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Horsham District Council

Audit Committee

Wednesday, 4th January, 2017 at 5.30 pm
Hastings & Knepp, Parkside, Chart Way, Horsham

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

You are summoned to the meeting to transact the following business

Tom Crowley
Chief Executive

Agenda

Page No.

1. **Apologies for absence**

2. **Minutes** 3 - 8

   To approve as correct the minutes of the meeting held on 13th September 2016

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 2016/17** 9 - 26

   To receive the Audit Plan for 2016/17 – to be presented by the External Auditor

6. **Confirmation of auditor appointment for 2017/18** 27 - 28

7. **Treasury Management Strategy 2017/18** 29 - 46

   To receive the report of the Director of Corporate Resources

Accounts, Audit & Governance Committee
13 SEPTEMBER 2016

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

Apologies: Councillor: Adrian Lee

Also Present: Councillor: Leonard Crosbie
Paul King, Audit Director, Ernst & Young

AAG/16 **MINUTES**

The minutes of the meeting held on 28th June 2016 were approved as a correct record and signed by the Chairman.

AAG/17 **DECLARATIONS OF MEMBERS' INTERESTS**

There were no declarations of interest.

AAG/18 **ANNOUNCEMENTS**

There were no announcements.

AAG/19 **AUDIT RESULTS REPORT**

Paul King, Audit Director, Ernst & Young, presented the Audit Results Report for 2015/16. He indicated that the audit of the financial statements of the Council for 2015/16 had now been completed and he anticipated issuing an unqualified audit opinion on them.

The Auditor had identified an audit finding in respect of the Council's National Non-Domestic Rates rateable appeals provision, which had in their view been overstated. This was not considered to be material and therefore there was no proposal to adjust the provision. The risk of management override, was not a particular risk at Horsham but one that was identified and responded to on every audit engagement undertaken. The audit work found no evidence that management had attempted to override internal controls.

The Auditor again acknowledged the significant scale of the financial challenge faced by the Council in the near future and, from the work completed, had not identified any significant weaknesses in the Council's arrangements. It was noted that the Auditor expected to conclude that the Council had put in place proper arrangements to secure value for money in its use of its resources.

RESOLVED

That the report be noted.

AAG/20 **LETTER OF REPRESENTATION 2015/16**

The Director of Corporate Resources submitted the letter of representation to the External Auditor to Committee for approval.

It was noted that the first sentence in section G on the use of the work of a specialist had been amended to read: "We agree with the findings of the specialists that we engaged to evaluate the valuation of land and buildings and investment property **and in the calculation of the NDR appeals provision** and have adequately considered the qualifications of the specialists in determining the amounts and disclosures included in the financial statements and the underlying accounting records."

RESOLVED

That the Letter of Representation, as amended, be approved and signed by the Director of Corporate Resources and the Chairman of the Committee.

AAG/21 **STATEMENT OF ACCOUNTS 2015/16**

The Head of Finance presented the Statement of Accounts 2015/16, on which the External Auditor anticipated issuing an unqualified audit opinion.

It was noted that section 26 regarding leases had been amended to include reference to the Council's future commitments on the lease of its main office.

The officers in the Council's Finance Department were thanked for their work in preparing the Statement of Accounts.

RESOLVED

That the 2015/16 Statement of Accounts be approved.

REASON

It is a requirement of the Accounts and Audit (England) Regulations 2015 that the Statement of Accounts is approved by 30th September.

AAG/22 **ANNUAL GOVERNANCE STATEMENT 2015/16**

The Director of Corporate Resources reported that the Accounts and Audit (England) Regulations 2011 required the Council to review, at least annually, the effectiveness of its governance arrangements and to publish an Annual Governance Statement. The draft Statement had been considered at the last

meeting of the Committee, when Members had been invited to submit any comments to the Director of Corporate Resources (Minute No. AAG/12 (28.6.16) refers).

The review included information and assurance gathering processes to ensure that the published Annual Governance Statement was 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 was to ensure that the Council had effective governance, risk management and internal control processes in place to assist with accountability and the delivery of objectives. Additionally, the review process identified any shortfalls in these arrangements to enable them to be addressed.

With reference to the action plan for 2016/17, Members referred to the importance of budget monitoring and forecasting and the importance of the staff appraisal process and personal development plans.

The Chairman reminded Members that the Committee had been tasked with reviewing the effectiveness of the new governance arrangements once they had been in operation for a year.

RESOLVED

That the Annual Governance Statement for 2015/16 be approved.

REASON

There is a statutory duty for the Council to publish an Annual Governance Statement each year.

AAG/23 **TREASURY MANAGEMENT ACTIVITY AND PRUDENTIAL INDICATORS 2015/16 AND REQUEST FOR REVISION OF THE 2016/17 TREASURY MANAGEMENT STRATEGY**

The Director of Corporate Resources presented a report on treasury management activity and prudential indicators for 2015/16.

The report indicated that at the start of 2015/16, when under the terms of the new Treasury Management Strategy 2015/16 the Council's investment in unsecured banks had been reduced from £5,000,000 to £2,500,000 per institution, the limit was breached as an existing investment was not immediately reduced. The balance was reduced on 6th May 2015 and no loss was incurred by the Council. In all other instances the Council had complied with its legislative and regulatory requirements and the statutory borrowing limit (the Authorised Limit) had not been breached.

The report contained details of the Council's external debts and investments and reviewed the economic background to Treasury Management activity in 2015/16.

Due to the reduction in interest rates and the growth in funds needing to be invested, the report also sought approval for the mid-year revision of the 2016/17 Treasury Management Strategy in the form of an increase in the limit on long term investments from £8,000,000 to £12,000,000 and an increase in the limit on pooled funds from £5,000,000 to £10,000,000.

RESOLVED

(i) That the treasury management stewardship report for 2015/16 be noted.

(ii) That the actual prudential indicators for 2015/16 be noted.

RECOMMENDED TO COUNCIL

(iii) That the 2016/17 Treasury Management Strategy be amended with an increase in the limit on long term investments from £8,000,000 to £12,000,000 and an increase in the limit on pooled funds other than Money Market Funds from £5,000,000 to £10,000,000.

REASONS

(i) The annual treasury report is a requirement of the Council's reporting procedures. The report also covers the actual Prudential Indicators for 2015/16 in accordance with the requirements of the relevant CIPFA Codes of Practice.

(ii) External economic developments together with an increase in the monies needing to be invested necessitate a revision to the current strategy.

AAG/24 **RISK MANAGEMENT - QUARTERLY UPDATE**

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

The Senior Leadership Team had reviewed all outstanding actions on the corporate risk register and updated the comments to reflect the current position for each risk. Two emerging risks had been added relating to Cyber Risk (CRR18) and Brexit (CRR19).

RESOLVED

That the report be noted.

REASON

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

AAG/25 **INTERNAL AUDIT - QUARTERLY UPDATE REPORT**

The Chief Internal Auditor submitted a report summarising the work of the Internal Audit Section since June 2016.

A summary of audit findings in respect of Building Control Partnership - Cost Sharing Arrangements and Private Sector Housing Assistance Grants (both of which had achieved an overall audit opinion of substantial assurance); Recruitment (which had achieved an overall audit opinion of satisfactory assurance); and Security - Parkside (which had achieved an overall audit opinion of limited assurance) was submitted. The Committee was advised of actions being undertaken to address the control weaknesses identified in respect of Parkside security, in particular those highlighted and discussed by Members. Further information would be provided to the Members of the Committee in respect of this issue, as requested at the meeting.

The report also summarised other work being undertaken by the Internal Audit team and gave a progress update in respect of the Audit Plan.

RESOLVED

That the summary of audit and project work undertaken since June 2016 be noted.

REASONS

(i) To comply with the requirements set out in the Public Sector Internal Audit Standards 2013.

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

AAG/26 **URGENT BUSINESS**

There were no urgent matters to be considered.

AAG/27 **EXCLUSION OF THE PRESS AND PUBLIC**

RESOLVED

That, under Section 100A(2) of the Local Government Act 1972, the press and public be excluded from the meeting for the following item of business on the grounds that it involves the likely disclosure of exempt

information, as defined in Part I of Schedule 12A of the Act, by virtue of the paragraph specified against each item, and in all the circumstances of the case, the public interest in maintaining the exemption outweighs the public interest in disclosing the information.

AAG/28 **INTERNAL AUDIT – QUARTERLY UPDATE ON AUDIT FOLLOW-UPS**

The Chief Internal Auditor submitted a report summarising progress since June 2016 on the implementation of actions in respect of audits undertaken in 2016/17, 2015/16, 2014/15, 2013/14 and 2012/13.

RESOLVED

(i) That progress in terms of agreed actions implemented since June 2016 be noted.

(ii) That the position in respect of the specific areas highlighted by the Chief Internal Auditor be noted.

REASON

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

The meeting closed at 6.51 pm having commenced at 5.30 pm

CHAIRMAN

Horsham District Council

Year ending 31 March 2017

Audit Plan

December 2016

Ernst & Young LLP

Building a better working world

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Building a better working world

20 December 2016

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

Dear Committee Members

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 2016/17 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.

We welcome the opportunity to discuss this Audit Plan with you on 4 January 2017 and to understand whether there are other matters which you consider may influence our audit.

Yours faithfully

Paul King

Executive Director
For and behalf of Ernst & Young LLP
Enc

Contents

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

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

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

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

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

1. Overview

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 2017 and of the income and expenditure for the year then ended;

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.

2. Financial statement risks

We outline below our current assessment of the financial statement risks facing the Council, identified through our knowledge of the Council's operations and discussion with those charged with governance and officers.

At our meeting, we will seek to validate these with you.

Significant risks (including fraud risks)	Our audit approach
Risk of management override	
As identified in ISA (UK and Ireland) 240, management is in a unique position to perpetrate fraud because of its ability to manipulate accounting records directly or indirectly and prepare fraudulent financial statements by overriding controls that otherwise appear to be operating effectively. We identify and respond to this fraud risk on every audit engagement.	Our approach will focus on: ► Testing the appropriateness of journal entries recorded in the general ledger and other adjustments made in the preparation of the financial statements ► Reviewing accounting estimates for evidence of management bias, and ► Evaluating the business rationale for significant unusual transactions

2.1 Responsibilities in respect of fraud and error

We would like to take this opportunity to remind you that management has the primary responsibility to prevent and detect fraud. It is important that management, with the oversight of those charged with governance, has a culture of ethical behaviour and a strong control environment that both deters and prevents fraud.

Our responsibility is to plan and perform audits to obtain reasonable assurance about whether the financial statements as a whole are free of material misstatements whether caused by error or fraud. As auditors, we approach each engagement with a questioning mind that accepts the possibility that a material misstatement due to fraud could occur, and design the appropriate procedures to consider such risk.

Based on the requirements of auditing standards our approach will focus on:

- Identifying fraud risks during the planning stages;
- Enquiry of management about risks of fraud and the controls to address those risks;
- Understanding the oversight given by those charged with governance of management's processes over fraud;
- Consideration of the effectiveness of management's controls designed to address the risk of fraud;
- Determining an appropriate strategy to address any identified risks of fraud, and,
- Performing mandatory procedures regardless of specifically identified risks.

3. Value for money risks

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.
For 2016/17 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 which defines as:

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

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

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

Significant value for money risks	Our audit approach
Sustainable Resource Development	
Local government continues to face considerable financial challenges and Horsham District Council is not immune from these pressures. We are aware from our review of the Council's budget monitoring for 2016/17 to quarter 2 that it is forecasting a budget underspend of around £94,000 for the year. The Council is also planning to set a balanced budget for 2017/18 and 2018/19. However, the financial position in future	Our approach will focus on: ▸ Detailed review of how the medium term financial plan is created. ▸ Examine and challenge the key assumptions used by the Council to create the medium term financial plan. ▸ Review the extent to which the Council is dependent upon future savings. For significant savings we will test the estimated savings in order to ensure that the Council's assumptions are reasonable.

years is far more challenging and achieving financial balance will become progressively harder. The current medium term financial plan is predicting significant budget gaps over the remaining years of the medium term financial plan to 2021 of £0.5m in 2019/20 and £2.3m in 2020/21 before remedial action.

4. Our audit process and strategy

4.1 Objective and scope of our audit

Under the Code of Audit Practice our principal objectives are to review and report on the Council's:

- Financial statements
- Arrangements for securing economy, efficiency and effectiveness in its use of resources to the extent required by the relevant legislation and the requirements of the Code.

We issue an audit report that covers:

1. **Financial statement audit**

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

Alongside our audit report, we also review and report to the NAO on the Whole of Government Accounts return to the extent and in the form they require.

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.

4.2 Audit process overview

Processes

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

- Accounts payable
- Accounts receivable
- Payroll
- Cash and bank

To the fullest extent permissible by auditing standards, we will seek to place reliance on the work of Internal Audit to test controls in its annual programme of work.

We have also identified the following key processes that we will test substantively post year-end:

- Council Tax
- Business Rates
- Housing Benefit
- Property, Plant and Equipment
- Treasury management

- Financial Statements Close Process.

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
- 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

As in prior years, we will 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 we raise issues that could have an impact on the year-end financial statements

Use of specialists

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

Area	Specialists
IAS19 Pensions	EY pensions specialists Hymans Robertson - Actuary
Property, Plant and Equipment valuations	Wilkes, Head and Eve – RICS Registered Valuers

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 environment 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 expert to establish whether the source date 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.

4.3 Mandatory audit procedures required by auditing standards and the Code

As well as the financial statement risks (section two) and value for money risks (section three), we must 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;
- 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
- Reviewing and reporting on the Whole of Government Accounts return, in line with the instructions issued by the NAO.

Finally, we are also required to discharge our statutory duties and responsibilities as established by the Local Audit and Accountability Act 2014 and Code of Audit Practice.

4.4 Materiality

For the purposes of determining whether the financial statements are free from material error, we define materiality as the magnitude of an omission or misstatement that, individually or in aggregate, could reasonably be expected to influence the users of the financial statements. Our evaluation requires professional judgement and so takes into account qualitative as well as quantitative considerations implied in the definition.

We have determined that overall materiality for the financial statements of the Council is £1.550 million based on 2% of 2015/16 gross service expenditure. We will communicate uncorrected audit misstatements greater than £77,500 to you.

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 the circumstances that might ultimately influence our judgement. 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 financial statements, including the total effect of any audit misstatements, and our evaluation of materiality at that date.

4.5 Fees

The duty to prescribe fees is a statutory function delegated to Public Sector Audit Appointments Ltd (PSAA) by the Secretary of State for Communities and Local Government. PSAA has published a scale fee for all relevant bodies. This is defined as the fee required by auditors to meet statutory responsibilities under the Local Audit and Accountability Act 2014 in accordance with the NAO Code. The indicative fee scale for the audit of Horsham District Council is £50,094.

4.6 Your audit team

The engagement team is led by Paul King, who has significant experience on Horsham District Council. Paul King is supported by Hannah Lill, who is responsible for the day-to-day direction of audit work and is the key point of contact for the Head of Finance and the Director of Corporate Resources.

4.7 Timetable of communication, deliverables and insights

We have set out below a timetable showing the key stages of the audit, including the value for money work and the Whole of Government Accounts. The timetable includes the deliverables we have agreed to provide to the Council through the Audit Committee's cycle in 2016/17. These dates are determined to ensure our alignment with PSAA's rolling calendar of deadlines.

From time to time matters may arise that require immediate communication with the Audit Committee and we will discuss them with the Chair as appropriate.

Following the conclusion of our audit we will prepare an Annual Audit Letter to communicate the key issues arising from our work to the Council and external stakeholders, including members of the public.

Audit phase	Timetable	Audit Committee timetable	Deliverables
High level scope and fee planning	**April 2016**	**April 2016**	Audit Fee Letter
Initial planning, risk assessment and setting of scopes	**December 2016 – January 2017**	**January 2017**	Audit Plan
Testing routine processes and controls	**February – March 2017**	**March 2017**	Progress Report
Year-end audit	**June 2017**		
Completion of audit	**June 2017**	**July 2017**	► Report to those charged with governance via the Audit Results Report ► Audit report (including our opinion on the financial statements; [our opinion on the regularity of your expenditure and income]; and, overall value for money conclusion). ► Audit completion certificate Reporting to the NAO on the Whole of Government Accounts return.
Conclusion of reporting	**September**	**September 2017**	Annual Audit Letter

In addition to the above formal reporting and deliverables we will seek to provide practical business insights and updates on regulatory matters.

5. Independence

5.1 Introduction

The APB Ethical Standards and ISA (UK and Ireland) 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 on our independence and objectivity. The Ethical Standards, as revised in December 2010, require that we do this formally both at the planning stage and at the conclusion of the audit, as well as during 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 EY including consideration of all relationships between 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.	► A written disclosure of relationships (including the provision of non-audit services) that bear on our objectivity and independence, the threats to our independence that these create, 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 we are independent; ► Details of any inconsistencies between APB Ethical Standards, the PSAA Terms of Appointment and your policy for the supply of non-audit services by EY and any apparent breach of that policy; and ► An opportunity to discuss auditor independence issues.

During the course of the audit we must also communicate with you whenever any significant judgements are made about threats to objectivity and independence and the appropriateness of our safeguards, 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 contracted services, and details of any written proposal to provide non-audit services;

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 are disclosed, analysed in appropriate categories.

5.2 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 any principal threats. However we have adopted the safeguards below to mitigate these threats along with the reasons why they are considered to be effective.

Self-interest threats

A self-interest threat arises when EY has financial or other interests in your entity. Examples include where we have an investment in your entity; 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 the Council.

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 the Council has approved and that are in compliance with PSAA Terms of Appointment.

At the time of writing, there are no non-audit fees.

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 the Council. We confirm that no member of our audit engagement team, including those from other service lines, is in this position, in compliance with Ethical Standard 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 your entity. Management threats may also arise during the provision of a non-audit service where management is required to make judgements or decisions based on that work.

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

Other threats

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

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

Overall Assessment

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

5.3 Other required communications

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 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 June 2016 and can be found here:

http://www.ey.com/uk/en/about-us/ey-uk-transparency-report-2016

Appendix A Fees

A breakdown of our agreed fee is shown below.

	Planned Fee 2016/17 £	Scale fee 2016/17 [current year] £	Outturn fee 2015/16 [prior year] £	Explanation
Opinion Audit and VFM Conclusion	50,094	50,094	50,094	
Total Audit Fee – Code work	**50,094**	**50,094**	**50,094**	
Certification of claims and returns	12,383	12,383	12,360	The indicative fee is based on actual 2014/15 benefit certification fees
Non-audit work	**0**	**0**	**0**	

All fees exclude VAT.

The agreed fee presented above is based on the following assumptions:

- Officers meeting the agreed timetable of deliverables;
- The operating effectiveness of the internal controls for the key processes outlined in section 4.2 above;
- We can rely on the work of internal audit as planned;
- Our accounts opinion and value for money conclusion being unqualified;
- Appropriate quality of documentation is provided by the Council; 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 UK required communications with those charged with governance

There are certain communications that we must provide to the Audit Committee. These are detailed here:

Required communication	Reference
Planning and audit approach Communication of the planned scope and timing of the audit including any limitations.	► Audit Plan
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 ► Findings and issues regarding the opening balances on initial audits [delete if not an initial audit]	► Audit Results Report
Misstatements ► Uncorrected misstatements and their effect on our audit opinion ► The effect of uncorrected misstatements related to prior periods ► A request that any uncorrected misstatement be corrected ► In writing, corrected misstatements that are significant	► Audit Results Report
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
External confirmations ► Management's refusal for us to request confirmations ► Inability to obtain relevant and reliable audit evidence from other procedures	► Audit Results Report
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

Required communication	Reference
Independence Communication of all significant facts and matters that bear on EY's objectivity and independence Communication of key elements of the audit engagement director'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 Plan ► 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
Significant deficiencies in internal controls identified during the audit	► Audit Results Report
Fee Information ► Breakdown of fee information at the agreement of the initial audit plan ► Breakdown of fee information at the completion of the audit	► Audit Plan ► Audit Results Report Annual Audit Letter if considered necessary
Certification work ► Summary of certification work undertaken	► Certification Report

EY | Assurance | Tax | Transactions | Advisory

Ernst & Young LLP

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

ey.com

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Public Sector Audit Appointments

22 September 2016

Jane Eaton
Director of Corporate Resources
Horsham District Council
Parkside
Chart Way
Horsham
West Sussex
RH12 1RL

Email auditorappointments@psaa.co.uk

Dear Mrs Eaton

Horsham District Council - confirmation of auditor appointment for 2017/18

I am writing to confirm the appointment of Ernst & Young LLP to audit the accounts of Horsham District Council for 2017/18.

This is an extension of the appointment made under section 3 of the Audit Commission Act for the audit of the accounts up to 2016/17, under the audit contracts previously let by the Audit Commission. The auditor appointment has been extended for one year as a consequence of the extension of the transitional arrangements made by the Department of Communities and Local Government.

The appointment of Ernst & Young LLP under the current audit contracts will conclude with the completion of the audit of the accounts for 2017/18.

Extension of the transitional arrangements

Following the closure of the Audit Commission in 2015, the Secretary of State for Communities and Local Government delegated statutory functions on a transitional basis from the Audit Commission Act 1998 to PSAA. These were delegated by a commencement order made under the Local Audit and Accountability Act 2014.

In October 2015, the Secretary of State confirmed that the transitional provisions would be amended to allow an extension of the audit contracts for a period of one year for audits of principal local government bodies only. A commencement order was made on 27 June 2016, supported by a revised letter of delegation to PSAA.

The audit contracts novated to PSAA have therefore also been extended for one year for principal local government bodies, and will end with the completion of the audits of the 2017/18 accounts.

Changes to auditor appointments

Please be aware that it is a statutory requirement for PSAA to make the auditor appointment for principal local government bodies for 2017/18, on the basis of the provisions set out in the Audit Commission Act 1998.

If you wish to make representations about the extension of the current auditor appointment, please send them by email to auditorappointments@psaa.co.uk by **7 October 2016**. Your email should set out the reasons why you think the appointment should change. Any changes in auditor appointments can only be made under these audit contracts for the 2017/18 audit.

We will consider carefully any representations you make about your current auditor appointment. If we accept your representations, we will consult you on an alternative appointment.

Local auditor appointment requirements from 2018/19

The arrangements for local auditor appointment set out in the Local Audit and Accountability Act will apply for audits of the accounts of principal local government bodies from 2018/19 onwards. Auditor appointments must be made for 2018/19 audits by 31 December 2017, as required by section 7 of the Local Audit and Accountability Act 2014. Appointments may be made by the audited body itself, by groups of audited bodies, or by a specified appointing person.

PSAA has been specified by the Secretary of State for Communities and Local Government as the appointing person for principal local government bodies under the provisions of the 2014 Act. This means that PSAA will make auditor appointments to relevant principal local government bodies that choose to opt into the national appointment arrangements PSAA is developing. We will be communicating with audited bodies separately on this.

If you have any questions about your auditor appointment, please email us at auditorappointments@psaa.co.uk.

Yours sincerely

Jon Hayes
Chief Officer

Report to Audit Committee

Date of meeting 4 January 2017
By the Director of Corporate Resources
DECISION REQUIRED

Not exempt

Horsham District Council

Treasury Management Strategy 2017/18

Executive Summary

This report is an annual statutory requirement setting the strategy for treasury management and specific treasury management indicators for the financial year 2017/18. The strategy is set against the context of the projected interest rates and the Council's capital spend.

The new strategy changes some of the limits for pooled funds as set out in paragraph 5.26 but otherwise continues the current strategy.

Recommendations

The Committee is recommended to recommend that the full Council:

i) approve the Treasury Management Strategy for 2017/18.

ii) approve the Treasury Management Indicators for 2017/18.

Reasons for Recommendations

i) The Council has adopted the Chartered Institute of Public Finance and Accountancy's Treasury Management in the Public Services: Code of Practice 2011 Edition (the CIPFA Code) which requires the Council to approve a treasury management strategy before the start of each financial year.

ii) The Department for Communities and Local Government (CLG) issued revised guidance on local authority investments in March 2010 that requires the Council to approve an investment strategy before the start of each financial year.

Consultation: Arlingclose Limited
Wards affected: All
Contact: Julian Olszowka, Group Accountant, Technical, ext 5310

Background Information

1 Introduction

The purpose of this report

1.1 The Council has significant investments and borrowing which bring with them financial risks including the loss of invested funds and the revenue effect of changing interest rates. It therefore requires an overall strategy as well as sets of practices and procedures to identify, monitor and control those risks. There is a body of statute and other regulation that lays down what a strategy should do. This report sets out a Treasury Management Strategy for 2017/18 that fulfils legal requirement and provides a workable framework for day-to-day operations.

2 Background

Economic background

2.1 The Council's Treasury Management Strategy must take account of expectation of the general economy. The Council receives advice on this from Arlingclose Ltd and Appendix 1 is a commentary by them on the economic background.

2.2 The forecast for the Bank Rate is that it remains at 0.25%. For the purpose of the budget any new investments are estimated to be on or about the Bank Rate.

2.3 The treasury management environment remains difficult with yields and quality counterparties remaining reduced in the aftermath of the financial crisis of 2008. Governments and regulators have put in place measures prompted by the crisis that restrict any government bail-out of individual financial institutions. This year's strategy continues an approach less reliant on single institutions and their credit rating and more reliant on diversification.

Statutory background

2.4 This report fulfils the Council's legal obligation under the Local Government Act 2003 to have regard to both the CIPFA Code and the Department for Communities and Local Government Guidance.

Relevant Government policy

2.5 The Department for Communities and Local Government (CLG) issued revised guidance on local authority investments in March 2010 that requires the Council to approve an investment strategy before the start of each financial year.

Relevant Council policy

2.6 In February 2012 the Council adopted the Chartered Institute of Public Finance and Accountancy's Treasury Management in the Public Services: Code of Practice 2011 Edition (the CIPFA Code) which requires the Council to approve a Treasury Management Strategy before the start of each financial year.

2.7 The existing Treasury Management Strategy 2016/17 was approved by the Council on 24 February 2016 having been approved by this Committee on 6th January 2016. It was modified by the Council on 9 October 2016 based on a recommendation agreed by this Committee on 13 September 2016. The modifications increased limits on long term investments and pooled funds.

3 Current and Position and Projection

3.1 The Council's treasury portfolio at 30th November 2016 was:

Type of investment or borrowing	Principal £m	Interest Rate % Average
Call accounts	0.7	0.25
Money market funds	22.4	0.64
Short-term deposits	12.9	0.63
Long-term deposits	5.8	1.57
Pooled funds	10.0	4.35*
Total Investments	**51.8**	**1.45**
Long-term PWLB loans	4.0	3.38
Total Borrowing	**4.0**	**3.38**
Net Investments	**47.8**	**1.29**

*Rates used are last full year

3.2 The current cash balances are at their highest level since the mid 2000's. For example, last year the comparative figure for total investments was £36m. The Council's reserves and other balances have been added to by large inflows of Affordable Housing payments. Although much of this cash will eventually flow out, this will take some time. In the meantime other inflows from further developments may well happen.

3.3 Members will recall that pooled funds, other than money market funds, were a new introduction for 2016/17. The return from them exceeds other classes of investment but the volatility of their capital value means they are regarded as a longer term investment.

3.4 As at the end of November 2016, the capital loss from the new pooled funds was £293,300. However, of that £255,200 relates to a property fund. The majority of the property fund loss is the result of the bid-offer spread inherent in property investments with a small element being a devaluation following from the Brexit vote. The bid-offer spread reflects the costs incurred by the fund manager when buying and selling property, particularly stamp duty land tax at 5%. The expectation is that this loss will be made good over the longer term as valuations increase with growing rents.

3.5 Any capital loss should be seen in context of the increased yield from pooled funds. The pooled funds the Council currently hold yield about 3% more that the next highest yielding investments the Council can currently access. The extra income from current £10m limit of pooled funds would be about £300,000 per annum.

3.6 At the strategic level treasury management works within the context of the Council's balance sheet and how much cash it represents. Below is the current projected analysis of the balance sheet to illustrate the trajectory of the Council's funds. It should be noted that the end of year cash balances are usually the low points in the year. The projection will be revised as the budget is finalised and a revised table will accompany the final Budget Report 2017/18.

All figures at year-end £m	**Actual 15/16**	**Estimate 16/17**	**Estimate 17/18**	**Estimate 18/19**	**Estimate 19/20**
CFR	13.2	15.9	30.3	29.2	30.6
Less external borrowing	4.0	4.0	4.0	4.0	0
Internal borrowing	9.2	11.9	26.3	25.2	30.6
Useable reserves, receipts, contributions held	35.2	47.4	50.6	52.4	54.8
Working capital/other balance.	5.7	4.7	4.7	4.7	4.7
Estimated Investments	31.7	40.2	29.0	31.9	28.9

3.7 Any projection involves a number of assumptions and the projection above has the following significant assumptions:

- The capital programme within the 2017/18 budget is approved
- New Homes Bonus payments will continue although at a reduced level
- The Council will balance its revenue budget
- A prudent estimate of developer payments in the next five years
- Affordable Housing spend is within the Council's long term capital programme

3.8 The Council can finance some of its capital programme from capital receipts and other resources but will not finance the whole programme. This gives rise to an underlying need to borrow for capital purposes which is measured by the Capital Financing Requirement (CFR). Up to this point the Council's strategy has been to maintain borrowing and investments below their underlying levels, sometimes known as internal borrowing. Although there is an increasing CFR due to the capital programme it is judged this can continue due to the internal resources available.

3.9 CIPFA's Prudential Code for Capital Finance in Local Authorities recommends that the Authority's total debt should be lower than its highest forecast CFR over the next three years. The table above shows that the Council expects to comply with this recommendation during 2017/18.

4 Borrowing Strategy

4.1 The Council currently holds a £4m long-term Public Works Loan Board (PWLB) loan, as it did in the previous year, as part of its strategy for funding previous years' capital programmes. The Council's capital financing requirement (CFR, or underlying need to borrow for capital purposes) as at 31st March 2017 is expected to be £15.9m, and is forecast to rise to £30.3m by March 2018 as capital expenditure is incurred.

4.2 The Council's chief objective when borrowing money is to strike an appropriately low risk balance between securing low interest costs and achieving cost certainty over the period for which funds are required. With short-term interest rates lower than long-term borrowing rates, the Council has felt it was more cost effective in the short-term to use internal resources. Effectively the Council has borrowed from its own internal funds; sometimes termed internal borrowing.

4.3 The Council has so far only borrowed externally following its first unfinanced project of Steyning Health Centre in 2005 (refinanced in 2009). The underlying need to borrow has been increasing as the number of projects requiring funding are increasing in number and size. On balance the projections suggest healthy cash balances so there is no need for long term external borrowing in the medium term.

4.4 The approved sources of long-term and short-term borrowing are:

- Public Works Loan Board and any successor body
- Any institution approved for investments (see below)
- Any other bank or building society authorised to operate in the UK
- UK public and private sector pension funds (except West Sussex County Council Pension Fund)
- Capital market bond investors
- UK Municipal Bond Agency and other special purpose companies created to enable joint local authority bond issues.

4.5 In addition, capital finance may be raised by the following methods that are not borrowing, but may be classed as other debt liabilities:

- Operating and finance leases
- Hire purchase
- Private Finance Initiative
- Sale and leaseback

4.6 The Council has previously raised its long-term borrowing from the PWLB, but it will, if required, investigate other sources of finance, such as local authority loans and bank loans, that may be available at more favourable rates.

4.7 In addition to any long-term borrowing, the Council may borrow short-term loans (normally for up to one month) to cover unexpected cash flow shortages.

4.8 Short-term and variable rate loans leave the Council exposed to the risk of short-term interest rate rises and are therefore subject to the limit on the net exposure to variable interest rates in the treasury management indicators below.

4.9 **Debt Rescheduling:** The PWLB allows authorities to repay loans before maturity and either pay a premium or receive a discount according to a set formula based on current interest rates. The Council may take advantage of this and replace some loans with new loans, or repay loans without replacement, where this is expected to lead to an overall saving or reduction in risk although this is not expected in the medium term.

5 Investment Strategy

5.1 The Council holds significant funds, representing income received in advance of expenditure plus balances and reserves held. In the past year, the Council's total investments have ranged between £32m and £58m, 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 of at least £28m for the next four years.

5.2 Both the CIPFA Code and the CLG 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.

5.3 The Council may invest its surplus funds with any of the counterparty types in the table below, subject to the cash limits (per counterparty) and the time limits shown:

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
BBB+	£2.5m 100 days	£2.5m 6 months	£4m 2 years	£1m 6 months	£2.5m 2 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	£5m per Fund				

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

5.4 **Credit Rating**: Investment limits are set with reference to the lowest published long-term credit rating from Fitch, Moody's or Standard & Poor's. Where available, the credit rating relevant to the specific investment or class of investment is used, otherwise the counterparty credit rating is used. However, investment decisions are never made solely based on credit ratings, and all other relevant factors including external advice will be taken into account.

5.5 **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. Unsecured investment with banks rated BBB will be restricted to overnight deposits at the Council's current account bank NatWest plc which is currently rated at BBB+.

5.6 **Building Societies:** Although the regulation of building societies is no longer any different to that of banks the Council takes additional comfort from the 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 is used to avoid investment with very small societies. Limits of £1m per Society and £8m in total apply for unrated societies.

5.7 **Banks Secured**: Covered bonds, reverse repurchase agreements and other collateralised arrangements with banks and building societies. These investments are secured on the bank's assets, which limits the potential losses in the unlikely event of insolvency, and means that they are exempt from bail-in. Where there is no investment specific credit rating, but the collateral upon which the investment is secured has a credit rating, the highest of the collateral credit rating and the counterparty credit rating will be used to determine cash and time limits. The combined secured and unsecured investments in any one bank will not exceed the cash limit for secured investments.

5.8 **Government**: Loans, bonds and bills issued or guaranteed by national governments, regional and local authorities and multilateral development banks. These investments are not subject to bail-in, and there is an insignificant risk of insolvency. Investments with the UK Central Government may be made in unlimited amounts for up to 50 years and with a UK local government body up to £4m for up to 10 years.

5.9 **Corporates**: Loans, bonds and commercial paper issued by companies other than banks and registered providers. These investments are not subject to bail-in, but are exposed to the risk of the company going insolvent. Loans to unrated companies will only be made as part of a diversified pool in order to spread the risk widely.

5.10 **Registered Providers:** Loans and bonds issued by, guaranteed by or secured on the assets of Registered Providers of Social Housing, formerly known as Housing Associations. These bodies are tightly regulated by the Homes and Communities Agency and, as providers of public services; they retain the likelihood of receiving government support if needed.

5.11 **Pooled Funds - Money Market Funds**: These funds are pooled investment vehicles consisting of money market deposits and similar instruments. They have the advantage of providing wide diversification of investment risks, coupled with the services of a professional fund manager. Fees of between 0.10% and 0.20% per annum are deducted from the interest paid to the Council.

5.12 Funds that offer same-day liquidity and aim for a constant net asset value will be used as an alternative to instant access bank accounts, while funds whose value changes (termed variable net asset value) with market prices and/or have a notice period will be used for longer investment periods.

5.13 **Pooled Funds – other than Money Market Funds**: Shares in diversified investment vehicles consisting of the any of the above investment types, plus equity shares, corporate bonds 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.

5.14 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. Capital values are "marked to market" and so are volatile although the volatility will not affect the revenue account until the investment is sold.

5.15 The wider use of pooled funds was introduced in last year's strategy and the limits were increased in the year. The limits this year are an attempt to develop the use of this type of fund, which has provided a step change in returns, while recognising the risk of the volatility of capital values. A wider discussion of pooled funds and rationale behind the new limits is discussed in Appendix 2. The new limits seek to balance capital volatility, liquidity and yield. They are set in the context of the projections in paragraph 3.6 above.

5.16 The categories for investment above have been reviewed in consultation with Arlingclose in response to the post financial crisis environment. The emphasis has shifted from unsecured bank investments to other sectors and diversified investments. Where banks are used the strategy makes a distinction between secured investments where a bank failure would be covered to a large extent.

5.17 **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 maintains its limit of £12m on the total long term (over a year) investments.

5.18 **Risk Assessment and Credit Ratings**: Credit ratings are monitored by the Council's treasury advisors, who will notify changes in ratings as they occur. Where an entity has its credit rating downgraded so that it fails to meet the approved investment criteria then:

- no new investments will be made,
- any existing investments that can be ended at no cost will be, and
- full consideration will be given to the recall or sale of all other existing investments with the affected counterparty.

5.19 Where a credit rating agency announces that a rating is on review for possible downgrade (also known as "rating watch negative" or "credit watch negative") so that it may fall below the approved rating criteria, then no investments other than call investments will be made with that organisation until the outcome of the review is announced. This policy will not apply to negative outlooks, which indicate a long-term direction of travel rather than an imminent change of rating.

5.20 **Other Information on the Security of Investments**: The Council understands that credit ratings are good, but not perfect, predictors of investment default. Full regard will therefore be given to other available information on the credit quality of the organisations in which it invests, including credit default swap prices, financial statements and reports in the quality financial press. No investments will be made with an organisation if there are substantive doubts about its credit quality, even though it may meet the Council's credit rating criteria.

5.21 When financial market conditions affect the creditworthiness of all organisations, as in 2008 and 2011, this is not generally reflected in credit ratings, but can be seen in other market measures. In these circumstances, the Council will restrict its investments to those organisations of higher credit quality and reduce the maximum duration of its investments 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, then the surplus cash balances will be deposited with the UK Government or other local authorities although this will cause a reduction in the level of investment income earned.

Specified and Non-specified Investments

5.22 The CLG Guidance, that the Council must follow, uses the terms "specified" and "non-specified" investments. The guidance defines specified investments as:

- denominated in pound sterling,
- due to be repaid within 12 months of arrangement,
- not defined as capital expenditure by legislation, and
- invested with one of:
  - the UK Government,
  - a UK local authority, parish council or community council, or
  - a body or investment scheme of "high credit quality".

5.23 The Council defines "high credit quality" organisations and securities as those having a credit rating of A- or higher that are domiciled in the UK or a foreign country with a sovereign rating of AA+ or higher. For money market funds and other pooled funds "high credit quality" is defined as those having a credit rating of A- or higher.

5.24 Any investment not meeting the definition of a specified investment is classed as "non-specified". The Council does not intend to make any investments denominated in foreign currencies, nor any with low credit quality bodies, nor any that are defined as capital expenditure by legislation, such as company shares.

5.25 "Non-specified" investments will therefore be limited to long-term investments, i.e. those that are due to mature 12 months or longer from the date of arrangement and investments with bodies and schemes not meeting the definition on "high credit quality". The limits on "non-specified" investments are shown below.

Non-Specified Investment Limits	Cash limit
Total long-term investments	£12m
Total investments without credit ratings or rated below A-	£30m
Total investments with institutions domiciled in foreign countries rated below AA+	£10m
Total "Non-specified"	£52m

Investment limits

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

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

*Modified or new limit explained in 5.13 to 5.15 above and Appendix 2

Cash flow management

5.27 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 plan.

6 Treasury Management Indicators

Security benchmark: average credit rating

6.1 The Council has adopted a voluntary measure of its exposure to credit risk by monitoring the value-weighted average credit rating of its investment portfolio. This is calculated by applying a score to each investment (AAA=1, AA+=2, etc.) and taking the arithmetic average, weighted by the size of each investment. Unrated investments are assigned a score based on their perceived risk. The benchmark for 2017/18 will be an average credit rating of A-.

Liquidity benchmark

6.2 The liquidity benchmark for 2017/18 is an amount of cash available to meet unexpected payments within a rolling three month period, without additional borrowing. For 2017/18 the benchmark amount available will be £3m.

Yield benchmark

6.3 The yield benchmark will remain at the 7 day London Interbank bid rate.

Interest rate exposures

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

	2017/18	2018/19	2019/20
Upper limit on fixed interest rate exposures	£15m	£15m	£15m
Upper limit on variable interest rate exposures	£0m	£0m	£0m

Maturity structure of borrowing

6.5 This indicator is set to control the Council's exposure to refinancing risk. The upper and lower limits on the maturity structure of fixed rate borrowing are shown below. The Council only has one such debt at present and may have another so will set limits to allow the flexibility to change the terms and maturity date as it sees fit.

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

Principal sums invested for periods longer than 364 days

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

	2017/18	2018/19	2019/20
Limit on investment over a year	£12m	£12m	£12m

7 Other Treasury Management issues

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

Policy on use of financial derivatives

7.2 Local authorities have previously made use of financial derivatives embedded into loans and investments both to reduce interest rate risk (e.g. interest rate collars and forward deals) and to reduce costs or increase income at the expense of greater risk (e.g. LOBO loans and callable deposits). The general power of competence in Section 1 of the Localism Act 2011 removes much of the uncertainty over local authorities' use of standalone financial derivatives (i.e. those that are not embedded into a loan or investment).

7.3 The Council will only use standalone financial derivatives (such as swaps, forwards, futures and options) where they clearly reduce the overall level of risk. Additional risks presented, such as credit exposure to derivative counterparties, will be taken into account when determining the overall level of risk. Embedded derivatives, including those present in pooled funds and forward starting transactions, will not be subject to this policy, although the risks they present will be managed in line with the overall treasury risk management strategy.

7.4 Financial derivative transactions may be arranged with any organisation that meets the approved investment criteria. The current value of any amount due from a derivative counterparty will count against the counterparty credit limit and the relevant foreign country limit.

Treasury Management advisors

7.5 The Council's treasury management advisor is Arlingclose Limited. Arlingclose provide advice and information on the Council's investment, borrowing and capital financing activities. However, responsibility for final decision making remains with the Council and its officers. The quality of service will be monitored and officers will meet with a representative of the advisers twice a year. The services received include:

- advice and guidance on relevant policies, strategies and reports,
- advice on investment decisions and relevant analysis,
- notification of credit ratings and changes,
- other information on credit quality,
- advice on debt management decisions,
- accounting advice,
- reports on treasury performance,
- forecasts of interest rates, and
- training courses.

Staff training

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

Investment of money borrowed in advance of need

7.7 The Council may, from time to time, borrow in advance of spending need, where this is expected to provide the best long term value for money. Since amounts borrowed will be invested until spent, the Council is aware that it will be exposed to the risk of loss of the borrowed sums, and the risk that investment and borrowing interest rates may change in the intervening period. These risks will be managed as part of the Council's overall management of its treasury risks.

7.8 The total borrowed will not exceed the authorised borrowing limit which is £15m. The maximum period between borrowing and expenditure is expected to be two years, although the Council does not link loans with items of expenditure.

8 Other courses of action considered but rejected

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

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

9 Staffing consequences

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

10 Financial consequences

10 .1 The budget for investment income in 2017/18 is £0.59m, based on an average investment portfolio of £38m at an interest rate of 1.6%. This is based on the current strategy so as not to pre-empt decisions by this Committee. For illustration only assuming additional interest of 2.5% for highest volatility pooled fund and property fund and 0.5% for rated bond fund if the Council were, after due investigation, to invest to the new limits it would increase income by approximately £0.25m. The budget for debt interest paid in 2017/18 is £0.14m, based on the existing debt of £4m.

11 Other considerations

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

Appendix 1 Economic background and interest rate forecast

Economic background

The major external influence on the Authority's treasury management strategy for 2017/18 will be the UK's progress in negotiating a smooth exit from the European Union. Financial markets, wrong-footed by the referendum outcome, have since been weighed down by uncertainty over whether leaving the Union also means leaving the single market. Negotiations are expected to start once the UK formally triggers exit in early 2017 and last for at least two years. Uncertainty over future economic prospects will therefore remain throughout 2017/18.

The fall and continuing weakness in sterling and the near doubling in the price of oil in 2016 have combined to drive inflation expectations higher. The Bank of England is forecasting that Consumer Price Inflation will breach its 2% target in 2017, the first time since late 2013, but the Bank is expected to look through inflation overshoots over the course of 2017 when setting interest rates so as to avoid derailing the economy.

Initial post-referendum economic data showed that the feared collapse in business and consumer confidence had not immediately led to lower GDP growth. However, the prospect of a leaving the single market has dented business confidence and resulted in a delay in new business investment and, unless counteracted by higher public spending or retail sales, will weaken economic growth in 2017/18.

Looking overseas, with the US economy and its labour market showing steady improvement, the market had priced in the Federal Reserve increasing interest rates in December 2016. The US outlook could change rapidly with the Trump presidency which promised both protectionism and fiscal stimulus. The Eurozone meanwhile has continued to struggle with very low inflation and lack of momentum in growth, and the European Central Bank has left the door open for further quantitative easing.

The impact of political risk on financial markets remains significant over the next year. Although markets seem to have more or less ridden out what appears to be a growing political anti-establishment mood as manifested by Brexit, Donald Trump and Italy's referendum on its constitution it would be premature to expect that would continue with the growing reality of Brexit, a Trump presidency and the political uncertainty of the French presidential and general elections (April – June 2017) and the German federal elections (August – October 2017).

Credit outlook:

The Markets have expressed concern over the financial viability of a number of European banks recently which the recent Italian referendum did not help. Sluggish economies and continuing fines for pre-crisis behaviour have weighed on bank profits, and any future slowdown will exacerbate concerns in this regard.

Bail-in legislation, which ensures that large investors including local authorities will rescue failing banks instead of taxpayers in the future, has now been fully implemented in the European Union, Switzerland and USA, while Australia and Canada are progressing with their own plans. The credit risk associated with making unsecured bank deposits has therefore increased relative to the risk of other investment options available to the Authority; returns from cash deposits however continue to fall.

Interest rate forecast

The Authority's treasury adviser Arlingclose's central case is for UK Bank Rate to remain at 0.25% during 2017/18. The Bank of England has, however, highlighted that

excessive levels of inflation will not be tolerated for sustained periods. Given this view and the current inflation outlook, further falls in the Bank Rate look less likely. Negative Bank Rate is currently perceived by some policymakers to be counterproductive but, although a low probability, cannot be entirely ruled out in the medium term, particularly if the UK enters recession as a result of concerns over leaving the European Union.

Gilt yields have risen sharply, but remain at low levels. The Arlingclose central case is for yields to decline when the government triggers Article 50. Long-term economic fundamentals remain weak, and the quantitative easing (QE) stimulus provided by central banks globally has only delayed the fallout from the build-up of public and private sector debt. The Bank of England has defended QE as a monetary policy tool, and further QE in support of the UK economy in 2017/18 remains a distinct possibility, to keep long-term interest rates low.

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

	Dec-16	Mar-17	Jun-17	Sep-17	Dec-17	Mar-18	Jun-18	Sep-18	Dec-18	Mar-19	Jun-19	Sep-19	Dec-19	Average
Official Bank Rate														
Upside risk	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.25	0.25	0.25	0.25	0.25	0.25	**0.12**
Arlingclose Central Case	**0.25**	**0.25**	**0.25**	**0.25**	**0.25**	**0.25**	**0.25**	**0.25**	**0.25**	**0.25**	**0.25**	**0.25**	**0.25**	**0.25**
Downside risk	0.25	0.25	0.25	0.25	0.25	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	**0.40**
5-yr gilt yield														
Upside risk	0.25	0.40	0.40	0.40	0.40	0.40	0.40	0.40	0.40	0.40	0.40	0.40	0.40	**0.39**
Arlingclose Central Case	**0.50**	**0.40**	**0.35**	**0.35**	**0.35**	**0.40**	**0.40**	**0.40**	**0.45**	**0.50**	**0.55**	**0.60**	**0.65**	**0.45**
Downside risk	0.30	0.45	0.45	0.45	0.45	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	**0.47**
10-yr gilt yield														
Upside risk	0.30	0.40	0.40	0.40	0.40	0.40	0.40	0.40	0.40	0.40	0.40	0.40	0.40	**0.39**
Arlingclose Central Case	**1.15**	**0.95**	**0.85**	**0.85**	**0.85**	**0.85**	**0.85**	**0.90**	**0.95**	**1.00**	**1.05**	**1.10**	**1.15**	**0.96**
Downside risk	0.30	0.45	0.45	0.45	0.45	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	**0.47**
20-yr gilt yield														
Upside risk	0.25	0.40	0.40	0.40	0.40	0.40	0.40	0.40	0.40	0.40	0.40	0.40	0.40	**0.39**
Arlingclose Central Case	**1.70**	**1.50**	**1.40**	**1.40**	**1.40**	**1.40**	**1.40**	**1.45**	**1.50**	**1.55**	**1.60**	**1.65**	**1.70**	**1.75**
Downside risk	0.40	0.55	0.55	0.55	0.55	0.60	0.60	0.60	0.60	0.60	0.60	0.60	0.60	**0.57**
50-yr gilt yield														
Upside risk	0.25	0.40	0.40	0.40	0.40	0.40	0.40	0.40	0.40	0.40	0.40	0.40	0.40	**0.39**
Arlingclose Central Case	**1.60**	**1.40**	**1.30**	**1.30**	**1.30**	**1.30**	**1.30**	**1.35**	**1.40**	**1.45**	**1.50**	**1.55**	**1.60**	**1.41**
Downside risk	0.40	0.55	0.55	0.55	0.55	0.60	0.60	0.60	0.60	0.60	0.60	0.60	0.60	**0.57**

Appendix 2 Pooled funds – discussion of their use

Pooled funds can be said to cover a spectrum of risk from pure equity with volatile fund prices to funds which are usually termed money market funds where fund prices are stable due to the short dated nature of the underlying investments. Arlingclose don't recommend that there are limits within the pooled funds universe as it introduces unnecessary complexity in the strategy in their eyes. However, this Council has, in view of some concerns from Members, set a limit – currently £10m - to pooled funds excluding money market funds.

Short-term money market funds whose capital value is stable, so called Constant Net Asset Value, will continue to be used as instant access funds while those with Variable Net Asset Value where value changes with market prices and/or have a notice period will be used for cash required in timescale under a year. One limit for both types is thought sufficient to control risks and the proposed limit is £30m as in 2016/17.

Progressing up the risk spectrum the next category is bond funds which have ratings from recognised rating agency. These have capital values more volatile than money market funds but invest in shorter term high quality bonds. The Council has not used this categorisation before although it is useful for funds available for a year or more as they have low but not immaterial capital volatility. A rating of at least AA and a limit of £15m is proposed for this category.

Property funds were previously included with the higher volatility equity funds but it is proposed that they be a class of their own as they have a significantly different risk profile with more stable capital values than equity containing funds. As the Treasury Management Strategy should reflect the Council's risk appetite it should recognise that the Council is comfortable with property investment as it has demonstrated by its approval of direct investment in local commercial property. The investment the Treasury Management Strategy envisages for property will be through a large UK wide diversified fund which should be less volatile than a direct local property investment and more liquid. That said, a limit of £5m will be set to limit investment so as not to overbalance investments towards property.

All other pooled funds which comprise equity, high yield bonds, and derivatives as well as any of the types of instruments in lower volatility funds will be the highest risk category the Council will envisage investing in. It should be noted that all pooled fund investments will be discussed in detail with Arlingclose from a selection of funds that they have previously researched as appropriate for local government treasury purposes. The Council will not invest with a fund that Arlingclose is not comfortable with for this Council's risk profile. Council staff will talk to the fund managers together with the advisers to ensure the funds used will have a core principle of preserving capital over the medium term and are not liable to take risks the Council and its advisers are not happy with. Taking all this into account the limit proposed for this category is £12m.

Pooled fund manager limit – having discussed the limit per manager with Arlingclose the limit per manager has been raised to £10m as the £5m was deemed over-restrictive as, for instance, it would restrict investing when the Council already held a Money Market Fund with the manager. The funds would be separate entities even if they are run by the same manager and the fund limit of £5m remains.

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Report to Audit Committee
Date of meeting 4 January 2017
By the Director of Corporate Resources
INFORMATION REPORT

Not exempt

Treasury Management and Prudential Indicators mid-year report 2016/17

Executive Summary

This report covers treasury activity and prudential indicators for the first half of 2016/17. During the period the Council complied with its legislative and regulatory requirements and the statutory borrowing limit, the Authorised Limit, was not breached. There was an instance when the single institution limit of £2.5m was breached by £80,000 for one day; otherwise all limits and indicators were within estimates.

At 30 September 2016, the Council's external debt was £4m (£4m at 31 March 2016) and its investments totalled £52.8m (£31.8m at 31 March 2016).

During the first half of 2016/17, the Council's cash balances were invested in accordance with the Council's treasury management strategy. Interest of £0.26m was earned on investments at an average return of 1.1% (0.8% full year 2015/16).

Recommendations

The Committee is recommended to:

i) Note the treasury management stewardship report at the mid-year 2016/17
ii) Note the mid-year prudential indicators for 2016/17

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 2016-17" – A.A.G Committee 6 January 2016
"Budget 2016/17 and Medium Term Financial Strategy" – Council 24 February 2016

Consultation: Arlingclose Limited. Council's Treasury management advisors

Wards affected: All
Contact: Julian Olszowka, Group Accountant ,Technical Ext. 5310

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 2016/17. 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 2016/17 together with Treasury Management Strategy 2016/17 were approved by Council on 24 February 2016. The Treasury Management Strategy 2016/17 had been recommended for approval by this Committee on 6 January 2016.

1.3 The economic background to treasury management remains challenging with fears over Brexit and global growth weighing on the economy and financial system which was still recovering from the 2008 financial crisis. Interest rates have again hit historic lows and positive news on UK growth is balanced by fears over Brexit and the global economy. Arlingclose Limited, the Council's treasury management advisors have provided a commentary on the year so far in Appendix 1.

1.4 At the end of 2015/16 the Council's underlying need to borrow for capital purposes as measured by the Capital Financing Requirement (CFR) was £13.2m, while usable reserves and working capital which are the underlying resources available for investment were £41m. The Council had £4m of borrowing and £31.8m of investment reflecting its use of internal resources rather than borrowing.

2 Treasury management

Borrowing strategy

2.1 On 30 September 2016, at the midpoint of the year, the Council's borrowing remained the single £4m PWLB loan at 3.38% as has been the case since 2009 . The Council does not expect to borrow in 2016/17.

Investment Activity

2.2 The treasury management position at 30 November 2016 is shown below. This is a snapshot rather than the cumulative returns.

	Principal £m	Average Interest Rate %
Call accounts	0.7	0.25
Money Market Funds	22.4	0.64
Short-term deposits	12.9	0.63
Long-term deposits	5.8	1.57
Pooled Funds	10.0	4.35*
Total Investments	**51.8**	**1.45**
Long-term PWLB loans	4.0	3.38
Total Borrowing	**4.0**	**3.38**
Net Investments	**47.8**	**1.29**

*Rates used are last full year

2.3 Investment income was £0.26m, well over the budget of £0.13m. The average return was 1.1% against a budget of 0.8% and the adopted yield benchmark 7 day LIBID of 0.37%. Cash balances ranged from £31.8m to £58.4m averaging £46m against a budgeted average balance of £33m. The comparative minimum and maximum balances last year were £24.7m and £45.3m. Although short term rates remain low the combination of extra cash and use of pooled funds, newly introduced in 2016/17, mean that the full year budgeted interest income could be in the region of £0.5m compared to budget of £0.275m.

2.4 Security of capital has remained the Council's main investment objective. Key to this is the counterparty policy as set out in its treasury management strategy. Counterparty credit quality was assessed and monitored with reference to credit ratings, credit default swap prices, financial statements, information on potential government support and reports in the quality financial press.

2.5 **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 A+ during the first half of the year.

2.6 **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 exceeding the £3m.

2.7 **Counterparty Update –** Arlingclose Limited, the Council's treasury management advisors, monitor the quality of potential counterparties and have provided a commentary on the developments in the first part of the year in Appendix 2. None of the changes affected the Council's existing investments.

Compliance with Prudential Indicators

2.8 The Council confirms compliance with its Prudential Indicators for 2016/17, which were set out in January 2016 as part of the Council's Treasury Management Strategy apart from a breach of the single institution limit of £2.5m for the Council's own bank

2.9 On 29th September the Council's balance with its own Bank NatWest was £2.58m which exceeded the limit of £2.5m. The Council had been expecting to make a large payment of just over £1.7m at the time so more was kept with the bank that usual in readiness. The payment was not made on that date, but balance was not reduced in time before the end of business for the day. This was rectified the next morning.

Treasury Management Indicators

2.10 **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	£-32m	✓

2.11 **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	0	✓
12 months and within 24 months	100%	0	0	✓
24 months and within five years	100%	0	100%	✓
Five years and within 10 years	100%	0	0	✓
10 years and above	100%	0	0	✓

2.12 **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	£8m	£5.8m

3 **Prudential Indicators 2016/17**

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 2016/17 -** 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.

2016/17	Original Estimate £000	Current projection £000
Total capital expenditure	19,247	10,178
Resourced by:		
Capital receipts and contributions	(6,860)	(5,010)
Capital grants	(442)	(513)
Revenue reserves	(2000)	(1,119)
Unfinanced capital expenditure (additional need to borrow)	9,945	3,536

3.3 The capital spend in 2016/17 has been under the budget. The final financing at the year-end will be well within the prudential indicator estimates.

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 2016/17 MRP Policy was approved on 24th February 2016 within the 2016/17 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 as unfinanced capital spend has been reduced or re-phased and thus is below estimate. No increase in borrowing is now projected in this financial year.

Capital Financing Requirement and External Debt Year end 2016/17	Original estimate £000	Current projection £000
CFR	22,019	15,958
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 2016/17 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 2016/17 Budget report.

3.9 **Operational boundary for external debt:** The operational boundary is based on the Authority's estimate of most likely, i.e. prudent, but not worst case scenario for external debt.

3.10 **Authorised limit for external debt:** The authorised limit is the affordable borrowing limit determined in compliance with the Local Government Act 2003. It is the maximum amount of debt that the Council can legally owe. The authorised limit provides headroom over and above the operational boundary for unusual cash movements.

	Limit	Actual	Met?
Operational boundary – borrowing	£9m	£4m	✓
Operational boundary – other long-term liability	£0m	£0m	✓
Operational boundary – TOTAL	£9m	£4m	✓
Authorised limit – borrowing	£14m	£4m	✓
Authorised limit – other long-term liability	£1m	£0m	✓
Authorised limit – TOTAL	£15m	£4m	✓

3.11 **The ratio of financing costs to net revenue stream -** This indicator identifies the trend in the cost of capital (financing costs net of interest and investment income) against the net revenue stream. The indicator for the year was 6% and the current estimate is approximately 4% mostly due to investment income being expected to exceed 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 above budget improving the current year's financial performance. The outturn is forecast to be £0.225m above budget as a result of having higher cash balances and a better return from the pooled funds.

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 1

Economic background to the midpoint of 2016/17

The preliminary estimate of Q2 2016 GDP showed reasonably strong growth as the economy grew 0.7% quarter-on-quarter, as compared to 0.4% in Q1 and year/year growth running at a healthy pace of 2.2%. However the UK economic outlook changed significantly on 23rd June 2016. The surprise result of the referendum on EU membership prompted forecasters to rip up previous projections and dust off worst-case scenarios. Growth forecasts had already been downgraded as 2016 progressed, as the very existence of the referendum dampened business investment, but the crystallisation of the risks and the subsequent political turmoil prompted a sharp decline in household, business and investor sentiment.

The repercussions of this plunge in sentiment on economic growth were judged by the Bank of England to be severe, prompting the Monetary Policy Committee to initiate substantial monetary policy easing at its August meeting to mitigate the worst of the downside risks. This included a cut in Bank Rate to 0.25%, further gilt and corporate bond purchases (QE) and cheap funding for banks (Term Funding Scheme) to maintain the supply of credit to the economy. The minutes of the August meeting also suggested that many members of the Committee supported a further cut in Bank Rate to near-zero levels (the Bank, however, does not appear keen to follow peers into negative rate territory) and more QE should the economic outlook worsen.

In response to the Bank of England's policy announcement, money market rates and bond yields declined to new record lows. Since the onset of the financial crisis over eight years ago, Arlingclose's rate outlook has progressed from 'lower for longer' to 'even lower for even longer' to, now, 'even lower for the indeterminable future'.

The UK government followed the example set by the Bank of England in acting to mitigate an expected Brexit downturn and after six years of fiscal consolidation, the Autumn Statement on 23rd November shifted tack to bring in measures to support economic activity and confidence.

Market reaction: Following the referendum result gilt yields fell sharply across the maturity spectrum on the view that Bank Rate would remain extremely low for the foreseeable future. The yield on the 10-year gilt fell from 1.37% on 23rd June to a low of 0.52% in August, a quarter of what it was at the start of 2016. It has since risen to 0.69% at the end of September. The yield on 2- and 3-year gilts briefly dipped into negative territory intra-day on 10th August to -0.1% as prices were driven higher by the Bank of England's bond repurchase programme. However both yields have since recovered to 0.07% and 0.08% respectively. The fall in gilt yields was reflected in the fall in PWLB borrowing rates, with rates for 50 year maturity loans going as low as 2.08%. Money market rates followed the Bank Rate down, most noticeably for very short-dated periods (overnight to 1 month) where rates fell to between 0.1% and 0.2%

In contrast, after an initial sharp drop, equity markets appeared to have shrugged off the result of the referendum despite warnings from IMF, Treasury and Bank of England on the impact on growth from 'Brexit' as investors counted on QE-generated liquidity to drive risk assets.

Appendix 2

Counterparty update

Various indicators of credit risk reacted negatively to the result of the referendum on the UK's membership of the European Union. UK bank credit default swaps saw a modest rise but bank share prices fell sharply, on average by 20%, with UK-focused banks experiencing the largest falls. Non-UK bank share prices were not immune although the fall in their share prices was less pronounced.

Fitch downgraded the UK's sovereign rating by one notch to AA from AA+, and Standard & Poor's downgraded its corresponding rating by two notches to AA from AAA. Fitch, S&P and Moody's have a negative outlook on the UK. S&P also downgraded the long-term ratings of the local authorities to which it assigns ratings as well as the long-term rating of the EU from AA+ to AA, the latter on the agency's view that it lowers the union's fiscal flexibility and weakens its political cohesion.

Moody's affirmed the ratings of nine UK banks and building societies but revised the outlook to negative for those that it perceived to be exposed to a more challenging operating environment arising from the 'leave' outcome.

There was no immediate change to Arlingclose's credit advice on UK banks and building societies as a result of the referendum result. Arlingclose believe there is a risk that the uncertainty over the UK's future trading prospects will bring forward the timing of the next UK recession.

The European Banking Authority released the results of its 2016 round of stress tests on the single market's 51 largest banks after markets closed on Friday 29th July. No bank was said to have failed the tests. The Royal Bank of Scotland was one of the worst performers as its ratios fell by some of the largest amounts, but from a relatively high base. Barclays Bank and Deutsche Bank ended the test with Common Equity Tier 1 (CET1) ratios below the 8% threshold, and would be required to raise more capital should the stressed scenario be realised.

At the end of November after the period being reported on the Bank of England released the results of its latest stress tests on the seven largest UK banks and building societies. Royal Bank of Scotland, Barclays and Standard Chartered Bank were found to be the weakest performers. Arlingclose did not changing its counterparty advice in response to the stress test results as the advised use of those banks was already quite cautious.

In July Arlingclose completed a review of unrated building societies' annual financial statements. Cumberland, Harpenden and Vernon Building Society were removed from Arlingclose's advised list, following a deterioration in credit indicators. The maximum advised maturity was also lowered for eleven societies from 6 months to 100 days due to the uncertainty facing the UK property market following the EU referendum.

Report to Accounts, Audit & Governance Committee
4th January 2016
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 / Departmental Risk Registers

Wards affected: All

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

Background Information

1 Introduction and Background

1.1 The Accounts, Audit and Governance 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 (approved by the Council's Senior Leadership Team on 7th December 2015) is a component part of the Policy, and this document sets out to achieve the following objectives:

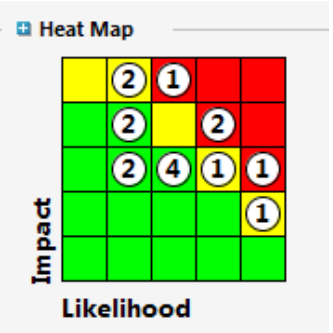
- Fully integrate risk management into the culture of the Council and its strategic and service planning processes;
- Ensure that the risk management framework is understood and that ownership and accountability for managing risks is clearly assigned;
- Ensure the benefits of risk management are realised through maximising opportunities and minimising threats;
- Ensure consistency throughout the Council in the management of risk.

3 Details

3.1 Corporate Risk Register

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

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



There are four risks which are currently considered to be high, four medium risks and eight low risks. The high risk areas relate to the following:

CRR01b	Uncertainty about the Council's Financial position beyond 2020.
CRR14	CIL (Community Infrastructure Levy) and Section 106 Agreements: Failure to deliver the infrastructure needs of the District.
CRR17	Qualification of the Housing Benefit Subsidy Return.
CRR19	Future uncertainty in the UK economy following the Brexit vote.

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.

Since the last report, the new Finance system has been added (see CRR20) which is due to be implemented in August 2017.

Risks CRR08 and Risk CRR13 have now been mitigated and the Senior Leadership Team has confirmed that these should be removed.

3.2 Departmental Risk Registers

All 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.

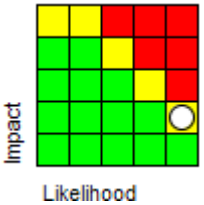
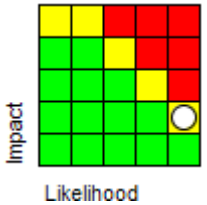
Appendix 1

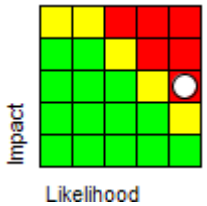
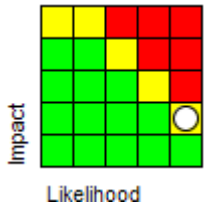
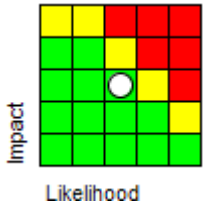
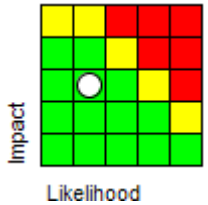
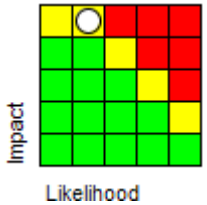
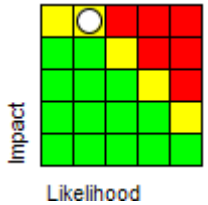
Corporate Risk Report December 2016

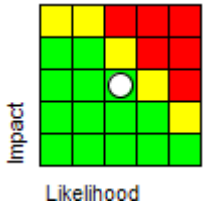
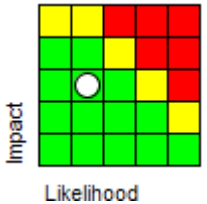
Generated on: 15 December 2016

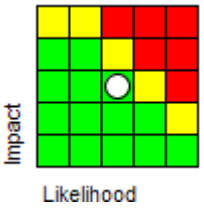
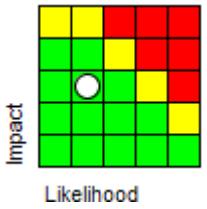
Horsham District Council

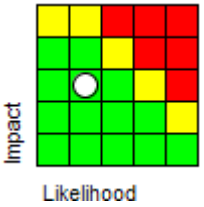
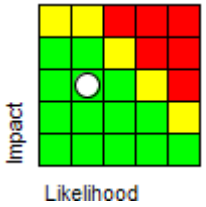
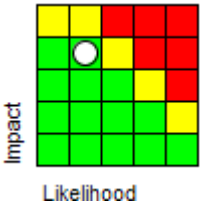
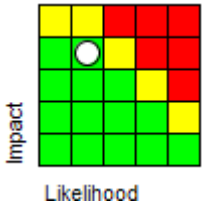
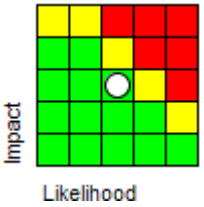
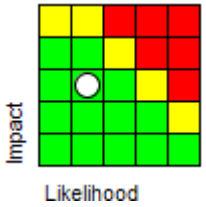
Status Icons: = Completed; = Assigned & in progress; = Overdue

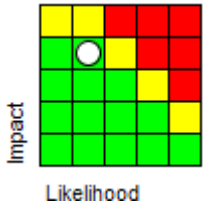
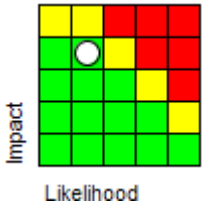
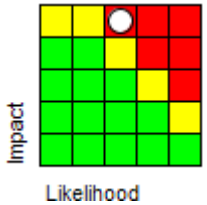
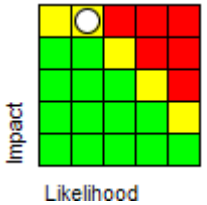
Risk Code & Description	Consequences	Risk Owner	Current Risk Matrix	Control Action	Control Action Owner	Status	Target Risk Matrix	Quarterly Update
CRR01a Financial Source: The Council is reliant on Central Controlled Government funding (eg. Business Rates). Event: (i) Failure to achieve the required 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 2017/18 budget (October Annually)	Dominic Bradley			December 2016 Update: An updated MTFS was reported to Cabinet on 24 November 2016. This updated the assumptions used. The 2017/18 budget process is well underway to firm up some of the proposed ideas to plug the budget gaps, the outcome of which should result in the 2017/18 budget being balanced and the deficits for future years reducing. The Council's acceptance of the 2015/16 four year settlement during 2016 has helped to provide a degree of certainty for the next three years, in as much as the Revenue Support Grant and the baseline Business Rates funding reduction from £2.2m in 2017/18 to £1.4m in 2019/20 won't get any worse during this period. The December Settlement will also feed into the January budget where a revised MTFS will also be presented.
				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 (Future Horsham)	Dominic Bradley			
				CRR.01.5 Commissioning reviews being undertaken, each of which will provide recommendations (programme of reviews to be completed by 31/03/19)	Mark Pritchard			

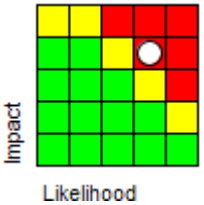
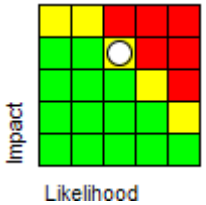
Risk Code & Description	Consequences	Risk Owner	Current Risk Matrix	Control Action	Control Action Owner	Status	Target Risk Matrix	Quarterly Update
CRR01b Financial Source: The Council is reliant on Central Controlled Government funding (eg. Business Rates). Event: (ii) Funding from Government is less generous than assumed in the MTFS from 2020.	. Reductions in funding . Adverse effect on morale . Financial . Failure to achieve agreed objectives							December 2016 Update: See notes from CRR01a
CRR02 Managerial / Professional Source: The Council has a legal obligation to protect personal data. The Information Commissioner has the power to levy significant financial penalties up to £500k for data breaches. Some information held by the Council is politically / commercially sensitive, and it is important that such information is not leaked. Event: Major data breach or leak of sensitive information to a third party.	. 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 . Adverse publicity . Reputation damage	Jane Eaton		CRR.02.1 Develop appropriate processes & procedures which underpin the IT Security Policy CRR.02.2 Provide a programme of training on Information Security to all staff. CRR.02.3 Annual PSN Accreditation	Paul Cummins Paul Cummins Dave Briggs			December 2016 Update: A Data Protection e-learning module has now been written which will be formally launched in January 2017.
CRR03 Legal Source: 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	. 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	Natalie Brahma-Pearl		CRR.03.1 Update corporate business continuity plan and regular review. CRR.03.2 Update departmental business continuity plans and regular review.	Trevor Beadle Trevor Beadle			December 2016 Update: All departmental business continuity plans have been audited. These will be updated and amended over the coming months and the information contained within will inform the review of the corporate plan and the business impact analysis (BIA). The BIA will be used by IT services to inform the Council's Disaster Recovery Plan for HDC.

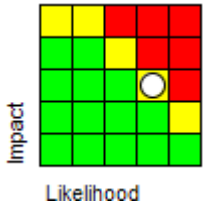
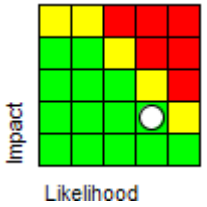
Risk Code & Description	Consequences	Risk Owner	Current Risk Matrix	Control Action	Control Action Owner	Status	Target Risk Matrix	Quarterly Update
emergencies, and for advising local businesses. Event: The Council is found to have failed to fulfil its obligations under the Act in the event of a civil contingency.								
CRR05 Governance Source: Managers are responsible for ensuring that controls to mitigate risks are consistently applied. Event: 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 . Reputation damage	Jane Eaton		CRR.05.1 Officer training	Jane Eaton			December 2016 Update: Training has been planned for Democratic Services to provide support to Members.
				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).	Jane Eaton			
CRR06 Physical Source: The Council is responsible for the health & safety of its clients, staff and other stakeholders, owns and	. People come to harm . Complaints/claims/ litigation . Financial losses			CRR.06.1 Set up a Health & Safety Forum with clear terms of reference (by 30/11/15).	Robert Laban			December 2016 Update: CRR.06.2 - Corporate H&S Adviser continues to inspect HDC premises. Premises Coordinators have been nominated and briefed and premises inspection format is currently being agreed with Property & Facilities Manager. Line / team manager self-audits being progressed, but still in development. CRR.06.3 - H&S generic responsibilities have been set out in the Corporate H&S Policy; specific responsibilities are set out in H&S subject policies, which are approximately 70% complete; directorate H&S Working Groups are responsible for
				CRR.06.2 Develop and implement a corporate inspection strategy (By 30/06/16).	Robert Laban / Health & Safety Officer			
				CRR.06.3 Clarity of responsibilities and implementation of a training programme	Robert Laban			
				CRR.06.4 Implement a central repository for risk assessments (by 30/06/16).	Robert Laban / Health & Safety Officer			

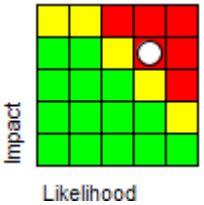
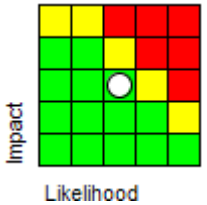
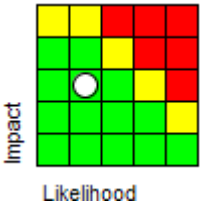
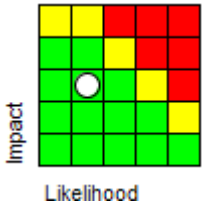
Risk Code & Description	Consequences	Risk Owner	Current Risk Matrix	Control Action	Control Action Owner	Status	Target Risk Matrix	Quarterly Update
Page 62								implementing these policies as required, for their areas. E-learning courses for H&S key topics have been written and are accessible via LEON; a corporate e-learning strategy/ promotion will make this more prominent. A H&S Training matrix has been drafted and will be introduced as part of a new corporate competencies framework from April 2017. 06.04 - The introduction of a central repository for risk assessments has not progressed due to lack of technical infrastructure; current requirements are as stated in the risk assessment policy. It is anticipated that the introduction of Office 365 in 2017 will provide a solution.
CRR07 Managerial / Professional Source: There is a lack of corporate consistency in terms of the way in which contracts are managed, and contract management is inadequate in some areas. Event: Failure of contract / poor service delivery / failure to achieve value for money.	. Failure of business objectives . Financial . Service delivery . Compliance with regulations . Personal Privacy Infringement . Reputation damage	Jane Eaton		CRR.07.1 Specific contract management guidelines will be developed. (By 31/01/17). CRR.07.2 A contract management training programme will be designed and implemented. (By 31/01/17).	Mark Pritchard Mark Pritchard			December 2016 Update: The guidelines and training programme is currently under development and will be completed by the end of January.

Risk Code & Description	Consequences	Risk Owner	Current Risk Matrix	Control Action	Control Action Owner	Status	Target Risk Matrix	Quarterly Update
CRR08 Governance Source: The Council's decision-making processes are based on a Constitution that is overly bureaucratic and unnecessarily complicated Event: Non-compliance with the Constitution and delays in decision-making	. Opportunities lost . Complaints / claims / litigation . Financial losses . Lack of openness and transparency	Paul Cummins		CRR.08.1 The Council's Constitution will be updated using the 2011 template. (By December 2016).	Paul Cummins			December 2016 Update: The revised Constitution was approved by Full Council on 7th December. This risk is now mitigated and will be removed from the Corporate Risk Register.
CRR09 Governance Source: The Council's decision-making relies upon the taking of professional advice from officers or external consultants Event: Advice is not taken.	. Poor/ultra vires decisions . Complaints/claims/ litigation . Financial losses . Reputation damage	Tom Crowley		CRR.09.1 Member training (ongoing)	Paul Cummins			December 2016 Update: Further training is going to be undertaken over the next quarter.
				CRR.09.2 Officer training (ongoing)	Paul Cummins			
				CRR.09.3 Member briefings to improve communications	Paul Cummins			
CRR12 Partnership / Supplier / Contractual Source: The Council is subject to EU procurement rules and regulations, is putting more services out to tender, and contractors are increasingly challenging contract awards. Event: A contractor successfully challenges an award (eg on inflexible price:quality ratios).	. Financial losses . Censure by audit / inspection . Reputation damage . Adverse effect on morale	Jane Eaton		CRR.12.1 Staff training	Mark Pritchard / Roger Dennis			December 2016 Update: Updates awaiting a decision on the new Constitution.
				CRR.12.2 Up-to-date procedures (by 31/7/17).	Mark Pritchard / Roger Dennis			
				CRR.12.3 Reference to Procurement Team for advice (ongoing)	Mark Pritchard / Roger Dennis			
				CRR.12.4 Proactive monitoring by the Procurement Team (ongoing)	Mark Pritchard / Roger Dennis			

Risk Code & Description	Consequences	Risk Owner	Current Risk Matrix	Control Action	Control Action Owner	Status	Target Risk Matrix	Quarterly Update
CRR13 Governance Source: Decisions are not always based on data. Event: Wrong decision made.	. Missed opportunities . Poor decisions . Poor VFM . Increased costs / financial losses	Tom Crowley		CRR.13.1 Robust evaluation of business cases to inform decisions (ongoing)	SLT			December 2016 Update: Since the appointment of a Performance Analyst, there has been a significant improvement in this area. Specific external expertise was used to provide supporting data for the alternate bin collection business case. This risk has now been mitigated and will be removed from the "live" register.
				CRR.13.2 Ensure that decisions are properly documented (Ongoing)	SLT			
CRR14 Customer/Citizen Source: The negotiation of Section 106 and CIL (Community Infrastructure Levy) are essential for ensuring necessary level of infrastructure provision for residents. Event: Failure to deliver the infrastructure needs of the District.	Reduced funding to deliver outcomes for the community	Chris Lyons		CRR.14.1 Ensure that leisure priorities are understood within the CIL schedule process and keep under review	Trevor Beadle			December 2016 Update: The Draft Charging Schedule and Proposed Modifications - submitted for examination on 18 November 2016. The Proposed Modifications were also published on 18 November for consultation. Comments invited until 19 December. All comments received will be submitted to the Examiner. Revised CIL Preparation Timetable: Examination (Inspector appointed – Geoff Salter) – November 2016 - January 2017 Examiner's Report - February 2017 Adoption – April 2017 CIL in place & Governance Procedures Working Group – Summer 2017 Anticipated CIL income stream from spring/summer 2018
				CRR.14.2 Identify the impact of funding erosion with competing partners e.g. WSCC	Barbara Childs			
				CRR.14.3 Update the Planning Obligations SPD (Supplementary Planning Document) and CIL charging schedule.	Barbara Childs			

Risk Code & Description	Consequences	Risk Owner	Current Risk Matrix	Control Action	Control Action Owner	Status	Target Risk Matrix	Quarterly Update
CRR17 Source: 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. Targeted sample testing is undertaken to ensure that housing benefit claims have been correctly administered, and extended sample testing is carried out should errors be identified. The amount of the error is then extrapolated across the entire population (for that particular cell) to produce an estimate of the total error amount. Where errors are identified, the Subsidy claim may be qualified, and financial penalties may occur. It is important to note that the Administration of Housing Benefit is undertaken by the CenSus Partnership and Benefits staff are employed by Mid-Sussex. Event: Errors may be made which are not identified by quality control checking. This may result in the Benefit Subsidy claim being qualified and/or financial losses.	Financial Service Delivery Compliance with regulations Reputation	Jane Eaton		CRR.17.1 Increase / improve the level of quality control checking.	Tim Delany			December 2016 Update: This area is currently under review.
				CRR.17.2 Continued implementation of the Census Quality Plan which came out of the 2013/14 audit.	Tim Delany			
				CRR.17.3 A reassessment of all "Working Age In Work" cases will be undertaken by the end of May 2017.	Tim Delany			

Risk Code & Description	Consequences	Risk Owner	Current Risk Matrix	Control Action	Control Action Owner	Status	Target Risk Matrix	Quarterly Update
CRR 18 Technological Source: Council services are increasingly reliant on IT systems at a time when there are greater opportunities for malicious attackers to exploit security weaknesses. Event 1: A malicious attacker exploits a known or unknown security weakness to penetrate the Council's ICT systems. Event 2: An internal attack on ICT systems by a disgruntled employee or other trusted user.	. 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 Training	Claire Oliver / Robert Laban			December 2016 Update: PSN accreditation has been achieved for 2016/17, and training is ongoing. ICT officers are aware of most of the latest threats but there is a need to cover the ICT security officer position following the recent retirement of the previous post holder (the preferred option is a managed service which is currently being pursued). Most patches are undertaken automatically but a few are manual. Again, a managed service is currently being explored which will assist. CRR.18.6 is currently being reviewed by Legal & Democratic Services. CRR.18.7 We have recovery documentation in place and can recover systems as required.
				CRR.18.2 Awareness of current threats	Claire Oliver			
				CRR.18.3 An effective ICT Service delivery team	Claire Oliver			
				CRR.18.4 Effective patching and updates to mitigate known vulnerabilities	Claire Oliver			
				CRR.18.5 Compliance with expected security standards. (PSN, PCI-DSS)	Claire Oliver			
				CRR.18.6 Effective policies in place which outline security requirements for users of ICT	Paul Cummins			
				CRR.18.7 Effective back-up and recovery processes in place for Council ICT systems	Claire Oliver			

Risk Code & Description	Consequences	Risk Owner	Current Risk Matrix	Control Action	Control Action Owner	Status	Target Risk Matrix	Quarterly Update
CRR19 Source: The Brexit vote has caused some uncertainty in the UK economy. The Government has spoken about an additional 5% reduction in local government funding, and in years to come, there may be a further deterioration in the local government pension fund. There is a risk that EU Law will not be complied with during the interim period.. Event: 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		CRR19.1 MTFS is being designed with £1m headroom being built in.	Jane Eaton			December 2016 Update: The uncertain economic environment is being continually monitored.
				CRR19.2 Monitor the external environment	SLT			
				CRR19.3 Monitor internal indicators, particularly income generation	SLT			
CRR20 Technological Source: There is an inherent risk when significant financial systems change. Current contract for Financial Management System (FMS) expires on 31 March 2017. Event: System that has not been adequately tested or is without the right level of functionality goes live. Lack of integration with other systems that requires significant systems re-	• Incorrect data migration • Data inaccuracies • Inaccurate reporting and decision-making • Failure to achieve agree objectives and deliver statutory services • Poor VFM	Jane Eaton		CRR.20.1 Monitor and control Joint tender process (with A&WDC) in line with procurement requirements.	Dominic Bradley			December 2016: New Risk
				CRR.20.2 Training and implementation for finance users. Parallel running of old and new system.	Dominic Bradley			
				CRR.20.3 Training and implementation for all Council users to enable access and self-service usage of new system.	Dominic Bradley			
				CRR.20.4 Project management and				

Risk Code & Description	Consequences	Risk Owner	Current Risk Matrix	Control Action	Control Action Owner	Status	Target Risk Matrix	Quarterly Update
processing.				sufficient testing time incorporated into plan.				
				CRR.20.5 Ensure procedure notes for new system and skills are maintained.	Dominic Bradley			

Report to Accounts, Audit & Governance Committee

4th January 2017

By the Chief Internal Auditor

INFORMATION REPORT

Not Exempt

Internal Audit – Quarterly Update Report

Executive Summary

This report summarises the work completed by the Internal Audit Section since September 2016.

Recommendations

The Committee is recommended to:

i) Note the summary of audit and project work undertaken since September 2016.

Reasons for Recommendations

i) To comply with the requirements set out in the Public Sector Internal Audit Standards 2013.

ii) The Accounts, Audit and Governance Committee is responsible for reviewing the effectiveness of the Council's system of internal control.

Background Papers

Internal Audit Reports and Correspondence

Wards affected: All.

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

Background Information

1 Introduction and Background

1.1 The purpose of this report is to provide a quarterly summary of work undertaken by the Internal Audit Team since September 2016.

1.2 The Accounts and Audit (England) Regulations 2015 state that "A relevant authority must undertake an effective internal audit to evaluate the effectiveness of its risk management, control and governance processes, taking into account public sector internal auditing standards or guidance." This responsibility is discharged through the Council's Internal Audit Section.

2 Relevant Policy / Professional Standards

2.1 Internal Audit follows the mandatory standards set out in the Public Sector Internal Audit Standards (PSIAS) published by the Chartered Institute of Public Finance and Accountancy (CIPFA) and the Chartered Institute of Internal Auditors.

2.2 Internal Audit is conducted in accordance with the Council's Constitution. Financial Procedure Rule 4e 32 states that: "the Chief Finance Officer, as determined by the Council, will ensure that the Council has appropriate arrangements in place to maintain an adequate and effective internal audit". The terms of reference for Internal Audit are detailed in the Council's Internal Audit Charter which is approved and reviewed by the Audit Committee.

3 Summary of Audit Findings

3.1 Emergency Planning

OVERALL AUDIT OPINION: SATISFACTORY ASSURANCE (↑)[1]

Controls and processes relating to Emergency Planning were reviewed and are generally working effectively. Audit testing identified a few areas where improvements should be made. In particular the Emergency Plan (and severe weather plans) need to be reviewed and updated where necessary. It was also identified that there are currently no formal training records held.

3.2 Software License Management

[1] *1 The symbols in brackets indicate the movement in the level of assurance when the area was last audited.*

(↑) = Improved. (↔) = No change. (↓) = Reduced. If blank ~ No previous opinion

OVERALL AUDIT OPINION: SATISFACTORY ASSURANCE

Controls are in place for the management of software licenses and from sample audit testing, the auditor did not identify any unlicensed software.

However, it is important that the Systems Development Manager is consulted prior to entering into procurement arrangements for the acquisition or maintenance of application systems. It is also important that an accurate and up-to-date inventory of software applications is maintained to support future decision-making, particularly as the authority moves towards cloud-based solutions. Actions have been agreed to tighten controls in these areas and to help ensure that value for money is achieved.

3.3 Release and Change Management

OVERALL AUDIT OPINION: SATISFACTORY ASSURANCE

The CenSus ICT has introduced a formal change management process which is based on ITIL* best practice. The process is currently focused on the IT infrastructure. However, at the time of the audit, there was no formal 'release management' or 'change management' process in place for application systems. Changes will be implemented with the introduction of the Cherwell application system (a new IT service management solution).

3.4 Events Management

OVERALL AUDIT OPINION: SATISFACTORY ASSURANCE

There is a sound system of control in place for the administration of events management. A dedicated events team is in place which manages and facilitates a comprehensive annual events programme. The main finding related to the need to improve the organisation of the department's equipment store room and associated inventories. Remedial action has been agreed.

3.5 Complaints Management **SATISFACTORY ASSURANCE**

There is a sound system of control in place for the administration of complaints. A dedicated complaints management tool (Covalent) was introduced in February 2015 which provides a central repository for the whole Council to record complaints and compliments in a standardised format.

The main finding related to complaint representatives not fully understanding or complying with the requirements of the Council's policy and procedures. It has been agreed that complaint representatives will be reminded of the policy requirements and the need to adhere to the required standards. It has also been agreed that quality control checks will be undertaken to ensure compliance.

3.6 Contracts **LIMITED ASSURANCE** *(⇔)*

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* *ITIL (IT Infrastructure Library) is a set of practices which have been designed for effective IT service management.*

The auditor identified a number of shortcomings in terms of compliance with the Council's Procurement Code. In particular, greater focus should be given to ensuring that suppliers are treated fairly and that value for money is being achieved.

As a result of the audit, the profile of this area has been raised. In particular, there will be greater involvement of the Senior Leadership Team in ensuring compliance, and more informative reporting to highlight potential areas of concern.

3.7 Payment Card Industry Data Security Standard **LIMITED ASSURANCE**

Compliance with the Payment Card Industry Data Security Standard (PCI DSS) is a mandatory requirement for all organisations that store, process or transmit payment card data. The audit found that the Council is not fully compliant with PCI DSS, however, the risk is substantially mitigated as our payment card data is stored off-site with third party suppliers.

It has been agreed that further training will be provided to staff who take payments from the public. In addition, the Head of Finance has added PCI DSS to his departmental risk register and will monitor risk exposure on a regular basis.

4. Other Audit Work

4.1 The Internal Audit team has been involved in a number of other areas:

- Significant contribution to the Internal Audit shared service work stream (involving Arun, Chichester and Horsham District Councils).

- Following the transfer of the Benefits Fraud Investigation Officers to the Department of Work and Pensions department, Internal audit now coordinates the NFI (National Fraud Initiative) data matching exercise on behalf of the Cabinet Office (formally administered by the Audit Commission). Fair Processing Notices are now in place for all data sets submitted to the Cabinet Office, and all requested data has now been securely uploaded.

- A new Code of Corporate Governance has been drafted following the recent publication of new CIPFA guidance. This document will help to inform the Annual Governance Statement for 2016/17.

5. Audit Plan ~ Progress Update

5.1 The audit plan is progressing well (see Appendix 2 for current status). However, as stated in my September report, the 'Shared Services' project has had a significant impact on resources this year. As a consequence, some elements of the audit plan may not be achieved.

A decision has already been taken to postpone the audit of IT Governance on the basis that the IT Strategy and IT Service are currently being comprehensively reviewed.

The new Finance system will not be available for testing until after 31st March 2017, and therefore this piece of work will be carried forward to the 2017/18 financial year.

From 2017/18, it is likely that the audit plan will be significantly cut. Limited resources will inevitably result in audit coverage being reduced, and it is therefore important that managers provide adequate focus in the areas of risk management and controls within their areas of responsibility. The control environment has incrementally improved during the last five years and this will need to be sustained. The audit plan in future years will continue to focus on key risk areas, and reliance will be placed on the Council's risk registers.

6 Next Steps

6.1 The Committee will be kept informed about progress in terms of the audit plan and the outcomes of the Shared Services project.

7 Outcome of Consultations

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

8 Other Courses of Action Considered but Rejected

8.1 Not applicable.

9 Resource Consequences

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

10 Legal Consequences

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

11 Risk Assessment

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

12 Other Considerations

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

Appendix 1

SUMMARY OF INTERNAL AUDIT ASSURANCE OPINIONS

Substantial Assurance	System of Control: There is a sound system of control in place which minimises risk to the Council; and/or Compliance with Controls: Audit testing identified that expected controls are being consistently applied. Only a few errors or weaknesses were identified, but the implementation priority is considered to be of low importance.
Satisfactory Assurance	System of Control: Whilst there is an adequate system of control and all key controls are in place, there are some weaknesses which may place the Council at risk in a few areas; and/or Compliance with Controls: Audit testing identified a lack of compliance with controls in a few areas.
Limited Assurance	System of Control: There are several weaknesses in the system of control and / or the absence of one or more key controls, which is placing the Council at risk in a number of areas; and/or Compliance with Controls: Audit testing identified a lack of compliance with several controls and/or one or more key controls and/or potential risk of abuse.
No Assurance	System of Control: The system of control is generally weak leaving the system open to significant error or abuse; and/or Compliance with Controls: Significant non-compliance with basic control processes leaves the processes / systems open to significant error or abuse.

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APPENDIX 2

	= Current Status

ANNUAL AUDIT PLAN 2016/17 ~ PROGRESS UPDATE

		STATUS UPDATE		
	Annual Audits ~ Key Financial Systems	***Commenced***	***Draft Report Stage***	***Completed***
1	Ernst & Young Key Financial Controls (ISA)			
2	Asset Management (IT Asset Inventory)			
3	Housing Benefits (CenSus Partnership)			
4	Cash & Bank			
5	Creditors			
6	Debtors			
7	Payroll			
8	Treasury Management			
	Annual Audits ~ Other			
9	BACS			
10	Business Continuity			
11	Contracts			
12	IT / Data Governance	Postponed	until 2017/18	
13	Computer Audit ~ Release & Change Management			
14	Computer Audit ~ Software License Management			
15	Computer Audit ~ PCI DSS (Payment Card Industry Data Security Standards)			
16	Computer Audit ~ New Finance System	Postponed	until 2017/18	
17	Ethics, Values & Behaviours			
18	Risk Management Assurance			
19	Purchase Cards			
	4 Year Cycle			
20	Budgetary Control			
21	Building Maintenance & Facilities Management			
22	Car Parking ~ Review of ANPR System			
23	Communications (to include Marketing)			
24	Use of Consultants			
25	Customer Service / Complaints Management			
26	Depots ~ Bulky Waste			
27	Depots ~ Trade Waste			
28	Events Management			
29	Emergency Planning			
30	Grants ~ Private Sector Housing Assistance Grants			
31	Building Control ~ Cost Sharing Arrangements			
32	Project Management ~ Audit of BBHLC Project Governance Arrangements			
33	Recruitment			
34	Security			
	Other Work			
	Corporate Governance ~ Update Code of Corporate Governance			
	Corporate Governance ~ Coordinate completion of the Annual Governance Statement			
	National Fraud Initiative (NFI) Data Matching (Coordinate Uploads)			
	National Fraud Initiative (NFI) Data Matching (Review Reports)			
	Consultancy ~ Parks & Open Spaces / Grounds Maintenance Contract			
	Consultancy ~ IT Software (to assist Future Horsham Project)			
	PSIAS (External) Review ~ Rother			
	PSIAS (External) Review ~ Hastings			
	Assurance Framework ~ Pilot within Finance			

Unscheduled Work	***In Progress***	***Completed***
Shared Services ~ Outline Business Case		
Data Matching on behalf of Saxon Weald Homes		
Bribery Proecdures written		
Disabled Facilities Capital Grant Certification for Central Government		
Review of proposed new Supplier e-form		
Review of new E-Bay procedure		
Development of a formal Risk Management Process for Projects		

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