRR01b Financial Cause: The Council is reliant on Central Controlled Government funding (e.g. Business Rates). Risk: (ii) Funding from Government is less generous than	Reductions in funding Adverse effect on morale	Jane Eaton		CRR.01b.1 Continue to keep a watching brief	Dominic Bradley			November 2018 update: Uncertainty beyond 2019/20, especially with regards to the localisation (75%) retention of business rates and changes from the fair funding review remains a significant area of concern. This will

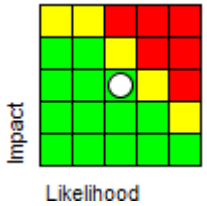
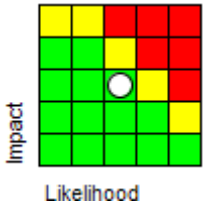
Risk Code & Description	Effect	Risk Owner	Current Risk Matrix	Control Action	Control Action Owner	Status	Target Risk Matrix	Quarterly Update
assumed in the MTFS from 2020	Financial Failure to achieve agreed objectives							be reviewed as information and guidance on how the business rates scheme will work and results from the fair funding review are released. The November 2018 MTFS forecasts a deficit in the region of £2m in 2022/23 unless significant savings and new income are achieved. An updated MTFS will be presented to Members when the 2019/20 budget is finalised.
CRR18 Technological <u>Cause</u>: Council services are increasingly reliant on IT systems at a time when there are greater opportunities for malicious attackers to exploit security weaknesses. <u>Risk:</u> A malicious attacker exploits a known or unknown security weakness to penetrate the Council's ICT systems.	Loss of key systems resulting in disruption to Council services. Cost of investigation and recovery of systems. Fraud/theft. Loss of the integrity of Council Records. Exposure of sensitive/personal data resulting in penalties from the ICO. Reputational or political damage from adverse media coverage.	Jane Eaton		CRR.18.1 Staff Member Training	Claire Oliver / Robert Laban			<u>November 2018 Update</u>: Level of attack is so great. Remediation ongoing. CRR.18.1 - IT Security Training is being rolled out to all staff. CRR.18.2 – This work is ongoing. CRR.18.3 All work is ongoing. CRR.18.4Patching of devices ongoing. CRR.18.5 PSN accreditation has been gained for 2018/2019. CRR.18.6 – Work is ongoing. CRR.18.7 – Work is ongoing. CRR.18.8 – Work is ongoing.
				CRR.18.2 Awareness of current threats	Andrea Curson			
				CRR.18.3 An effective ICT Service delivery team	Andrea Curson			
				CRR.18.4 Effective patching and updates to mitigate known vulnerabilities	Andrea Curson			
				CRR.18.5 Compliance with expected security standards. (PSN, PCI-DSS)	Andrea Curson			
				CRR.18.6 Effective policies in place which outline security requirements for users of ICT	Andrea Curson			
				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			
				CRR.18.9 LGA Cyber Security review plan developed, approved	Andrea Curson			

Risk Code & Description	Effect	Risk Owner	Current Risk Matrix	Control Action	Control Action Owner	Status	Target Risk Matrix	Quarterly Update
				internally and now being carried out.				
CRR01c Financial Cause: The Council is reliant on Central Controlled Government funding (e.g. Business Rates). Risk: (iii) Decrease in Rateable Value due to several large buildings being redeveloped and coming off the RV list, including Piries Place, Park North and North Point. This causes the Council to fall below the business rates baseline, resulting in loss of funding.	Reductions in funding Financial	Jane Eaton		CRR.01c.1 Continue to keep a watching brief	Dominic Bradley			November 2018 Update: There was a £1.16m reduction in Rateable Value on the 2017 list and £2.07m reduction against the 2010 list in 2017/18. On the 2010 list specifically, the resolution of appeals over the GP surgeries has been settled and the removal of the former Novartis site from the 2010 ratings also lost a further significant RV. The 2017 list in 2018/19 has recovered by £420k at M7, but is £740k lower than the position at 1 April 2017. This overall 'trend' remains a significant concern and risk to the Council's funding position should it continue.
CRR05 Governance Cause: Managers are responsible for ensuring that controls to mitigate risks are consistently applied. Risk: Officers are either unaware of expected controls or do not comply with control procedures.	Failure of business objectives Health & Safety Financial Service Delivery Compliance with Regulations Personal Privacy Infringement	Jane Eaton		CRR.05.1 Officer training	Jane Eaton			November 2018 Update: A failure by management to apply internal controls dating from 2015 was identified during November. A number of factors led to the issues and a report will be taken to the December Audit Committee. The sums involved suggest we must raise current and target risk impact level to 4. CRR.05.3: Ongoing
				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			
				CRR.05.3 All Service Managers required to sign an Assurance Statement. (By 30th June Annually) (Cyclical)	Jane Eaton			

Risk Code & Description	Effect	Risk Owner	Current Risk Matrix	Control Action	Control Action Owner	Status	Target Risk Matrix	Quarterly Update
	Reputation damage							
CRR19 Cause: Uncertainty in the UK and World economy. The Government has spoken about an additional 5% reduction in local government funding, and further cuts in years to come. 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.	Financial Service Delivery Compliance with Regulations	Jane Eaton		CRR.19.2 Monitor the external environment	Dominic Bradley			November 2018 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. 19.4: Focus of Productivity and Commercialisation reviews have changed to look at specific projects going forward, such as fees and charges.
				CRR.19.3 Monitor internal indicators, particularly income generation	Dominic Bradley			
				CRR.19.4 Productivity and commercialisation reviews will provide recommendations going forward. (Programme of reviews to be completed by 30.09.2018)	Adam Chalmers			
CRR25 Cause: The transition from Mid Sussex DC (who currently host the service for HDC residents) to the 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 (extended to November 2018).	Service Delivery Reputation	Jane Eaton		CRR.25.1 Effective project delivery teams at HDC and LGSS	Jane Eaton			November 2018 Update: The Horsham operational service is working well although benefits processing work is taking longer than targeted. This is because LGSS are unable to turn on their resilience team due to difficulties accessing the Academy system while it remains based in Mid Sussex. The date for the transfer of this system, which has proved a complex and time consuming project, is December. If this project does not complete on time as planned then benefits processing time issues could continue.
				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			
				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			
CRR26 Cause: The combination of the original partnership agreement, the full integration of staff within CenSus Revenues and Benefits and MSDC's approach to disaggregation. Risk: That the cost of exiting the	Financial Reputation	Jane Eaton		CRR.26.1 Continue to work with MSDC to reduce costs	Jane Eaton			November 2018 Update: Horsham District Council and Mid Sussex District Council have so far been unable to reach agreement on the final sum.

Risk Code & Description	Effect	Risk Owner	Current Risk Matrix	Control Action	Control Action Owner	Status	Target Risk Matrix	Quarterly Update
existing Revenues and Benefits agreement with MSDC may be high.								
CRR01a Financial Cause: The Council is reliant on Central Controlled Government funding (e.g. Business Rates). Risk: (i) Failure to achieve the required level of savings and income in the MTFS to 2019/20	Reductions in funding Adverse effect on morale Financial Failure to achieve agreed objectives	Jane Eaton		CRR.01.1 Review current budgets in preparation for the 2019/20 budget (October Annually)	Dominic Bradley			November 2018 update: A balanced budget with a £0.6m surplus for 2018/19 was approved by Council on 21 February 2018. This incorporated many of the efficiency and additional income plans worked on during the year. The MTFS was also updated which forecasts a small surplus in 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. Ideas are being worked through to identify areas where further income and efficiencies can be generated. This is being done across a number of work streams and includes a longer term review for ideas and schemes through to 2021/22. CRR.01.5: Focus of Productivity & Commercialisation reviews have changed to look at specific projects going forward, such as fees and charges.
				CRR.01.2 Develop options to deal with pressure for consideration by Members	Dominic Bradley			
				CRR.01.3 Implement the Medium Term Plan	Dominic Bradley			
				CRR.01.4 Ongoing monitoring under the Service Efficiency Board	Dominic Bradley			
				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)	Adam Chalmers			
CRR02 Managerial / Professional Cause: The Council has a legal obligation to protect personal data. The Information Commissioners powers are much more far reaching when they change in May 2018. Risk 1: Major data breach or leak of sensitive information to a third party. Risk 2: Risk of significant ICO fine	People and businesses come to harm and suffer loss that might not otherwise have occurred Complaints / claims / litigation Resources consumed in	Jane Eaton		CRR.02.1 Develop appropriate processes & procedures which underpin the IT Security Policy	Andrea Curson / Sharon Evans			November 2018 Update: CRR.02.1 This work is ongoing. CRR02.3 GDPR on line training rolled out to all staff in February and briefing for Councillors arranged for March. CRR02.4 PSN accreditation has been gained for 2018/2019.
				CRR.02.3 Provide a programme of Induction and at least annual training on Information Security to all staff.	Robert Laban			
				CRR.02.4 Annual PSN Accreditation	Andrea Curson			

Risk Code & Description	Effect	Risk Owner	Current Risk Matrix	Control Action	Control Action Owner	Status	Target Risk Matrix	Quarterly Update
for non-compliance with new General Data Protection Regulations (GDPR).	defending claims Financial losses Fines from regulators Adverse publicity Reputation damage			CRR.02.5 Representatives from each department meeting every other month to maintain compliance, updates and training	Sharon Evans			
CRR03 Legal Cause: The Civil Contingencies Act 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 business continuity management. The Council is also responsible for warning and informing the public in relation to emergencies, and for advising local businesses. Risk: The Council is found to have failed to fulfil its obligations under the Act in the event of a civil contingency.	People and businesses come to harm and suffer loss that might not otherwise have occurred Complaints / claims / litigation Resources consumed in defending claims Financial losses Censure by regulators Reputation damaged			CRR.03.1 Update corporate business continuity plan and regular review. CRR.03.2 Update departmental business continuity plans and regular review. CRR.03.4 Build IT disaster recovery procedure into new warm site. Further plan revision will be made to reflect changes. 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 Trevor Beadle Adam Chalmers Trevor Beadle			November 2018 update: CRR.03.1: Corporate BCP currently undergoing annual review – awaiting information from reviewed departmental BCP's due at end of Nov(see below). CRR.03.2: Awaiting updated plans from all heads of service. All working towards a deadline of 30th Nov – after which the corporate BCP will be completed. CRR.03.5: Next BC bite size is January 2019. This training is ongoing throughout 2019 and includes response and recovery training. All heads of service and relevant managers advised to attend.
CRR06 Physical Cause: The Council is responsible for the health & safety of its clients, staff and other stakeholders, owns and maintains significant assets, and also has responsibility for H&S in some partner organisations where it does not have operational control. Risk: A health & safety failure occurs.	People come to harm Complaints/claims/ litigation Financial losses Censure by audit / inspection Reputation damage Adverse effect on morale Stress and	Glen Chipp		CRR.06.2 Develop and implement a corporate inspection strategy (By 30/06/16). CRR.06.3 Clarity of responsibilities and implementation of a training programme CRR.06.4 Implement a central repository for risk assessments	Robert Laban / Health & Safety Officer Robert Laban Robert Laban / Health & Safety			November 2018 Update: CRR.06.2: Corporate H&S Adviser continues to inspect HDC premises. A self-inspections approach is being developed throughout 2018/19. CRR.06.3 - H&S responsibilities are set out in the Corporate H&S Policy and H&S subject policies. H&S Management Forum is responsible for implementing these policies and sharing best practice

Risk Code & Description	Effect	Risk Owner	Current Risk Matrix	Control Action	Control Action Owner	Status	Target Risk Matrix	Quarterly Update
	absenteeism				Officer			across the Council. Team self-audits to 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.06.4: The introduction of a central repository for risk assessments remains deferred until the roll-out of Office 365 is completed or Technology One can be configured in this respect - this is not likely to start before April 2019.
CRR17 Cause: The External Auditors audit the HDC Benefits Grant Subsidy return to the Department for Work and Pensions (DWP) on an annual basis to identify errors. Risk: The Benefit Subsidy claim may be qualified and/or financial losses. HDC has a case load with a particularly high number of working people with many changes of circumstances. **Refer to new risk CRR25**	Financial Service Delivery Compliance with regulations Reputation	Jane Eaton		CRR.17.1 Continuously monitor the level of quality control checking. CRR.17.6 Complete successful transfer to new provider	Beccy Salmon Jane Eaton	 		November 2018 Update: This is an ongoing risk. The risk remains until Universal Credit comes in for all working age cases. The 2017/18 claim also below lower threshold.

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Report to Audit Committee

12th December 2018
By the Horsham Chief Internal Auditor

INFORMATION REPORT

Not Exempt

Internal Audit Progress Report – Quarter 2 (01/07/18 - 30/09/18)

Executive Summary

To provide Members with an update on all internal audit and counter fraud activity completed during the quarter, including a summary of all key findings. The report also includes details of progress on delivery of the annual audit plan along with an update on the performance of the internal audit service during the period.

Recommendations

The Committee is recommended to:

- Note the report and consider any further action required in response to the issues raised; and
- Identify any new or emerging risks for consideration for inclusion in the internal audit plan.

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 systems of internal control.

Background Papers

Internal Audit Strategy and Annual Plan 2018-19

Wards affected: All.

Report Author: Paul Miller, Horsham Chief Internal Auditor
Contact Details: Russell Banks, Orbis Chief Internal Auditor Tel No. 01273 481447
Paul Miller, Horsham Chief Internal Auditor Tel No. 01403 215319

Background Information

1 Introduction and Background

Background

1.1 This progress report covers work completed between 1 July 2018 and 30 September 2018.

Supporting Information

1.2 The current annual plan for internal audit is contained within the Internal Audit Strategy and Annual Plan 2018-19 which was approved by the Audit Committee on 11 April 2018.

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 27 states that, in accordance with legislation, the Council should "make arrangements for the proper administration of their financial affairs". 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 Conclusion and Reasons for Recommendation

3.1 Key audit findings from final reports issued will, in future, be summarised in Appendix A.

3.2 Overall, of the four formal audits finalised during the quarter, one received 'substantial assurance', two received opinions of 'reasonable assurance' and one received 'partial assurance'. There were no opinions of 'minimal assurance'.

3.3 Although the same range of internal audit opinions are issued for all audit assignments, it is necessary to also consider the level of risk associated with each area under review when drawing an opinion on the Council's overall control environment. Taking into account these considerations, the Chief Internal Auditor is able to provide reasonable assurance that the Council has in place an effective framework of governance, risk management and internal control.

3.4 The overall conclusion has been drawn based on all audit work completed in the year to date and takes into account the management response to audit findings and the level of progress in subsequent implementation. This is something which will continue to be monitored and reported on by Internal Audit throughout the year.

3.5 Formal follow up reviews continue to be carried out for all audits where 'minimal assurance' opinions have been given and for higher risk areas receiving 'partial assurance'. Progress on action tracking is provided in Section 3 of Appendix A, and details of outstanding high and medium actions are provided in Section 3.4.

3.6 Members will recall that flexibility was built into the audit plan to allow resources to be directed to any new and emerging risks. We continue to liaise with departments to identify these but would also welcome input from Members. Details of those reviews added and removed from the plan so far this year are set out in section 4 of Appendix A.

3.7 Progress against our performance targets (focussing on a range of areas relating to our service) can be found in section 5 of Appendix A. All targets have been assessed as on target (green).

4 Next Steps

4.1 The Committee will be kept informed about progress in terms of the delivery of the audit plan for 2018/19.

5 Outcome of Consultations

5.1 Heads of Service / Service managers are consulted during each audit. At the end of each review, audit findings are discussed with the Heads of Service 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.

6 Other Courses of Action Considered but Rejected

6.1 Not applicable.

7 Resource Consequences

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

8 Legal Consequences

8.1 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.

9 Risk Assessment

9.1 All Internal Audit work is undertaken using a risk based approach.

10 Other Considerations

10.1 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.

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Appendix A

Internal Audit and Counter Fraud

Quarter 2 Progress Report 2018/19

CONTENTS

1. Summary of Completed Audits

Contract Management

1.1 The review focused on how effectively contracts are being managed including providing assurance that controls are in place to meet the following objectives:

- To review the governance arrangements for contract management to ensure that contracts are managed effectively;
- To ensure that the Council's Contracts Register is up-to-date and that there is clear accountability in terms of contract management responsibilities;
- To ensure contracts are formally agreed and signed in a timely manner;
- To ensure the Leisure and Rookwood contracts are properly managed, that services are provided in line with the contract, and that performance is adequately monitored.

1.2 Overall, we were only able to provide **Partial Assurance** over the controls operating within the area under review because of a number of weaknesses. Areas for improvement include:

- The Procurement Toolkit is a lengthy document, and contract management guidelines appear towards the end of the document. It would be helpful if the contract management section was made more visible by including appropriate signposting.
- The Council's Management Training e-learning suite does not include a module dealing with procurement (including contract management), although this has been purchased. The Council would benefit from adopting this module and making it available to staff.
- At the commencement of the audit, the auditor found that the Contracts Register on the Council's website was out of date. An updated version of the register has now been uploaded to replace the previous version.
- The Council's procurement officers maintain a more detailed version of the published Contracts Register on their own network drive, but information in key fields is not always recorded (e.g. contract start and finish dates, and significantly 'contract value'). Furthermore, the responsible contract manager is not always updated in the register when contract managers leave the organisation.

1.3 On a more positive note, testing of a sample of current contracts showed that when formal contracts have been entered into, Legal Services were able to easily locate the contract documentation.

1.4 Appropriate action to address the findings of this audit has been agreed with management within a formal action plan.

Community Infrastructure Levy

1.5 The Community Infrastructure Levy (CIL) scheme was introduced by Horsham District Council on 1st October 2017. At the time of the audit, only £30,000 had been received, but CIL receivable in respect of planning permissions granted was in the region of £1.54m (at that time).

1.6 The purpose of the review was to ensure that the CIL application and bidding process is operating effectively to maximise the Council's ability to secure funding, including assurance that funds received are used appropriately.

1.7 Overall, we were able to provide **Reasonable Assurance** over the controls operating within the area under review. Since CIL was introduced, the volume of developments dealt with is relatively low, although it is expected to increase steadily over time. Current arrangements deal well with this level of transactions but improvements to deal with the allocation and spending of funds, and associated reporting processes, are in need of some further development.

1.8 An early draft of a key Governance document to set out clearly the principles underpinning the relationship between stakeholders and infrastructure providers (both internal and external) requires contributions from the Council's Legal and Finance departments before it can be finalised and formally adopted. It will then be published on the Council's website.

1.9 At this relatively early stage the funds received and transferred to Parish Councils is small, but is expected to increase considerably over time and the agreement of working arrangements and establishment of responsibilities will be vital to ensure the correct level of consultation and to avoid disagreement between parties. Levels of authority and methodology of checking the levels and nature of spending need to be determined to be able to confirm that regulations have been complied with.

1.10 Communications with Parish representatives have shown that additional tailored guidance would be helpful to improve the level of understanding, both of the process and of the permitted spending areas.

1.11 An action plan has been agreed with management to develop these areas and secure further improvement.

Parking Enforcement

1.12 Horsham District Council's Parking Operations team undertakes parking enforcement on behalf of West Sussex County Council (WSCC) who, as the "Highway Authority", have a legal responsibility for maintaining traffic flow in accordance with the Traffic Management Act 2004. The County Council has taken the decision to discharge the parking enforcement function within West Sussex, entering into agency agreements with the local District and Borough Councils. This allows the councils to integrate on-street and off-street parking management and enforcement.

1.13 The primary objective of the review was to ensure that the Council is providing an effective service to WSCC in order for them to meet their statutory responsibilities and to provide the environmental and economic benefits to Horsham District Council.

1.14 The focus of the audit was on the enforcement of parking within the Controlled Parking Zones and council-owned pay and display car parks. The work did not include the enforcement of the town centre ANPR (Automatic Number Plate Recognition) car parks.

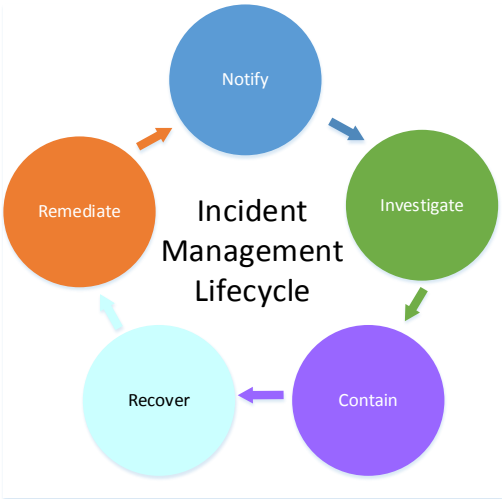
1.15 Overall, we were able to provide **Reasonable Assurance** over the controls operating within the area under review. The Si-Dem Parking Management system (used by the Parking Operations team) helps to ensure that parking enforcement is carried out in a controlled manner. The Si-Dem system manages all aspects of the enforcement process from the point that a PCN is issued through to the management and recovery of outstanding debt.

1.16 A few actions for improvement were identified relating to access controls which are being addressed. This will help to ensure that user permissions are correctly configured to reflect the role that each user performs within the Parking Operations team and will ensure appropriate separation of duties.

ICT Incident Management

1.17 Incident Management is a subset of Crisis Management. The audit focused on understanding and providing an opinion on the key elements of Crisis Management in relation to ICT security incidents. Incidents are defined by ITIL[1] as "an unplanned interruption to an IT Service or reduction in the quality of an IT service". Not all incidents will relate to a malicious attack on IT systems, it may simply be the failure of a component part of the IT infrastructure. There is however, a growing threat from cyber-attack, and these attacks would be managed through the Incident Management Process.

1.18 An Incident Management process should follow the following key stages:



1.19 Overall, we were able to provide **Substantial Assurance** over the controls operating within the area under review.

1.20 Based on the audit work undertaken, we were able to form an opinion on the effectiveness of the Incident Management process by considering the actions taken by the Technology Services department following an actual attack on the Council's IT systems carried out in May 2018. From the discussions held with officers involved with the incident, and the evidence obtained, it was clear that an effective incident management process was applied that minimised the impact on the Council's services. The incident management process included escalation to appropriate senior management, the Information Commissioner, and the Police.

1.21 However, at the time of the incident, the Technology Services department did not have a documented incident management process in place. Following the post incident review, the Head of Technology Services has now produced a documented incident management process. Whilst each event will require a different response plan to manage the incident effectively, having a basic document explaining the required process is important.

[1] ITIL (formerly the acronym, Information Technology Infrastructure Library) is a detailed practise for IT service management.

2. Counter Fraud and Investigation Activities

Proactive Counter Fraud Work

2.1 The Orbis Internal Audit structure came into effect from 1st April 2018. The integrated structure was designed to deliver the following benefits:

- Resilience, flexibility and quality;
- Specialisms;
- Sustain strong partnership focus.

A key strand of the structure was the formation of a counter fraud team that would deliver specialist fraud resource across the partnership. This will include the delivery of a fraud risk assessment for Horsham DC, and the rollout of proactive programmes and data analytics (shaped by fraud response plans).

2.2 Summary of Completed Investigations

None to date.

3. Action Tracking

3.1 All high and medium priority actions agreed with management as part of individual audit reviews are subject to action tracking. As at the end of quarter 2, 97% of high priority actions due had been implemented within agreed timescales.

3.2 Implementation of high and medium priority agreed audit actions (based on a 12 month rolling period):

Period to:	High & Medium Priority Agreed Actions Due	Not implemented	Implemented	% Implemented
30/09/18	31	1	30	97

3.3 Internal Audit will continue to work with senior management to ensure that sufficient attention is given to actions that remain overdue and an update on progress will continue to be reported to this committee.

3.4 Details of outstanding priority agreed action:

Audit / Agreed Action	Directorate	Due Date	Revised Date	Progress to date
Medium Priority *Creditors:* Orders raised as a percentage of invoices received: A target of 60% has been re-introduced for 2017/18 and will be reported within the performance indicators to the Finance and Performance Committee on a quarterly basis.	Corporate Resources	31/12/17	31/03/19	December 2018 Update: Work is being undertaken to review the most effective and efficient process when using purchase orders. The workflow also requires revisiting. Implementation has slipped due to pressing priorities in budget setting, monitoring and forecasting modules and garden waste process improvements.

4. Amendments to the Audit Plan

4.1 In accordance with proper professional practice, the internal audit plan for the year remains under regular review to ensure that the service continues to focus its resources in the highest priority areas based on an assessment of risk. Through discussions with management, the following reviews have been added to the audit plan during the year:

- Housing Benefits Subsidy – Lessons Learnt
- Review of bomb / lockdown procedures for Parkside and buildings owned by Horsham D.C.
- Input to the review of the Council's Constitution
- Review of Housing Company business case

4.2 Through the same process, the following audits have been removed or deferred from the audit plan and, where appropriate, will be considered for inclusion in the 2019/20 plan as part of the overall risk assessment completed during the annual audit planning process:

- Contracts - Procurement (as reported in October).
- ICT Service Desk

The review of the ICT Service Desk has been deferred as there are plans to replace the software system.

5. Internal Audit Performance

5.1 In addition to the annual assessment of internal audit effectiveness against Public Sector Internal Audit Standards (PSIAS), the performance of the service is monitored on an ongoing basis against a set up agreed key performance indicators as set out in the following table:

Aspect of Service	Orbis IA KPI	Target	RAG score	Actual Performance
Quality	Annual Audit Plan agreed by Audit Committee	By end April	G	Approved by Audit Committee on 11/04/18
	Annual Audit Report and Opinion	By end July	G	2017/18 report approved by Committee on 12/07/18
	Customer Satisfaction levels	90% satisfied	G	100% achieved.
Productivity and process efficiency	Audit Plan – completion to draft report stage	90%	G	57 % completed to draft report stage by end of Q2 (against a Q2 target of 50%)
Compliance with professional standards	Public Sector Internal Audit Standards complied with	Conforms	G	January 2018 - External assessment by the South West Audit Partnership gave an opinion of 'Generally Conforms' – the highest of three possible rankings
	Relevant legislation such as the Police And Criminal Evidence Act, Criminal Procedures and Investigations Act	Conforms	G	No evidence of non-conformance identified
Outcome and degree of influence	Implementation of management actions agreed in response to audit findings	95% for high & Medium priority agreed actions	G	97%
Our staff	Professionally qualified / accredited	80%	G	85%[2]

[2] [2] Includes part-qualified staff

Appendix B

Audit Opinions and Definitions

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.

By virtue of paragraph(s) 7 of Part 1 of Schedule 12A
of the Local Government Act 1972.

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