

FAREHAM

BOROUGH COUNCIL

AGENDA

AUDIT AND GOVERNANCE COMMITTEE

Date: Monday, 13 March 2017

Time: 6.00 pm

Venue: Collingwood Room - Civic Offices

Members:

Councillor Miss T G Harper (Chairman)

Councillor P J Davies (Vice-Chairman)

Councillors F Birkett
Mrs M Brady
J E Butts
Mrs T L Ellis
S D Martin

Deputies: Mrs S M Bayford
S Cunningham



1. Apologies

2. Minutes (Pages 5 - 10)

To confirm as a correct record the minutes of the Audit Committee meeting hold on 28 November 2016.

3. Chairman's Announcements

4. Declarations of Interest and Disclosures of Advice or Directions

To receive any declarations of interest from members in accordance with Standing Orders and the Council's Code of Conduct.

5. Deputations

To receive any deputations of which notice has been lodged.

6. External Audit Annual Certification Report (Pages 11 - 20)

To consider a report from the Director of Finance and Resources on the certification work carried out by the External Auditors for 2015-16.

7. External Annual Plan and Fee (Pages 21 - 38)

To consider a report from the Director of Finance and Resources on the External Auditor's Annual Plan and proposed Fee.

8. Arrangements for the Appointment of the next External Auditors - Update

To receive a verbal update from the Director of Finance and Resources on the proposed changes to the arrangements for appointing External Auditors from April 2018.

9. Revised Risk Management Policy (Pages 39 - 50)

To consider a report from the Director of Finance and Resources on the New Risk Management Policy.

10. Treasury Management Strategy and Prudential Indicators 2017-18 (Pages 51 - 72)

To consider a report from the Director of Finance and Resources on the Treasury Management Strategy and Prudential Indicators for 2017/18.

11. Internal Audit Annual Plan (Pages 73 - 78)

To consider a report by the Head of Finance and Audit on the Internal Audit Annual Plan for 2017/18.

12. Quarterly Audit Report (Pages 79 - 92)

To consider a report by the Head of Finance and Audit on the findings arising from the latest internal audit work to be finalised and the progress being made on delivering the internal audit plan.

13. Annual Audit and Governance Committee Report, Work Programme and Training Plan (Pages 93 - 98)

To consider the annual report by the Head of Finance and Audit on the work of the Audit and Governance Committee and the proposed work programme for 2017/18.

14. Exclusion of Public and Press

To consider whether it is in the public interest to exclude the public and representatives of the Press from the remainder of the meeting on the grounds that the matters to be dealt with involve the likely disclosure of exempt information, as defined in Paragraph 1 of Part 1 of Schedule 12A of the Local Government Act 1972.

15. Internal Audit Partnership (Pages 99 - 106)

To consider a confidential report by the Head of Finance and Audit summarising the proposed new Internal Audit Partnership.

P GRIMWOOD
Chief Executive Officer
www.fareham.gov.uk
3 March 2017

For further information please contact:
Democratic Services, Civic Offices, Fareham, PO16 7AZ
Tel:01329 236100
democraticservices@fareham.gov.uk

FAREHAM

BOROUGH COUNCIL

Minutes of the Audit and Governance Committee (to be confirmed at the next meeting)

Date: Monday, 28 November 2016

Venue: Collingwood Room - Civic Offices

PRESENT:

Councillor Miss T G Harper (Chairman)

Councillor P J Davies (Vice-Chairman)

Councillors: F Birkett, Mrs M Brady, J E Butts, Mrs T L Ellis and S D Martin

**Also
Present:**



1. APOLOGIES

There were no apologies received at this meeting.

2. MINUTES

RESOLVED that the minutes of the Audit and Governance Committee held on 19 September 2016 be confirmed and signed as a correct record.

3. CHAIRMAN'S ANNOUNCEMENTS

There were no Chairman's announcements made at this meeting.

4. DECLARATIONS OF INTEREST AND DISCLOSURES OF ADVICE OR DIRECTIONS

There were no declarations of interest made at this meeting.

5. DEPUTATIONS

There were no deputations made at this meeting.
MATTERS CONSIDERED FOR CONFIRMATION

6. NEW ARRANGEMENTS FOR THE APPOINTMENT OF EXTERNAL AUDITORS FROM APRIL 2018

The Committee considered a report by the Director of Finance and Resources summarising the proposed arrangements for appointing the next External Auditors.

Members discussed the proposed arrangements and agreed that opting into the Public Sector Audit Appointments (PSAA) was a clear and sensible option.

RESOLVED that the Committee recommends that Council accepts Public Sector Audit Appointments (PSAA) invitation to 'opt in' to the sector led option for appointment of external auditors for five financial years commencing 01 April 2018.

7. UPDATES TO FINANCIAL REGULATIONS

The Committee received a report by the Head of Finance and Audit proposing changes to the Financial Regulations; 4 – Authorisation Limits and 13 – Physical Assets.

Members asked for more information about the reasons for the increase to the Level 1 Budget Expenditure outlined in Appendix A of the report. The Director of Finance and Resources explained to the Committee that the rise is to ensure that the Director who understands their service is able to make a decision regarding payment, rather than the Director of Finance and Resources who is not necessarily always best placed to do so.

Members sought clarification on the proposed changes outlined in bold on page 87 of the report and asked that the wording be changed from 'Property, Estates or Procurement teams, as appropriate to the acquisition.' to 'Property, Estates or Procurement teams, as appropriate to the acquisition and within the remit of their service'.

RESOLVED that

- (a) the proposed changes to Authorisation Limits in Financial Regulation 4, as set out in Appendix A to the report, be agreed and recommended to Council for approval; and
- (b) the proposed changes to wording in Financial Regulation 13.2.2, as outlined at paragraph 4 of the report be agreed and recommended to Council for approval, subject to the inclusion of the words "and within the remit of their service" so that it reads 'Property, Estates or Procurement teams, as appropriate to the acquisition and within the remit of their service'.

DECISIONS MADE UNDER DELEGATED POWERS

8. ANNUAL AUDIT LETTER

The Committee considered a report by the Director of Finance and Resources on the External Auditors Letter summarising the findings from the 2015/16 audit.

The new Executive Director of Ernst and Young, Helen Thompson, addressed the Committee to introduce herself and explain that she will be presenting the external auditor's reports to the Audit and Governance Committee for the foreseeable future.

RESOLVED that the Committee notes the content of the report.

9. TREASURY MANAGEMENT POLICY AND STRATEGY IMPLEMENTATION

The Committee considered a report by the Director of Finance and Resources on the implementation of the Treasury Management Policy and Strategy.

RESOLVED that the Committee note the contents of the report.

10. SCHEME OF DELEGATION

The Committee received a verbal update from the Monitoring Officer on proposed updates to the Council's Scheme of Delegation to Officers.

(Councillor Miss Harper temporarily left the room during deliberation of this item)

It was noted that the correct title for this item should be 'Scheme of Delegation to Officers'.

The Head of Democratic Services addressed the Committee to give details of the work being undertaken by the working group set up to review the constitution, and the recent review of the Scheme of Delegation to Officers.

Periodic organisational restructures have had an impact on the efficiency and operational usefulness of the Officer Delegation Scheme, especially at the highest level of management where there are now 3 Directors instead of the 5 who were in place up until 2009. In order to reduce time delays and to ensure resilience, the designation to the Chief Officer level has been updated to include relevant Heads of Service. It is therefore proposed that certain delegations are adjusted to Head of Service level for some functions.

The draft amendments will be reported to the following parent committees for consideration on these dates:-

- 09 January 2017 – Executive
- 24 January 2017 – Licensing & Regulatory Affairs Committee
- 25 January 2017 – Planning Committee
- 13 March 2017 – Audit and Governance Committee

The final document will then go to Council for approval on 27 April 2017.

RESOLVED that the Committee notes the content of the verbal update.

11. LOCAL CODE OF CORPORATE GOVERNANCE

The Committee considered a report by the Head of Finance and Audit which recommended a new version of the Local Code of Corporate Governance.

RESOLVED that the new version of the Local Code of Corporate Governance, as set out in Appendix A to the report, be approved.

12. UPDATE ON THE NEW RISK MANAGEMENT POLICY

The Committee received a presentation from the Head of Finance and Audit updating the Committee on the work being carried out to set the New Risk Management Policy.

The presentation gave a brief overview of the history of Risk Management Policy and explained why a change was needed as a result of systems thinking and the new ways of working within the Council.

The Head of Finance and Audit asked for the Committee to provide feedback on the proposals for the new policy and a lengthy discussion took place which will help to aid officers to finalise the new policy.

RESOLVED that the Committee, note the contents of the presentation.

13. QUARTERLY AUDIT REPORT

The Committee considered the Quarterly Audit Report by the Head of Finance and Audit.

RESOLVED that the Committee, notes the progress and findings arising from the internal audit work.

14. REVIEW OF WORK PROGRAMME AND TRAINING PLAN

The Committee considered a report by the Head of Finance and Audit which reviewed the Committee's Work Programme for 2016/17.

One addition to the programme was noted following the item on the Scheme of Delegation as this item will be brought back to the 13 March meeting.

RESOLVED that:-

- (a) the Scheme of Delegation to Officers item be added to the 13 March meeting; and
- (b) the Work Programme for the remainder of the year as set out in Appendix A of the report, be approved.

(The meeting started at 6.00 pm
and ended at 7.40 pm).

FAREHAM

BOROUGH COUNCIL

Report to Audit and Governance Committee

Date 13 March 2017

Report of: Director of Finance and Resources

Subject: EXTERNAL AUDIT ANNUAL CERTIFICATION REPORT

SUMMARY

This report presents the findings from the 2015-16 certification work carried out by the External Auditors (Ernst and Young). The work covered the Housing Benefit Subsidy Claim.

RECOMMENDATION

That the Committee:-

- (a) consider the information contained within the report and;
- (b) comment on the findings of the Annual Certification Report 2015-16 submitted by the Council's external auditors.

Appendix A: [Annual Certification Report 2015-16](#)

Background Papers: None

Reference Papers: Statement of responsibilities of grant-paying bodies, authorities, Public Sector Audit Appointments (PSAA) and appointed auditors in relation to claims and returns – issued by PSAA

Enquiries:

For further information on this report please contact Elaine Hammell. (Ext 4344)

Certification of claims and returns annual report 2015-16

Fareham Borough Council

November 2016

Ernst & Young LLP



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working world

The Members of the Audit and Governance Committee
Fareham Borough Council
Civic Office
Civic Way
Fareham
Hampshire
PO16 7AZ

5 December 2016
Ref: HB1

Direct line: 07974 007332
Email: HThompson2@uk.ey.com

Dear Members

Certification of claims and returns annual report 2015-16

We are pleased to report on our certification work. This report summarises the results of our work on Fareham Borough Council's 2015-16 claims and returns.

Scope of work

Local authorities claim large sums of public money in grants and subsidies from central government and other grant-paying bodies and must complete returns providing financial information to government departments. In some cases these grant-paying bodies and government departments require appropriately qualified auditors to certify the claims and returns submitted to them.

Public Sector Audit Appointments Ltd (PSAA) made arrangements for certifying claims and returns in respect of the 2015-16 financial year. These arrangements required only the certification of the housing benefits subsidy claim. In certifying this claim we followed a methodology determined by the Department for Work and Pensions and did not undertake a full audit of the claim.

Statement of responsibilities

The 'Statement of responsibilities of grant-paying bodies, authorities, Public Sector Audit Appointments and appointed auditors in relation to claims and returns', issued by PSAA, serves as the formal terms of engagement between ourselves as your appointed auditor and the Council as audited body.

This report is prepared in the context of the statement of responsibilities. It is addressed to those charged with governance and is prepared for the sole use of the Council. As appointed auditor we take no responsibility to any third party.

Summary

We checked and certified the housing benefits subsidy claim with a total value of £20,001,898. We met the deadline for this work.

Fees for certification work are summarised in section 2. The scale fees for 2015-16 are available on PSAA website (www.psaa.co.uk).



We welcome the opportunity to discuss the contents of this report with you at the Audit and Governance Committee on 13 March 2017.

Yours faithfully

Helen Thompson
Executive Director
For and on behalf of Ernst & Young LLP
Enc

Contents

1. Housing benefits subsidy claim.....1

2. 2015-16 certification fees.....2

3. Looking forward.....3

1. Housing benefits subsidy claim

Scope of work	Results
Value of claim presented for certification	£20,001,898
Amended/Not amended	Not amended
Qualification letter	Yes
Fee – 2015-16	£15,959
Fee – 2014-15	£15,080

Local Government administers the Government's housing benefits scheme for tenants and can claim subsidies from the Department for Work and Pensions (DWP) towards the cost of benefits paid. The DWP require appropriately qualified auditors to certify housing benefit subsidy claims, and determine the methodology auditors follow when certifying them.

Our certification guidance stipulates the level of initial testing auditors are required to perform and requires auditors to complete more extensive '40+' or extended testing if initial testing identifies errors in the calculation of benefit or compilation of the claim. 40+ testing may also be carried out to determine if errors detected in the prior year's claim have reoccurred.

We then either report the extrapolated value of detected errors in a qualification letter or, if appropriate, agree an amendment to the claim with the Council.

We have highlighted any errors detected during our work and the responses below:

- From an initial sample of 20 Non HRA Rent Rebate cases we identified three errors as a result of incorrect assessment of earnings. The impact was:
 - two underpayments of benefit with total values between £0.36 and £3.72; and
 - one overpayment of benefit with total value of £2.40.

Amendments have been made to individual claims in 2016-17, ensuring that the benefit paid to claimants has been corrected. '40+' or extended testing was performed to a sample of Non HRA Rent Rebate cases and no further errors were detected. Our certification guidance requires us to report these errors to the DWP in a qualification letter along with the extrapolated value of overpayments, which was £5. This extrapolation represents an indication of the total value of overpayments caused by incorrect earnings assessments in Non HRA Rent Rebates.

- '40+' or extended testing was performed on a sample of HRA Rent Rebate cases as a result of incorrect assessment of earnings in the prior year's claim. We identified two errors as a result of this testing. The impact was:
 - two underpayments of benefits with total values between £19.61 and £30.65.

Amendments have been made to individual claims in 2016-17, ensuring that the benefit paid to claimants has been corrected. Our certification guidance requires us to report these errors to the DWP in a qualification letter.

2. 2015-16 certification fees

Public Sector Audit Appointments (PSAA) determine a scale fee each year for the audit of claims and returns. For 2015-16, these scale fees were published by the PSAA in April 2015 and are now available on the PSAA's website (www.psaa.co.uk).

Claim or return	2014-15	2015-16	2015-16
	Actual fee £	Indicative fee £	Actual fee £
Total Housing benefits subsidy claim	15,080	15,959	15,959

3. Looking forward

From 1 April 2015, the duty to make arrangements for the certification of relevant claims and returns and to prescribe scales of fees for this work was delegated to PSAA by the Secretary of State for Communities and Local Government.

The Council's indicative certification fee for 2016-17 is £11,310. This was prescribed by PSAA in March 2016, based on no changes to the work programme for 2016-17.

Details of individual indicative fees are available at the following web address:

<http://www.psaa.co.uk/audit-and-certification-fees/201617-work-programme-and-scales-of-fees/individual-indicative-certification-fees/>

We must seek the agreement of PSAA to any proposed variations to these indicative certification fees. We would discuss the matter with the Director of Finance and Resources before seeking any such variation.

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FAREHAM

BOROUGH COUNCIL

Report to Audit and Governance Committee

Date 13 March 2017

Report of: Director of Finance and Resources

Subject: EXTERNAL AUDIT ANNUAL PLAN AND FEE

SUMMARY

This report brings to members' attention the Audit Plan from the Council's external auditors, Ernst & Young.

The plan provides the Committee with a basis to review the proposed audit approach and scope of work for the 2016/17 audit (carried out in 2017/18) and to ensure that the work is in line with members' expectations.

The report also brings to members' attention the Planned Fee for the 2016/17 audit work received from Ernst and Young.

RECOMMENDATION

That the Committee: -

- (a) approves the 2016/17 Audit Plan, attached as Appendix A to this report and;
- (b) approves the fees proposed for the External Audit of 2016/17 (paid in 2017/18).

Appendices:

[Appendix A](#) – Plan of Audit coverage of the year ending 31 March 17

Background Papers: None

Reference Papers: None

Enquiries: For further information on this report please contact Elaine Hammell. (Ext 4344)

Fareham Borough Council

Year ending 31 March 2017

Audit Plan

March 2017

Ernst & Young LLP



Building a better
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Audit and Governance Committee
Fareham Borough Council
Civic Offices
Civic Way
Fareham
Hampshire
PO16 7PU

13 March 2017

Dear Committee Members

Audit Plan

We are pleased to attach our Audit Plan which sets out how we intend to carry out our responsibilities as your auditor. Its purpose is to provide the Audit and Governance 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 13 March 2017 and to understand whether there are other matters which you consider may influence our audit.

Yours faithfully

Helen Thompson
For and on behalf of Ernst & Young LLP
Enc

Contents

1. Overview	1
2. Financial statement risks	2
3. Value for money risks	3
4. Our audit process and strategy.....	4
5. Independence.....	8
Appendix A Fees.....	10
Appendix B UK required communications with those charged with governance	11

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 Fareham Borough 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; and
- ▶ our conclusion on the Council's arrangements to secure economy, efficiency and effectiveness.

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

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

When planning the audit we take into account several key inputs:

- ▶ strategic, operational and financial risks relevant to the financial statements;
- ▶ developments in financial reporting and auditing standards;
- ▶ the quality of systems and processes;
- ▶ changes in the business and regulatory environment; and
- ▶ management's views on all of the above.

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

We have also been mindful of and given consideration to the Council's main developments and schemes, including but not limited to:

- ▶ Daedalus;
- ▶ Welborne;
- ▶ Vanguard;
- ▶ the capital programme; and
- ▶ the Housing Company.

In sections two and three of this plan we provide more detail on the identified risks and we outline our plans to address them. Our proposed audit process and strategy is set out in section four.

We will provide an update to the Audit and Governance Committee on the results of our work in these areas in our report to those charged with governance scheduled for delivery in September 2017.

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	
<p>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.</p> <p>We identify and respond to this fraud risk on every audit engagement.</p>	<p>Our approach will focus on:</p> <ul style="list-style-type: none"> ▶ 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. ▶ Evaluating the business rationale for significant unusual transactions. ▶ Evaluating the rationale for any changes in accounting policy. ▶ Reviewing the Minimum Revenue Provision policy and the appropriateness of charges made in the financial statements. We may engage the services of a specialist to assist us in this area.

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 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 value for money risk which we view as relevant to our value for money conclusion at this stage.

Significant value for money risks	Our audit approach
Sustainable resource deployment - Medium term financial outlook	
<p>Financial pressures in the public sector continue to mount. As a result of these pressures there is increased focus and wider public interest in the financial resilience of Local Government.</p> <p>The Council also has a number of ongoing developments and schemes which would need to be integrated into its revenue and capital budgets which could have a significant impact on the medium term finance strategy</p>	<p>Our approach will focus on:</p> <ul style="list-style-type: none"> • reviewing outturn against the 2016/17 budget. A strong history of managing service delivery to budget, provides comfort over the Council’s ability to set realistic and achievable budgets in the future; • reviewing the reasonableness of the 2017/18 budget and 5 year Finance Strategy, including integration of Daedalus (and other significant capital projects) into the Council’s revenue and capital budgets; and • evaluating the progress made with, and achievability of, the efficiency plan intended to address budget shortfalls in future years.

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; and
- ▶ arrangements for securing economy, efficiency and effectiveness in its use of resources to the extent required by the relevant legislation and the requirements of the Code.

We issue an audit report that covers:

1. Financial statement audit

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

We report to you by exception in respect of your governance statement and other accompanying material as required, in accordance with relevant guidance prepared by the NAO on behalf of the Comptroller and Auditor General.

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 in its use of resources.

4.2 Audit process overview

As part of our audit planning procedures we have assessed the design of your internal controls and determined where it will be most efficient to adopt a controls reliance approach. In those areas we will test the controls we determine as key to preventing and detecting material misstatement.

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:

- ▶ accounts payable;
- ▶ payroll; and
- ▶ housing benefits.

Analytics

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

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

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

Internal audit

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 audit reporting 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
Land and property valuations	Council's valuers
Pensions	Council actuary, EY third party specialists and EY Pensions team
NDR appeals provision	Council's third party specialist
Fair value disclosures	Council's third party specialist

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 data is relevant and reliable;
- ▶ assess the reasonableness of the assumptions and methods used;
- ▶ consider the appropriateness of the timing of when the specialist carried out the work; and
- ▶ assess whether the substance of the specialist's findings are properly reflected in the financial statements.

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.
- ▶ Satisfying ourselves that the Council has made proper arrangements for securing economy, efficiency and effectiveness in its use of resources.

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 £1,185,620 based on 2% of gross revenue expenditure. We will communicate uncorrected audit misstatements greater than £59,000 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 Fareham Borough Council is £48,230.

4.6 Your audit team

The engagement team is led by Helen Thompson. Helen is supported by Jason Jones, who is responsible for the day-to-day direction of audit work and is the key point of contact for the finance team.

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 and Governance

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 and Governance 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 and Governance Committee timetable	Deliverables
High level planning	December 2016	March 2017	Audit Plan
Risk assessment and setting of scopes and testing routine processes and controls	March 2017	July 2017	Progress Report
Year-end audit	August 2017	September 2017	Report to those charged with governance via the Audit Results Report Audit report (including our opinion on the financial statements and overall value for money conclusion) Audit completion certificate Reporting to the NAO on the Whole of Government Accounts return.
Conclusion of reporting	October 2017	November 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
<ul style="list-style-type: none"> ▶ 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. 	<ul style="list-style-type: none"> ▶ 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. ▶ 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 Council. 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 planned 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 other 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 Helen Thompson, 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 £	Outturn fee 2015/16 £
Opinion Audit and VFM Conclusion	48,230	48,230	48,230
Total Audit Fee – Code work	48,230	48,230	48,230
Certification of claims and returns ¹	11,310	11,310	15,959
Total	59,540	59,540	64,189

All fees exclude VAT.

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

- ▶ officers meet the agreed timetable of deliverables;
- ▶ the operating effectiveness of the internal controls for the key processes outlined in section 4.2 above;
- ▶ our accounts opinion and value for money conclusion are 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.

¹ Our fee for the certification of grant claims is based on the indicative scale fee set by the PSAA.

Appendix B UK required communications with those charged with governance

There are certain communications that we must provide to the Audit and Governance 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 <ul style="list-style-type: none"> ► Our view about the significant qualitative aspects of accounting practices including accounting policies, accounting estimates and financial statement disclosures ► Significant difficulties, if any, encountered during the audit ► Significant matters, if any, arising from the audit that were discussed with management ► Written representations that we are seeking ► Expected modifications to the audit report ► Other matters if any, significant to the oversight of the financial reporting process 	► Audit Results Report
Misstatements <ul style="list-style-type: none"> ► 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 <ul style="list-style-type: none"> ► Enquiries of the Audit and Governance 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: <ul style="list-style-type: none"> ► 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 <ul style="list-style-type: none"> ► 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 <ul style="list-style-type: none"> ► 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 and Governance 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 and Governance 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: <ul style="list-style-type: none"> ▶ 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 	<ul style="list-style-type: none"> ▶ 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: <ul style="list-style-type: none"> ▶ 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 	<ul style="list-style-type: none"> ▶ Audit Results Report
Significant deficiencies in internal controls identified during the audit	<ul style="list-style-type: none"> ▶ Audit Results Report
Fee Information <ul style="list-style-type: none"> ▶ Breakdown of fee information at the agreement of the initial audit plan ▶ Breakdown of fee information at the completion of the audit 	<ul style="list-style-type: none"> ▶ Audit Plan ▶ Audit Results Report ▶ Annual Audit Letter if considered necessary
Certification work <ul style="list-style-type: none"> ▶ Summary of certification work undertaken 	<ul style="list-style-type: none"> ▶ Annual Report to those charged with governance summarising grant certification, and Annual Audit Letter if considered necessary.

EY | Assurance | Tax | Transactions | Advisory

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FAREHAM

BOROUGH COUNCIL

Report to Audit and Governance Committee

Date **13 March 2017**

Report of: **Director of Finance and Resources**

Subject: **REVISED RISK MANAGEMENT POLICY**

SUMMARY

This report brings to the Committee a new Risk Management Policy for approval. The policy has been radically revised to reflect the changing culture of the organisation and the introduction of systems thinking into how services are delivered.

RECOMMENDATION

That the new Risk Management Policy be approved for adoption by the Council.

INTRODUCTION

1. The Council recently adopted a new Local Code of Corporate Governance which adheres to the latest CIPFA/SOLACE guidance. This local code sets out the following responsibilities in relation to Risk Management:

Managing risk	Recognising that risk management is an integral part of all activities and must be considered in all aspects of decision making. Implementing robust and integrated risk management arrangements and ensuring that they are working effectively. Ensuring that responsibilities for managing individual risks are clearly allocated.
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2. The Council has been challenging the exact nature of its risk management arrangements over the last 2 years to bring it in line with the changing culture of the organisation and the introduction of systems thinking into how services are delivered.
3. In the November meeting of the Audit and Governance Committee a presentation was provided to members on the proposed new approach for comment, particularly in relation to how the process can support the member role *“to provide to those charged with governance independent assurance on the adequacy of the risk management framework....”*
4. Further work on the policy has now been completed, following the feedback provided by members, and the new policy is now attached as Appendix 1 for approval.

KEY FEATURES OF THE POLICY

5. The main features of the policy are:
 - (a) Recognition of the importance of risk management
 - (b) Recognition that risk management should be embedded into every day management and not set up as a separate rigid process which can divert resources away from the management of risk.
 - (c) The adoption of 7 principles which lead to a robust and integrated process.
 - (d) The monitoring, reporting and assurance processes we will be using to review the effectiveness of the arrangements.

NEXT STEPS

6. A Heads of Service workshop is being arranged to roll out the principles in this policy and clarify expectations of services in the new arrangements.
7. The first monitoring report is then planned to be presented at the September Audit and Governance Committee.

RISK ASSESSMENT

8. Risk Management is a fundamental part of the Councils' Corporate Governance framework which is covered in the Annual Governance Statement and reviewed by the external auditors. This policy sets out what the arrangements are that the Council will be using to meet this obligation.

Background Papers: None

Reference Papers:

CIPFA / SOLACE - Delivering Good Governance in Local Government Framework April 2016 Edition

Report to Audit and Governance Committee on Local Code of Corporate Governance 28 November 2016.

Appendices:

Appendix A – [Draft Risk Management Policy 2017](#)

Enquiries:

For further information on this report please contact Elaine Hammell. (Ext 4344)

FAREHAM

BOROUGH COUNCIL

RISK MANAGEMENT POLICY (draft)



Introduction

Risk is a fact of life. The day to day management of an organisation and delivery of services involve foreseeing and averting problems and maximising opportunities. Risk management is not about risk avoidance but risk awareness.

Fareham Borough Council recognises that risk management is an intrinsic part of Corporate Governance. It seeks to ensure that every member and employee of the Council has regard for the management of risks throughout the organisation to ensure that the Council's resources that our customers rely on are not squandered as a result of uncontrolled risk.

However, our aim is to put dealing with risks and opportunities at the forefront of our process, rather than tie up resources in the management of a rigid supporting framework. Instead we will *implement robust and integrated risk management arrangements*, as required by our Local Code of Corporate Governance, by adopting and adhering to a number of key principles.

This document therefore sets out our approach to risk management, as determined by the Chief Executive's Management Team, and endorsed by the Audit and Governance Committee.

Overriding Principle

The overriding principle of this policy is:

Risk Management is an integral part of basic everyday management and decision making and is not a separate corporate process.

The Purpose of Risk Management

The Council has defined the purpose of its risk management arrangements as:

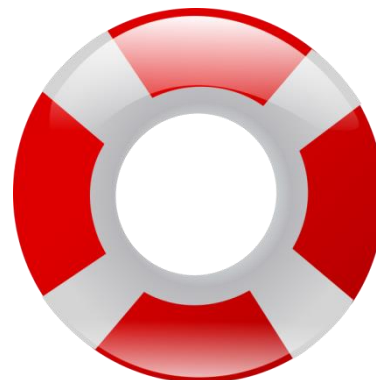
We want to know what risks we are facing
We want to know when opportunities arise

We want to be aware of what actions we are
relying on
We want to know if there are additional actions
we need to take



So that we can....

Prevent bad things from
happening
Not miss out on good things



So that we can....

Avoid injury to people
Minimise avoidable cost
Maximise resources available
Deliver the purposes of the services we
provide
Inspire confidence in our stewardship in our
customers and tax payers



The 7 Principles of Risk Management at Fareham Borough Council

The basic principles in which risk management operates at the Council are summarised below:

1. Risk Ownership in Services



- Risks are owned at the service level.
- Identifying and managing the risks of a service is an integral part of managing the service. This includes horizon scanning to identify new and changing risks and opportunities.
- Every service, system and project has an owner with responsibility for it.
- The owner for most risks is usually clear from the roles and responsibilities in the service.
- Managers make sure that employees are well briefed and actively involved in identifying and understanding risks and determining the actions they need to take to contribute to the management of risks.
- This means everyone should work to understand and remove the things that impede achievement of their purpose.

2. Competent and Responsible Employees



- We employ competent and responsible managers and employees.
- This is underpinned by strong recruitment and performance management processes and, where necessary, corrective action.
- We trust managers to manage well which includes the identification and management of risk and opportunity in their service area.
- We trust employees to carry out the actions required of them to mitigate risks.
- It is incumbent on all to be:
 - a) proactive in giving confidence to others that key risks are being managed effectively, by using appropriate reporting and assurance methods.
 - b) proactive in obtaining assurances from others involved in carrying out actions which help manage risks for which they are responsible.

3. Experts Pulled in to Advise



- Service managers who need help to manage specific risks pull in experts when required.
- This could also involve having a conversation with a senior manager or fellow manager who has been in a similar situation.
- Certain risks are cross cutting and also need ownership at a corporate level to lead on translating, learning and providing support and solutions to service managers.
- A list of experts for those risk areas where ownership is not clear from the organisational structure is maintained as Appendix 1 to this policy.

4. Process is supported by Having Conversations



- Further risks may be identified by others (e.g. team members, other managers, legal services, internal audit) which are brought to the service manager's attention by having conversations.
- Further risks may also be identified by having conversations with parties outside of the Council.
- Where ownership for a risk is not clear interested parties meet to agree a way forward.



5. Identifying Opportunities to Share

- The organisation shares information about risks being managed at the service level and identifies common issues that may turn them into cross cutting or corporate risks.
- It is the responsibility of managers to appreciate the roles and responsibilities of other services and when risks and solutions they have identified in their service might be relevant to them, and to bring it to their attention.
- We provide an environment that encourages all employees to feel part of one organisation and to be aware of the full range of services provided by the Council and to notice and pass on information that may be of value to another service. *(The eyes and ears of the borough)*
- Experts and support services are in an ideal position to appreciate when problems and solutions being identified for one service could be relevant to another. *(The eyes and ears of the organisation)*

6. Escalation of Issues



- Employees are trusted to identify when issues need to be escalated in order to alert supervisors, managers and senior managers, or so that resources can be diverted to help with the management of the risk.
- The culture of the organisation makes employees comfortable in escalating problems.
- Our aim is to avoid feeding too much detail upwards to allow managers to see the important issues clearly and react quickly.

7. Incident Management and Review



- Incidents are risks that have occurred and are a measure of how well we are achieving our purposes.
- Most Incidents are directly managed by the service or escalated if corporate awareness or support is needed.
- Some incidents may require the lead to be taken by another service, e.g. insurance claims.
- After the incident a review is undertaken to identify any actions that may be needed to prevent recurrence.
- Questions to be asked should include:
How did it happen, was it predictable, could it happen again, what could we do to prevent it?
- Conversations with Senior Managers take place, as appropriate, to understand incidents and facilitate learning and to provide feedback on actions taken to prevent recurrence.

Other Components of our Risk Management Arrangements

Other components of our governance framework which also assist in the management of risk are:



In particular Horizon Scanning by CXMT and internal audit will assist in identifying responsibility for new areas of risk

Monitoring and Reporting

Level 1 – Managers: Discussions are held with a selection of managers every 6 months to gain assurance that the principles are working in their areas. The conversation includes:

- Their perceptions of their current top risks
- Any new or changes in risk/opportunities they have identified

- c) Any mitigating actions they have taken recently to strengthen risk management arrangements
- d) Any incidents that have occurred and the lessons learnt/ actions taken as a consequence.

Level 2 – CXMT: A summary of these discussions is presented to the Chief Executive's Management Team where further topics being managed at the corporate level are noted. The top risks at the corporate level are agreed.

Level 3 – A&G: The top risks and incidents in the period are then presented to the next Audit and Governance Committee. Where appropriate, the manager involved in managing a key risk/incident also attends the Committee.

Annual Assurance on Arrangements

The Chief Executive's Assurance Group carries out an annual review of the effectiveness of the framework for identifying and managing risks and for performance and demonstrating accountability.

This includes a review of the Head of Internal Audit annual opinion on the adequacy and effectiveness of the Council's framework of governance, risk management and control.

Maintaining the Policy

This policy is not expected to be a static document and will be updated as implementation of the arrangements identifies a need for clarification, revision or expansion.

Appendix 1

Risk Leads/Experts for Cross Cutting Risks

Risk Subject	Risk Lead
Data Protection	Head of Democratic Services
Information Security	Head of Personnel and IT
Emergency Planning and Business Continuity	Head of Parking and Enforcement
Fraud and Corruption	Head of Finance and Audit
Governance	Head of Finance and Audit
Procurement	Head of Democratic Services (process) Fareham's Solicitor to the Council (compliance with the law)
Health and Safety of Employees	Head of Environmental Health
Health and Safety of the public	Relevant Head of Service in conjunction with Head of Environmental Health
Partnerships	Head of Corporate Services
Safeguarding	Head of Environmental Health
Trees	Head of Development Management

FAREHAM

BOROUGH COUNCIL

Report to Audit and Governance Committee

Date 13 March 2017

Report of: Director of Finance and Resources

Subject: TREASURY MANAGEMENT STRATEGY AND PRUDENTIAL
INDICATORS 2017-18

SUMMARY

Regulations require the Council to prepare and formally approve both an annual Treasury Management Strategy and Prudential Indicators. The document for 2017/18 is attached as Appendix A and was endorsed by the Executive on 6 February 2017 and submitted to Council for approval on 24 February 2017.

Main highlights in the Strategy are:

Capital Issues

- a) The level of capital expenditure estimated for 2017/18 is £30.4 million. We currently estimate that £19.7 million of this will be met by new borrowing.
- b) There will be an increase in the amount of council tax contributing to the cost of capital expenditure, due to new borrowing in 2016/17 and 2017/18.
- c) The Minimum Revenue Provision (MRP) policy statement has been amended to reflect assets that are held for less than 5 years. MRP will not be charged on these assets but the capital receipt generated by the sale of the asset will be used to repay the debt instead.

Treasury Management Issues

- d) The Council's treasury management advisers changed in 2016 to Arlingclose. The approved counterparty list has been amended to reflect Arlingclose's recommended layout.

- e) Unsecured bank limits per counterparty have reduced from £6 million to £2 million and the limit on money market funds has reduced from £6 million to £4 million per fund. This is to reflect the increasing risks and falling returns of short-term unsecured bank investments.
- f) Building Society limits have also changed from investments in all building societies with assets in excess of £5 billion to those only meeting the minimum credit rating criteria in the Strategy.

RECOMMENDATION

That the Treasury Management Strategy and Prudential Indicators for 2017/18, attached as Appendix A to this report, be noted by the Committee.

Background Papers: None

Reference Papers: None

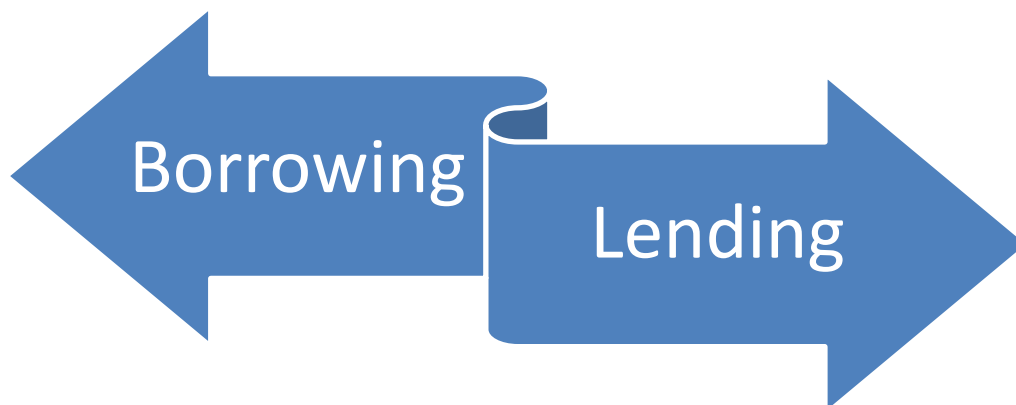
Enquiries:

For further information on this report please contact Caroline Hancock. (Ext 4589)

FAREHAM

BOROUGH COUNCIL

TREASURY MANAGEMENT STRATEGY AND PRUDENTIAL INDICATORS 2017/18



INTRODUCTION

WHAT IS TREASURY MANAGEMENT?

1. Treasury Management is defined as:

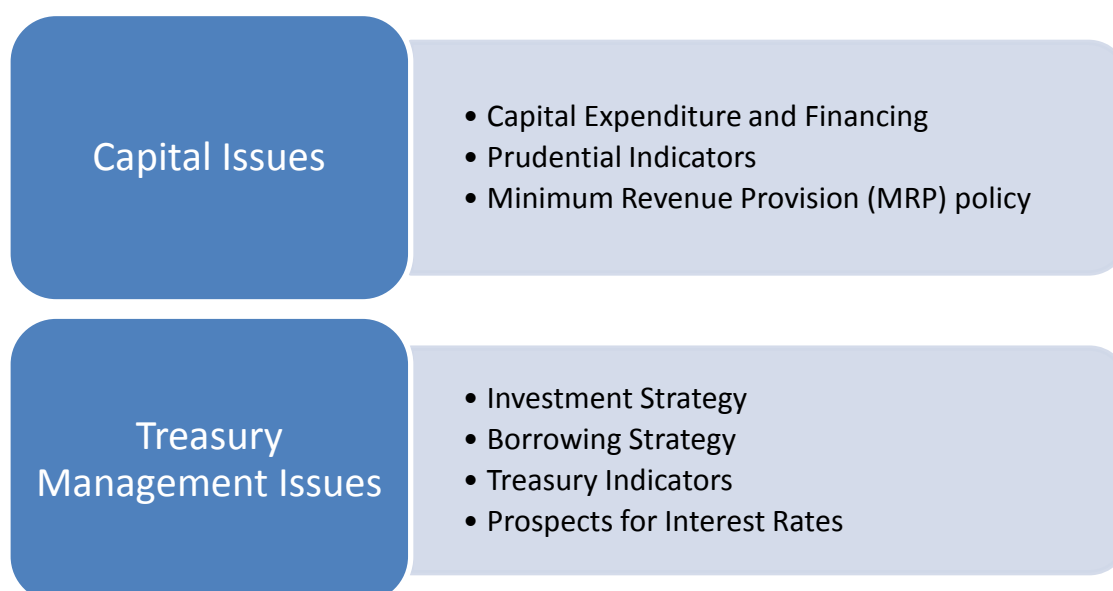
The management of the organisation's cash flows, its banking, money market and capital market transactions;

the effective control of the risks associated with those activities and the pursuit of optimum performance consistent with those risks.

2. The Council operates a balanced budget, which broadly means cash raised during the year will meet its cash expenditure. There are two aspects to the treasury management service:
 - a) To ensure the cash flow is adequately planned, with **cash being available when it is needed**. Surplus monies are invested in low risk counterparties or instruments commensurate with the Council's low risk appetite, providing adequate liquidity initially before considering investment return.
 - b) To ensure the cash flow meets the Council's **capital plans**. These capital plans provide a guide to the **borrowing need** of the Council. Essentially this is the longer term cash flow planning to ensure that the Council can meet its capital spending requirements. The management of longer term cash may involve arranging long or short term loans, or using longer term cash flow surpluses. On occasion any debt previously drawn may be restructured to meet Council risk or cost objectives.

CONTENT OF THE ANNUAL TREASURY MANAGEMENT STRATEGY

3. This strategy sets out the expected approach to treasury management activities for 2017/18 in light of the anticipated financial climate. It covers two main areas:



4. The content of the Strategy is designed to cover the requirements of the Local Government Act 2003, the CIPFA Prudential Code, the CIPFA Treasury Management Code and the DCLG Investment Guidance.

REPORTING REQUIREMENTS

5. The Council receives and approves three main reports each year in relation to Treasury Management, which incorporate a variety of policies, estimates and actuals. The three reports are:



6. The Executive Committee is responsible for the implementation and monitoring of these reports whilst the Audit and Governance Committee is responsible for the effective scrutiny of the treasury management strategy and policies.

TRAINING

7. The CIPFA Code requires the responsible officer to ensure that members with responsibility for treasury management receive adequate training in treasury management. This especially applies to members responsible for scrutiny.
8. Treasury management officers regularly attend training courses, seminars and conferences provided by the Council's treasury management advisors and CIPFA.

USE OF TREASURY MANAGEMENT CONSULTANTS

9. The Council has appointed Arlingclose as treasury management advisers and receives specific advice on investment, debt and capital finance issues.
10. The Council recognises that responsibility for treasury management decisions remains with the organisation at all times and will ensure that undue reliance is not placed upon our external service providers.
11. It also recognises that there is value in employing external providers of treasury management services in order to acquire access to specialist skills and resources. The Council will ensure that the terms of their appointment and the methods by which their value will be assessed are properly agreed and documented, and subjected to regular review.

CAPITAL ISSUES

CAPITAL EXPENDITURE AND FINANCING

12. The objectives of the CIPFA Prudential Code are to ensure that capital investment plans are **affordable**, **prudent** and **sustainable**, and that treasury decisions are taken in accordance with good professional practice.

PRUDENTIAL INDICATORS

13. The Council's capital expenditure plans are the key driver of treasury management activity. The output of the capital expenditure plans is reflected in the following **four** prudential indicators, which are designed to assist member's overview and confirm capital expenditure plans.

1) Level of Planned Capital Expenditure

This prudential indicator is a summary of the Council's capital expenditure plans and shows how these plans are being financed by capital or revenue resources.

Capital Expenditure and Financing	2016/17 Revised £'000	2017/18 Estimate £'000	2018/19 Estimate £'000	2019/20 Estimate £'000
Public Protection	0	0	0	0
Streetscene	543	311	0	0
Leisure and Community	5,407	797	120	0
Health and Housing	1,118	3,619	480	480
Planning and Development	478	13	13	14
Policy and Resources	21,587	20,850	1,520	770
Total General Fund	29,133	25,590	2,133	1,264
HRA	7,472	4,791	4,556	3,211
Total Expenditure	36,605	30,381	6,689	4,475
Capital Receipts	2,365	212	493	230
Capital Contributions	4,972	3,897	650	250
Capital Reserves	8,677	3,246	1,550	1,431
Revenue	2,484	3,344	3,696	2,564
Borrowing	18,107	19,682	300	0
Total Financing	36,605	30,381	6,689	4,475

2) The Council's Borrowing Need (Capital Financing Requirement)

This prudential indicator is the Council's Capital Financing Requirement (CFR). The CFR is the total historic outstanding capital expenditure which has not yet been paid for from either revenue or capital resources. It is essentially a measure of the Council's underlying borrowing need. Any capital expenditure financed by borrowing will increase the CFR.

The CFR does not increase indefinitely, as the minimum revenue provision (MRP) is a statutory annual revenue charge which broadly reduces the borrowing in line with the asset's life.

The CFR projections are as follows:

£'000	2016/17 Revised £'000	2017/18 Estimate £'000	2018/19 Estimate £'000	2019/20 Estimate £'000
General Fund	8,928	27,129	46,678	46,422
HRA	52,950	52,720	52,490	52,260
Total CFR	61,878	79,849	99,168	98,682

3) Financing Costs as % of Net Revenue Stream

This is an indicator of affordability and identifies the trend in the cost of capital (borrowing and other long term obligation costs net of investment income) against the net revenue stream.

The positive percentage for the Housing Revenue Account (HRA) reflects the net borrowing costs for the HRA settlement.

	2016/17 Revised	2017/18 Estimate	2018/19 Estimate	2019/20 Estimate
General Fund	-5%	-2%	-1%	-1%
HRA	14%	14%	14%	14%
Total	6%	8%	8%	8%

4) Incremental Impact of Capital Decisions on Council Tax and Housing Rents

This indicator shows the impact of capital decisions on council tax and housing rent levels. The incremental impact is the difference between the total revenue budget requirement of the current approved capital programme and the proposed capital programme to be approved during this budget cycle.

	2016/17 Revised	2017/18 Estimate	2018/19 Estimate	2019/20 Estimate
Council Tax Band D	£2.99	£4.53	£0.22	£0.05
Weekly Housing Rent Levels	£0.06	£0.15	£0.12	£0.04

HOUSING REVENUE ACCOUNT (HRA) RATIOS

- As a result of the HRA Reforms in 2012, the Council moved from a subsidy system to self-financing and was required to take on **£49.3 million** of debt. The table below shows additional local indicators relating to the HRA in respect of this debt.

	2016/17 Revised	2017/18 Estimate	2018/19 Estimate	2019/20 Estimate
HRA Debt £'000	49,268	49,268	49,268	49,268
HRA Revenues £'000	11,100	11,250	11,070	10,900
Number of HRA Dwellings	2,383	2,406	2,393	2,380
Ratio of Debt to Revenues %	4.43:1	4.38:1	4.45:1	4.52:1
Debt per Dwelling £	£20,675	£20,477	£20,588	£20,700

MINIMUM REVENUE PROVISION (MRP) POLICY STATEMENT

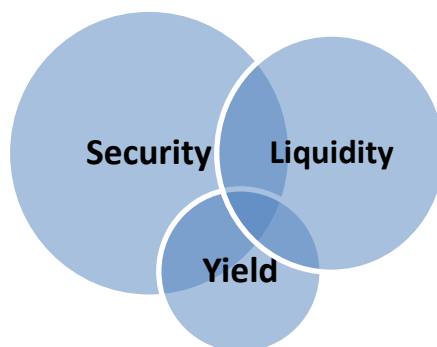
15. Where the Council finances capital expenditure by debt, it must **put aside resources to repay that debt** in later years. The amount charged to the revenue budget for the repayment of debt is known as **Minimum Revenue Provision (MRP)**.
16. The Council is required to set an annual policy on the way it calculates the prudent provision for the repayment of General Fund borrowing. The main policy adopted is that MRP will be determined by charging the expenditure over the **expected useful life** of the relevant assets on an **annuity basis** starting in the year after the asset becomes operational. This calculation will be reviewed on a case by case basis depending on the circumstances and with a view to minimising the impact on the council tax payer.
17. Where expenditure is on an asset which will be held on a short term basis (up to 5 years), no MRP will be charged. However, the capital receipt generated by the sale of the asset will be used to repay the debt instead.
18. No MRP will be charged in respect of assets held within the HRA, in accordance with DCLG Guidance and capital expenditure incurred during 2017/18 will not be subject to a MRP charge until 2018/19.

TREASURY MANAGEMENT ISSUES

INVESTMENTS

Investment Strategy

19. Both the CIPFA Code and DCLG Guidance require the Council to invest its funds prudently, and to have regard to the **security** and **liquidity** of its investments before seeking the highest rate of return, or **yield**.



20. The Council's objective when investing money is to strike an appropriate balance between **risk and return**, minimising the risk of incurring losses from defaults and the risk of receiving unsuitably low investment income. Where balances are expected to be invested for more than one year, the Council will aim to achieve a total return that is equal or higher than the prevailing rate of inflation, in order to maintain the spending power of the sum invested.
21. If the UK enters into a recession in 2017/18, there is a small chance that the Bank of England could set its Bank Rate at or below zero, which is likely to feed through to **negative interest rates** on all low risk, short-term investment options. This situation already exists in many other European countries. In this event, security will be measured as receiving the contractually agreed amount at maturity, even though this may be less than the amount originally invested.
22. Given the increasing risk and falling returns from short-term unsecured bank investments, the Council where practical and reasonable, aims to further diversify into more secure and/or higher yielding asset classes.

Approved Counterparties

23. 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
UK Govt	n/a	n/a	£Unlimited 50 years
AAA	£2m 5 years	£4m 20 years	£4m 50 years
AA+	£2m 5 years	£4m 10 years	£4m 25 years
AA	£2m 4 years	£4m 5 years	£4m 15 years
AA-	£2m 3 years	£4m 4 years	£4m 10 years
A+	£2m 2 years	£4m 3 years	£2m 5 years
A	£2m 13 months	£4m 2 years	£2m 5 years
A-	£2m 6 months	£4m 13 months	£2m 5 years

BBB+	£1m 100 days	£2m 6 months	£1m 2 years
None	£1m 6 months	n/a	£4m 25 years
Pooled Funds	£4m per fund		

24. Investment limits are set by 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.
25. Summary of counterparty types:
- a) **Banks Unsecured:** Accounts, deposits, certificates of deposit and senior unsecured bonds with banks and building societies. 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.
 - b) **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. The combined secured and unsecured investments in any one bank will not exceed the cash limit for secured investments.
 - c) **Government:** Loans, bonds and bills issued or guaranteed by national governments, regional and local authorities. 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.
 - d) **Pooled Funds:** Shares in diversified investment vehicles consisting of the any of the above investment types, plus equity shares and property. These funds have the advantage of providing wide diversification of investment risks, coupled with the services of a professional fund manager in return for a fee. Short-term Money Market Funds that offer same-day liquidity and very low or no volatility will be used as an alternative to instant access bank accounts, while pooled funds whose value changes with market prices and/or have a notice period will be used for longer investment periods.
26. The Council may also invest its surplus funds in corporates (loans, bonds and commercial paper issued by companies other than banks) and 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), subject to meeting the minimum credit rating criteria and time limits recommended by the Council's treasury advisers.

Risk Assessment and Credit Ratings

27. Credit ratings are obtained and monitored by the Council's treasury advisers, 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 recalled or sold 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.
28. Where a credit rating agency announces that a credit 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 only investments that can be withdrawn on the next working day 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.

Other Information on the Security of Investments

29. 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, information on potential government support 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 credit rating criteria.
30. The following **internal measures** are also in place:
- Investment decisions formally recorded and endorsed using a Counterparty Decision Document.
 - Monthly officer reviews of the investment portfolio and quarterly reviews with the Chief Executive Officer.
31. Where cash flows determine it necessary, the **Council's bankers, NatWest**, (part of the RBS group) will be used on **an unlimited basis**. If their credit quality is reduced, the Council will continue to use their banking services but no investments will be placed with them.

Specified Investments

32. The CLG Guidance defines specified investments as those:
- 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:
 - a) the UK Government,
 - b) a UK local authority, parish council or community council, or
 - c) a body or investment scheme of "**high credit quality**".
33. 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.

Non-specified Investments

34. 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 that are defined as capital expenditure by legislation, such as company shares. Non-specified investments will therefore be limited to **long-term investments**, i.e. those that are due to mature 12 months or longer from the date of arrangement, and investments with bodies and **schemes not meeting the definition on high credit quality**. Limits (per counterparty) on non-specified investments are shown in the table below.

	Cash limit
Total long-term investments	£4m
Total investments without credit ratings or rated below A-	£2m
Total investments (except pooled funds) with institutions domiciled in foreign countries rated below AA+	£2m
Total non-specified investments	£10m

Investment Limits

35. The Council’s revenue reserves available to cover investment losses are forecast to be £16 million on 31st March 2017. In order to minimise 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 £4 million. A group of banks under the same ownership will be treated as a single organisation for limit purposes. Limits will also be placed on fund managers, investments in brokers’ nominee accounts, foreign countries and industry sectors as below.

	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
Negotiable instruments held in a broker’s nominee account	£10m per broker
Foreign countries	£4m per country
Unsecured investments with Building Societies	£2m in total
Money Market Funds	£20m in total

Liquidity Management

36. The Council uses a purpose-built cash flow forecasting spreadsheet to determine the maximum period for which funds may prudently be committed. The forecast is compiled on a prudent basis to minimise the risk of the Council being forced to borrow on unfavourable terms to meet its financial commitments. Limits on long-term investments are set by reference to the Council's medium term financial plan and cash flow forecast.

Investment Treasury Indicator and Limit

37. Total principal funds invested for greater than 364 days. These limits are set with regard to the Council's liquidity requirements and are based on the availability of funds after each year-end.

£M	2016/17 Revised	2017/18 Estimate	2018/19 Estimate	2019/20 Estimate
Principal sums invested > 364 days	17	2	2	3

BORROWING

Current Portfolio Position

38. The Council's treasury portfolio position at 31 March 2016, with forward projections are summarised below. The table shows the actual external borrowing (the treasury management operations), against the capital borrowing need (the Capital Financing Requirement), highlighting any under or over borrowing.

£'000	2016/17 Revised	2017/18 Estimate	2018/19 Estimate	2019/20 Estimate
Debt at 1 April	44,826	45,626	65,308	65,608
Expected change in debt	800	19,682	300	0
Gross Debt at 31 March	45,626	65,308	65,608	65,608
Capital Financing Requirement (CFR)	61,878	79,849	99,168	98,682
Under/(Over) Borrowing	16,252	14,541	22,560	33,076
CFR for last, current and next 2 years	339,577	375,558	392,712	389,657

39. The Council is currently maintaining **an under-borrowed position**. This means that the capital borrowing need (the Capital Financing Requirement), has not been fully funded with loan debt as cash supporting the Council's reserves, balances and cash flow has been used as a temporary measure.
40. Within the prudential indicators there are a number of key indicators to ensure that the Council operates its activities within well-defined limits. One of these is that the Council needs to ensure that its gross debt does not, except in the short term, exceed the total of the CFR in the preceding year plus the estimates of any additional

CFR for 2017/18 and the following two financial years.

41. The Council complied with this prudential indicator in the current year and does not envisage difficulties for the future. This view takes into account current commitments, existing plans and the proposals in the budget report.

Treasury Indicators: Limits to Borrowing Activity

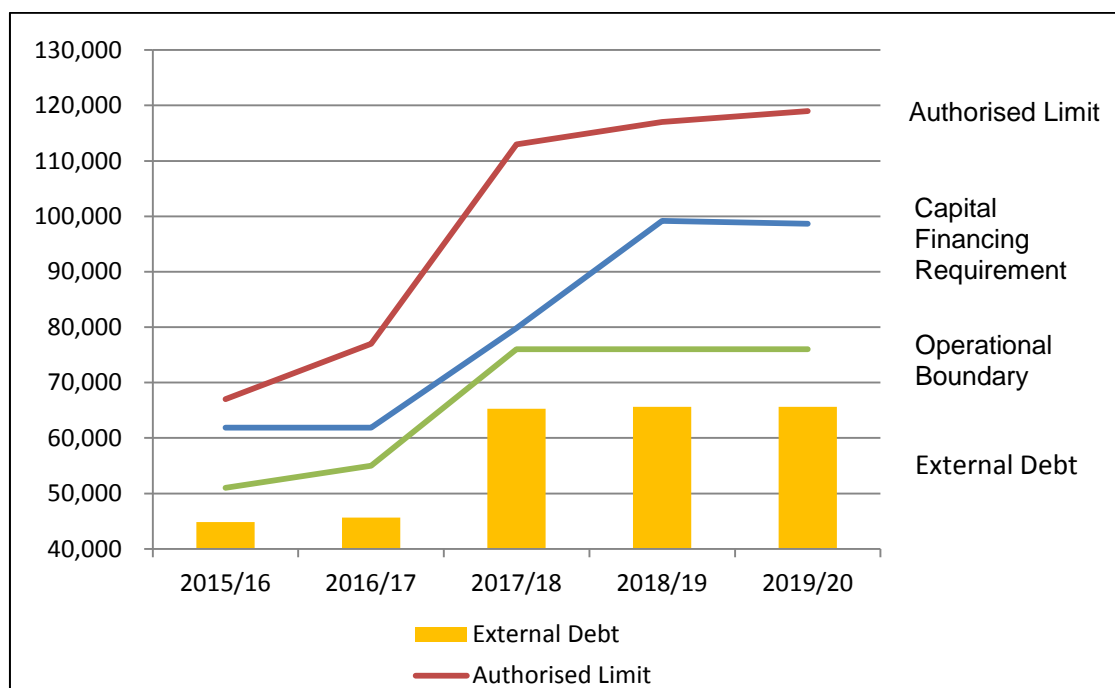
42. The treasury indicators includes two limits to borrowing activity:

- 1) The **operational boundary** is based on the Council's estimate of the most likely (i.e. prudent but not worst case) scenario for external debt. This is the limit beyond which external borrowing is not normally expected to exceed. In most cases, this would be a similar figure to the CFR, but may be lower or higher depending on the levels of actual borrowing.
- 2) 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.

43. The limits are:

£'000	2016/17 Revised	2017/18 Estimate	2018/19 Estimate	2019/20 Estimate
Operational Boundary				
Borrowing	50,000	70,000	70,000	70,000
Other long term liabilities	5,000	6,000	6,000	6,000
Total	55,000	76,000	76,000	76,000
Authorised Limit				
Borrowing	70,000	105,000	109,000	111,000
Other long term liabilities	7,000	8,000	8,000	8,000
Total	77,000	113,000	117,000	119,000

44. The graph below shows the projections for the CFR and borrowing limits:



45. Separately, the Council is also limited to a maximum HRA CFR through the HRA self-financing regime. This limit is currently:

£'000	2016/17 Revised	2017/18 Estimate	2018/19 Estimate	2019/20 Estimate
HRA Debt Cap	56,851	56,851	56,851	56,851
HRA CFR	52,951	52,721	52,491	52,261
HRA Headroom	3,900	4,131	4,360	4,590

Borrowing Strategy

46. The Council's main objective when borrowing money is to strike an appropriately low risk balance between **securing low interest costs** and achieving **certainty of those costs** over the period for which funds are required. The flexibility to renegotiate loans should the Council's long-term plans change is a secondary objective.
47. The Council has been in a debt free position for the General Fund for many years mainly due to having sufficient capital reserves to meet the Council's capital programme. However this position will change over the coming years as borrowing is required for large capital schemes at Daedalus and new property investment opportunities.
48. With short-term interest rates currently much lower than long-term rates, it is likely to be more cost effective in the short term to either **use internal resources**, or to **borrow short-term** loans instead.
49. By doing so, the Council is able to reduce net borrowing costs (despite foregone investment income) and **reduce overall treasury risk**. The benefits of internal borrowing or short term borrowing will be monitored regularly against the potential for incurring additional costs by deferring borrowing into future years when long-

term borrowing rates are forecast to rise modestly.

50. Our treasury advisors will assist the Council with this '**cost of carry**' and breakeven analysis. Its output may determine whether the Council borrows additional sums at long-term fixed rates in 2017/18 with a view to keeping future interest costs low, even if this causes additional cost in the short-term.
51. Alternatively, the Council may arrange forward starting loans during 2017/18, where the interest rate is fixed in advance, but the cash is received in later years. This would enable certainty of cost to be achieved without suffering a cost of carry in the intervening period.
52. In addition, the Council may borrow short-term loans (normally for up to one month) to cover unexpected cash flow shortages.

Sources of Borrowing

53. The approved sources of long-term and short-term borrowing are:
 - Public Works Loan Board (PWLB) and any successor body.
 - Any institution approved for investments, including other local authorities.
 - Any other bank or building society authorised to operate in the UK.
 - UK public and private sector pension funds (except the Hampshire County Council Pension Fund).
 - Capital market bond investors.
 - UK Municipal Bonds Agency plc and other special purpose companies created to enable local authority bond issues.
54. 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
55. The Council has previously raised all of its long-term borrowing from the PWLB but it will investigate other sources of finance, such as local authority loans and bank loans that may be available at more favourable rates.

Borrowing in Advance of Need

56. The Council may, from time to time, borrow in advance of 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.

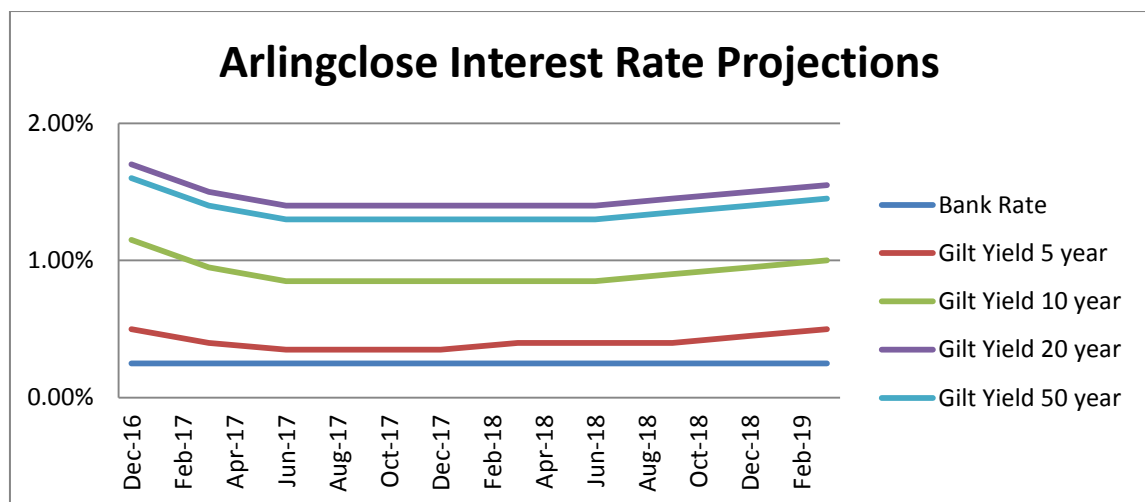
57. The total amount borrowed will not exceed the authorised borrowing limit of £77 million. The maximum period between borrowing and expenditure is expected to be two years, although the Council is not required to link particular loans with particular items of expenditure

Debt Rescheduling

58. 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 cost saving or a reduction in risk.

PROSPECTS FOR INTEREST RATES

59. The Council's Treasury Management Consultants assist the Council to formulate a view on interest rates. The latest detailed economic and interest rate forecast provided by Arlingclose is attached at Annex A.
60. The following graph and commentary gives the Arlingclose's central view on interest rates and economic update.



61. Globally, the outlook is uncertain and risks remain weighted to the downside. The UK domestic outlook is uncertain, but likely to be weaker in the short term than previously expected.
62. The likely path for Bank Rate is weighted to the downside. The Arlingclose central case is for Bank Rate to remain at 0.25%, but there is a 25% possibility of a drop to close to zero, with a very small chance of a reduction below zero.
63. 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.

TREASURY MANAGEMENT LIMITS ON ACTIVITY

64. There are **three** debt related treasury activity limits. The purpose of these are to restrain the activity of the treasury function within certain limits, thereby managing risk and reducing the impact of any adverse movement in interest rates. However, if these are set to be too restrictive they will impair the opportunities to reduce costs and improve performance. The indicators are:

- Upper limits on **variable interest rate exposure**. This identifies a maximum limit for variable interest rates based upon the debt position net of investments;
- Upper limits on **fixed interest rate exposure**. This is similar to the previous indicator and covers a maximum limit on fixed interest rates;
- **Maturity structure of borrowing**. These gross limits are set to reduce the Council's exposure to large fixed rate sums falling due for refinancing, and are required for upper and lower limits.

65. The treasury indicators and limits are:

Upper limits on interest rate exposures	2016/17	2017/18	2018/19	2019/20
	%	%	%	%
- Upper limit on variable interest rate exposures	25	25	25	25
- Upper limit on fixed interest rate exposures	100	100	100	100
Maturity structure of borrowing	Upper Limit			
	%	%	%	%
- Loans maturing within 1 year	25	25	25	25
- Loans maturing within 1 - 2 years	25	25	25	25
- Loans maturing within 2 - 5 years	25	25	25	25
- Loans maturing within 5 - 10 years	50	50	50	50
- Loans maturing in over 10 years	100	100	100	100

Other Items

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

67. **Policy on Use of Financial Derivatives:** The Council will only use standalone financial derivatives (such as swaps, forwards, futures and options) where they can be clearly demonstrated to reduce the overall level of the financial risks that the Council is exposed to. Additional risks presented, such as credit exposure to derivative counterparties, will be taken into account when determining the overall level of risk. Embedded derivatives, including those present in pooled funds and forward starting transactions, will not be subject to this policy, although the risks

they present will be managed in line with the overall treasury risk management strategy.

68. 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.
69. **Policy on Apportioning Interest to the HRA:** On 28th March 2012, the Council borrowed £40 million from the Public Works Loan Board (PWLB) to buy itself out of the HRA subsidy System. The monies were borrowed by the General Fund on behalf of the HRA. The interest on these loans is charged to the HRA on a half-yearly basis at the rate charged by PWLB. A further £9.268 million was lent by the General Fund to the HRA to complete the buyout. Interest on this element is charged at the average weighted rate of the PWLB loans.
70. The unfunded HRA capital financing requirement is also charged to the HRA at the average weighted rate of the PWLB loans.
71. The General Fund credits the HRA with interest earned on HRA credit balances calculated on the monthly movement in reserve balances and applied at year end. The rate used is the weighted interest rate on General Fund investments and cash balances.
72. **Financial Implications:** The budget for investment income in 2017/18 for the General Fund is £499,900 and the HRA is £118,000 and the budget for debt interest paid in 2017/18 is £1.86 million for the HRA. If actual levels of investments and borrowing, and actual interest rates differ from those forecast, performance against budget will be correspondingly different.

EXTERNAL CONTEXT BY ARLINGCLOSE

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 has priced in a high probability of the Federal Reserve increasing interest rates in December 2016. 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. With challenges such as immigration, the rise of populist, anti-establishment parties and negative interest rates resulting in savers being paid nothing for their frugal efforts or even penalised for them, the outcomes of Italy's referendum on its constitution (December 2016), the French presidential and general elections (April – June 2017) and the German federal elections (August – October 2017) have the potential for upsets.

Credit Outlook

Markets have expressed concern over the financial viability of a number of European banks recently. 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 possibility, to keep long-term interest rates low.

Underlying assumptions:

- The medium term outlook for the UK economy is dominated by the negotiations to leave the EU. The long-term position of the UK economy will be largely dependent on the agreements the government is able to secure with the EU and other countries.
- The global environment is also riddled with uncertainty, with repercussions for financial market volatility and long-term interest rates. Donald Trump's victory in the US general election and Brexit are symptomatic of the popular disaffection with globalisation trends. The potential rise in protectionism could dampen global growth prospects and therefore inflation. Financial market volatility will remain the norm for some time.
- However, following significant global fiscal and monetary stimulus, the short term outlook for the global economy is somewhat brighter than earlier in the year. US fiscal stimulus is also a possibility following Trump's victory.
- Recent data present a more positive picture for the post-Referendum UK economy than predicted due to continued strong household spending.
- Over the medium term, economic and political uncertainty will likely dampen investment intentions and tighten credit availability, prompting lower activity levels and potentially a rise in unemployment.
- The currency-led rise in CPI inflation (currently 1.0% year/year) will continue, breaching the target in 2017, which will act to slow real growth in household spending due to a sharp decline in real wage growth.

- The depreciation in sterling will, however, assist the economy to rebalance away from spending. The negative contribution from net trade to GDP growth is likely to diminish, largely due to weaker domestic demand. Export volumes will increase marginally.
- Given the pressure on household spending and business investment, the rise in inflation is highly unlikely to prompt monetary tightening by the Bank of England, with policymakers looking through import-led CPI spikes to the negative effects of Brexit on economic activity and, ultimately, inflation.
- Bank of England policymakers have, however, highlighted that excessive levels of inflation will not be tolerated for sustained periods. Given this view and the current inflation outlook, further monetary loosening looks less likely.

FAREHAM

BOROUGH COUNCIL

Report to Audit and Governance Committee

Date **13 March 2017**

Report of: **Head of Finance and Audit**

Subject: **INTERNAL AUDIT ANNUAL PLAN 2017/18**

SUMMARY

This report presents a draft plan of Internal Audit Work for delivery in 2017/18, for approval.

RECOMMENDATION

That the draft plan for 2017/18, as attached as [Appendix A](#) be approved.

INTRODUCTION

1. In March 2015, the Audit and Governance Committee approved a new Internal Audit Strategy which set out the principles to be used to set the Annual Plan of Internal Audit work.
2. In particular these included:
 - a) **Sources of Assurance:** The Annual Head of Audit's Opinion will take into account the findings from: a) individual audit opinion work, b) wider audit work and c) assurance available from other providers. The proportion of time spent on wider work will increase to allow more time to be spent getting to the root cause of problems and helping develop a solution.
 - b) **Minimum Audit Level:** The amount of individual audit opinion work carried out is not to fall below 173 days a year, and at least 20 discrete pieces of opinion or wider work will be delivered a year.
 - c) **High Risk Audits:** The opinion on all fundamental financial systems will be refreshed every 3 years. It should be noted that as from 2017/18 the external auditors no longer require annual coverage of the Payroll system and Accounts Payable system. Audit areas that are considered to be inherently High Risk will be given an audit opinion at least every 5 years. The plan each year will also include computer audit work and corporate level audit work or contract audit work.
3. A draft plan of Internal Audit Work for 2017/18 has been collated using these principles, and following discussions with the service managers of the Council.

DRAFT PLAN FOR 2017/18

4. The draft plan prepared for 2017/18 is shown in [Appendix A](#). The following should be noted:
 - (a) **Level of Opinion Audit:** There is provision in the plan for 192 days of individual audit opinion work plus an additional contingency of 35 days for the in-house team to support these audits. This contingency is lower than in previous years as a result of the partnership arrangements proposed.
 - (b) **Number of Assignments:** There are 21 discrete pieces of work included in the plan covering a variety of audit types and departments in the Council. This represents approximately 14% of the Audit Universe. There will also be reactive pieces of work completed in the year which will be used to support the Annual Audit Opinion.
 - (c) **Vanguard Reviews:** One of the areas of work in the plan relates to a service that has recently been the subject of a vanguard intervention.

RESOURCING THE PLAN

5. The plan will be delivered by a mixture of in-house audit and finance resources and partnership resources from a neighbouring Council. This arrangement is the subject of a separate report. The partnership resource will particularly focus on the Opinion work to strengthen the independence of the assurance provided.

6. One of the audits in the plan will also be providing assurance for Gosport Borough Council as part of their annual plan. The Gosport and Fareham Internal Audit teams will therefore be delivering this work jointly to reduce the costs to each Council.

RISK ASSESSMENT

7. The Council has a statutory requirement to carry out internal audits of services and systems. Delivery of this plan will therefore mitigate the risk of non-compliance.

Background Papers: None

Reference Papers:

Chartered Institute of Public Finance and Accountancy (CIPFA) 2013 – Local Government Application Note for the United Kingdom Public Sector Internal Audit Standards.

Report to Audit and Governance Committee on the Public Sector Internal Audit Standards and Internal Audit Charter on 25th November 2013

Report to Audit and Governance Committee on the Internal Audit Strategy and Annual Plan on 16th March 2015

Enquiries:

For further information on this report please contact Elaine Hammell. (Ext 4344)

Appendix A - Draft Internal Audit Plan for 2017/18

	Type	Title	Days
	OPINION WORK		
1	Fundamental System	Main Accounting System and Budgetary Control	11
2	Fundamental System	Accounts Receivable	15
3	Fundamental System	Housing Benefits	10
4	Fundamental System	Income Management	12
5	Corporate / Contract	Leisure Centre Contracts	10
6	Computer – application review	Chipside (Parking Management System)	12
7	Computer – data analytics	Multiple Parking Permits at Single Person Discount Properties	3
8	Services and Systems - High Risk Computer – application review	Ferneham Hall including Databox	20
9	Services and Systems - High Risk	Commercial Estates	15
10	Services and Systems - High Risk	Property Maintenance and Inspections - Council Buildings (Non Housing)	15
11	Services and Systems - High Risk	Developers Contributions	15
12	Services and Systems – High Risk	Homelessness (V)	15
13	Services and Systems - Other	Dog and Pest Control	12
14	Services and Systems - Other	Street Furniture	5
15	Services and Systems - Other	Pensions	10
	Contingency		15
	In-house support		35
	Total Opinion Work		230

Reason for Inclusion in Plan
Fundamental system last audited in 2013/14. It was not included in the plan last year to make way for the Banking audit; there had been more fundamental changes to the banking system so that was made the priority.
Fundamental system last audited 2014/15.
Fundamental system last audited 2014/15.
Fundamental system last audited 2014/15.
Holly Hill Leisure Centre now open, so need to give assurance on the contract and actual arrangements for the operation of the centre. The contract also covers Fareham Leisure Centre so both will be covered.
Significant IT system for Cyclical Coverage. No previous opinion given.
Pilot audit to include more proactive fraud work and computer data analytics into the audit plan.
High Risk on basis of gross expenditure and gross income. Last audited 2013/14.
High risk on basis of gross income. New income streams to be covered including Daedalus and investment properties. Last opinion given 2012/13.
High Risk audit on basis of gross expenditure and capital expenditure. Last audited 2012/13.
High Risk audit on basis of reputation risk and penalties that can be incurred.
High Risk audit on basis of gross expenditure and gross income. Last audited 2013/14. Has undergone a vanguard intervention.
Manager request to update assurance opinion following changes to the service and to carry out some analyses to help inform the future decisions. Last audited 2012/13. No opinion for dog control. Joint Assurance for Gosport BC.
Low risk audit chosen as no previous audit opinion.
No previous audit opinion and very little other coverage of this process in previous audit plans. Coverage will be the FBC role as an employer.

	WIDER WORK		
16	Thematic Review	IT Procurement and budgets	
17	Joint Working Project – Corporate System	Employee Performance Management	
18	Joint Working Project	Data Protection	
19	Joint Working Project – Corporate System	Contract Procedure Rules	
20	Thematic Review	Risk Inspections of Public Areas	
21	Joint Working Project	Use of depot storage areas and security of plant, equipment and materials.	

Targeted review of how budgets for IT costs are allocated in the accounts, plus a review of how procurement decisions are made and implemented.
Joint project with service to carry out a post implementation review of the revised process. Action for the Annual Governance Statement. Audit postponed from 2016/17.
Annual coverage of key governance system to support the Information Governance Opinion.
Overdue update of policy, which needs to be developed to reflect new culture and way of working.
Manager request for cross cutting work to review ownership of public areas and the inspection regimes in place
Manager request for joint work to review the hazards and security risks associated with storage at the depot

FAREHAM

BOROUGH COUNCIL

Report to Audit and Governance Committee

Date **13 March 2017**

Report of: **Head of Finance and Audit**

Subject: **QUARTERLY AUDIT REPORT**

SUMMARY

This report provides the assurances arising from the latest internal audit work and gives an update on progress being made with the delivery of the audit plans.

RECOMMENDATION

That the Committee notes the progress and findings arising from Internal Audit work.

INTRODUCTION

1. This report highlights the progress made to date on the delivery of the Internal Audit Plans and the assurances that can be obtained from the work now completed.

FINALISING PREVIOUS AUDIT PLANS

2. The current status of the 6 audits remaining from the previous Audit Plans is detailed in [Appendix One](#) . Further work has been carried out on 2 of these which are close to be finalised.

DELIVERY OF 2016/17 AUDIT PLAN

3. There has been one change to the current plan since the last meeting. This has been the postponement of the Employee Performance Management audit to make time available to carry out some work on the Building Services invoice and stock process.
4. Significant progress has now been made to deliver the rest of the plan as detailed in [Appendix Two](#) and a further five audits have now reached the final report stage.

FINDINGS FROM COMPLETED AUDITS

5. The five latest final reports that have been issued are listed below with the opinions given and number of recommendations made:

Audit	Assurance Opinion	Recommendations Made		
		New Essential	New Important	Outstanding Previous Essential or Important
Treasury Management 2016/17	Strong	-	2	-
Accounts Payable 2016/17	Strong	-	1	-
Trade Waste and Recycling 2016/17	Strong	-	-	-
Banking 2016/17	Reasonable	-	2	-
Risk Management Approach 2016/17	N/A	-	-	-

6. Detail of the recommendations made and the actions to be taken is provided in [Appendix Three](#). The revised policy arising from the Risk Management work is the subject of a separate report on the agenda.

RISK ASSESSMENT

7. There are no significant risk considerations in relation to this report

Appendices

Appendix One - Update on Outstanding Audits from Previous Plans

Appendix Two - Audits in the 2016/17 Audit Plan

Appendix Three - Findings from the Latest Completed Audits

Appendix Four - Reference Tables

Background Papers: None

Reference Papers:

Report by the Director of Finance and Resources to the Audit and Governance Committee on 10 March 2014 on the Contractor Annual Audit Plan 2014/15

Report by the Director of Finance and Resources to the Audit and Governance Committee on 16 March 2015 on the Internal Audit Strategy and Annual Audit Plan 2015/16

Report by the Head of Finance and Audit to the Audit and Governance Committee on 14 March 2016 on the Internal Audit Plan 2016/17

Enquiries:

For further information on this report please contact Elaine Hammell. (Ext 4344)

APPENDIX ONE

Update on Outstanding Audits from Previous Plans

The following table shows those audits that were outstanding in the last quarterly report and shows the current position with finalising the work.

Audit Title	Type of Audit**	Days in Plan	Stage reached of 10*	Assurance Opinion*	New Recommendations*			Previous Recs. (E and I only)		
					Essential	Important	Advisory	Implemented	Cancelled	Not Implemented
2014/15										
Income Collection & Banking	Fundamental	15	Stage 8							
Information Governance Opinion	Computer	6	Stage 8							
Contract Completion	Corporate, Specialist, Governance	10	Stage 8							
2015/16										
Recruitment and Selection	Corporate, Specialist, Governance (V)	15	Stage 9							
Land Charges	Service and Systems – HR	12	Stage 8							
Contract Deeds Management	Thematic Review	15	Not started							

* A key to the information in this column is given in Appendix 4.

** V denotes this audit was covering a service which had been subject to a Vanguard intervention

APPENDIX TWO

Audits in the 2016/17 Plan

No.	Audit Title	Type of Audit	Days in Plan	Stage reached of 10*	Assurance Opinion*	New Recommendations*			Previous Recs. (E and I only)		
						Essential	Important	Advisory	Implemented	Cancelled	Not Implemented
OPINION AUDITS											
1	Banking - new	Fundamen- tal System	10	Stage 10	Reasonable	-	2	2	-	-	-
2	Treasury Management - new		10	Stage 10	Strong	-	2	3	-	-	-
3	Housing Rents		15	Stage 4							
4	Accounts Payable - new		10	Stage 10	Strong	-	1	-	1	-	-
5	Payroll & Employee Expenses		10	Stage 4							
6	Sheltered Housing	Service and Systems – High Risk	15	Stage 5							
7	Trade Waste and Recycling - new		15	Stage 10	Strong	-	-	1	-	-	-
8	Building Control		15	Stage 9							
9	Daedalus Project		12	Stage 4							
10	Outdoor Sport and Recreation		15	Stage 5							
11	Neighbourhood Working, Public Relations & Consultation	Service and Systems - Other	10	Stage 10	Strong	-	-	3	-	-	-
12	Air Quality & Pollution (V)		15	Stage 5							
13	Countryside Management		8	Stage 5							
14	Technology Forge	Computer	15	Stage 4							
15	Cloud Based Computing		15	Stage 6							
	Contingency		10								
	In-house team support		50								
	Total Planned Time		250								
WIDER WORK											

No.	Audit Title	Type of Audit	Days in Plan	Stage reached of 10*	Assurance Opinion*	New Recommendations*			Previous Recs. (E and I only)		
						Essential	Important	Advisory	Implemented	Cancelled	Not Implemented
16	Leaseholder Charges	Joint working project		Stage 4							
17	Building Health and Safety Risks	Follow Up / Joint working project		Stage 4							
18	Data Protection	Joint working project		Stage 4							
	Employee Performance Management	Joint Working Project - Corporate System		Postponed							
19	Risk Management Approach - new	New Process		Stage 10	N/A	-	-	-	-	-	-
20	Effectiveness of Ethics related activities (part 2 – physical security)	Thematic Review		Stage 4							
21	Building Service Invoicing and Stock Control (new)	Service and Systems - Other		Stage 4							

Findings from the Latest Completed Audits

APPENDIX THREE

Audit Title	Treasury Management	Overview of Subject: Treasury Management's activities are defined as 'The management of the organisation's cash flows, its banking, money market and capital market transactions; the effective control of the risks associated with those activities; and the pursuit of optimum performance consistent with those risks.' This audit reviews the treasury management processes in use, with particular focus on controls over making investments and taking out loans
Year of Audit	2016/17	
Type of Work	Opinion audit	
Assurance Opinion Given	Strong	
Direction of Travel	↔ 2013/14	

Areas of Scope	Adequacy and Effectiveness of Controls		New Recommendations Raised			Previous Rec Implementation (E and I only)		
			Essential (🔴)	Important (🟡)	Advisory (🟢)	Implemented	Cancelled	Not Implemented
Treasury Management Strategy & Policy			-	-	1	-	-	-
Levels, Limits & Institutions			-	-	-	-	-	-
Compliance with Strategy			-	-	-	-	-	-
Investment & Borrowing Records			-	-	-	-	-	-
Authorisation Limits			-	-	1	-	-	-
Interest Receipts			-	-	-	-	-	-
Reporting			-	-	-	-	-	-
Cash Flow Monitoring			-	-	-	-	-	-
Contracts with Brokers & Advisers			-	1	-	-	-	-
Money Market Fund Controls			-	-	-	-	-	-
Rollover Loans/Investments			-	-	-	-	-	-
Borrowing			-	1	-	-	-	-
Contingency Planning			-	-	-	-	-	-
Declaration of Interests			-	-	1	-	-	-

Weaknesses identified during the audit and the proposed action (Essential and Important only)	
Important	Contract with Treasury Management Advisers – The form of the agreement with the advisers for the provision of treasury management services does not contain a formal dispute resolution path to follow should there be an issue with the quality of the service. Also if FBC wanted to terminate the contract there are no defined methods or clauses that specify under what conditions this can occur. Work is proposed to strengthen the nature of the contract.
Important	Borrowing Decision Document - A document similar to the Counterparty Decision Document used for investments needs to be created to provide an audit trail and sign off of borrowing decisions.

Audit Title	Accounts Payable	Overview of Subject: This audit covers the procedures the Council uses to order goods and services and pay invoices due to the supplier or contractor. Approximately 9,000 trade supplier invoices are processed a year.
Year of Audit	2016/17	
Type of Work	Opinion audit	
Assurance Opinion Given	Strong	
Direction of Travel	↑2015/16	

Areas of Scope	Adequacy and Effectiveness of Controls		New Recommendations Raised			Previous Rec Implementation (E and I only)		
			Essential (🔴*)	Important (🟡▲)	Advisory (🟢Ⓜ)	Implemented	Cancelled	Not Implemented
Annual Coverage								
Approval of Purchase Orders and Yellow Sticker Payments			-	-	-	-	-	-
Goods Receipting and Invoice Payment			-	-	-	-	-	-
Coding of Expenditure			-	-	-	-	-	-
Reconciliation of Invoice Batches & Payment Runs			-	-	-	-	-	-
New Suppliers & Supplier Bank Account Changes			-	-	-	1	-	-
Cyclical Coverage								
Payments by BACS (including on-line BACS)			-	-	-	-	-	-
Manual / Urgent Payments			-	-	-	-	-	-
Aged Creditor Management			-	1	-	-	-	-
Control of POPs Advances			-	-	-	-	-	-

Weaknesses identified during the audit and the proposed action (Essential and Important only)	
Important	<p>Monitoring of Aged Suppliers: The aged suppliers report highlights accounts that have been in debit (monies due to the supplier) or credit (monies due to the Council) for a period of time. Although a weekly report was being produced and was being reviewed by the Management and Financial Accounting Manager, the Finance Officer was not actively investigating all the entries on the report to get them resolved. This has now been addressed and monitoring is being actively carried out.</p>

Audit Title	Trade Waste	Overview of Subject: Waste Savers is the FBC business waste and recycling service. Trade waste has been collected in Fareham for over 40 years and the recycling service began in 2009. It is at businesses' discretion as to whether they use the service or not. At the time of audit, FBC had 934 live trade waste customers. Trade waste agreements have increased on average by 5% per annum since 2013 and the gross income generated in 2015/16 was approximately £730,000.
Year of Audit	2016/17	
Type of Work	Opinion audit	
Assurance Opinion Given	Strong	
Direction of Travel	↔ 2011/12	

Areas of Scope	Adequacy and Effectiveness of Controls		New Recommendations Raised			Previous Rec Implementation (E and I only)		
			Essential (🔴)	Important (🟡)	Advisory (🟢)	Implemented	Cancelled	Not Implemented
New Customer Administration			-	-	-	-	-	-
Direct Debit Process			-	-	-	-	-	-
Fees and Charging			-	-	-	-	-	-
Debt Monitoring			-	-	-	-	-	-
Issue of Waste Transfer Notices			-	-	-	-	-	-
Departing Customers			-	-	-	-	-	-
Income and Disposal Costs Budgeting and Monitoring			-	-	1	-	-	-
Scheduling of collections & Vehicle Tracking			-	-	-	-	-	-

Audit Title	Banking	Overview of Subject: The Council has its bank accounts with NatWest. There are two main accounts - the BP account (income) and the No 1 account (expenditure) and four other accounts. The Council utilises an online banking system (Bankline) which requires at least two authorised officers to make changes to user rights. Users use a smartcard, Card reader and passwords to log onto online banking.
Year of Audit	2016/17	
Type of Work	Opinion audit	
Assurance Opinion Given	Reasonable	
Direction of Travel	↔ 2004/05	

Areas of Scope	Adequacy and Effectiveness of Controls		New Recommendations Raised			Previous Rec Implementation (E and I only)		
			Essential (🔴)	Important (🟡)	Advisory (🟢)	Implemented	Cancelled	Not Implemented
Maintaining Bank Mandate			-	-	-	-	-	-
Monitoring Bank Charges			-	-	-	-	-	-
Reconciliations			-	1	-	-	-	-
Procurement/Value for Money of Banking Services			-	1	-	-	-	-
Access control to On-Line Banking			-	-	1	-	-	-
Transfers Between Bank Accounts			-	-	1	-	-	-
Unidentified Cash Receipts			-	-	-	-	-	-

Weaknesses identified during the audit and the proposed action (Essential and Important only)	
Important	Documentation of Reconciliations - Testing identified some improvements that could be made to the documentation of some of the bank reconciliations that are undertaken. This included inconsistencies in the records of the person carrying out the reconciliation and the date it was completed, documentation of the independent review of the completed reconciliations, retaining evidence of balances at the time of the reconciliation, and following through subsequent adjustments made to completed reconciliation.
Important	Service Level Agreement - There is no agreement in place between the Council and NatWest Bank plc which sets out the service standards expected, the dispute resolution process and exit strategy.

Reference Tables

1. Scale of Assurance Opinions

Strong	There is a strong system of control designed and operating effectively. Any weaknesses found were low impact and do not significantly affect key controls or the achievement of the objectives of the system.
Reasonable	There is basically a sound system of internal control but weaknesses were found in system design or compliance, which result in some risk to the achievement of the system objectives.
Limited	There are some weaknesses in the system of control designed or the level of compliance which result in significant risk to the achievement of the system objectives.
Minimal	Fundamental weaknesses have been identified such that many key controls are absent or not operating effectively which may put at risk the achievement of the corporate control objectives.

2. Scale of Recommendation Priorities

Essential	A fundamental weakness in the control system which presents immediate risk to the service or system of a significant nature. Requires urgent attention by management. Reported to the A&G Committee and implementation of proposed actions are monitored.
Important	A significant control weaknesses where the risk is not imminent or only of a moderate nature. This needs addressing but is not urgent. Reported to the A&G Committee and implementation of proposed actions are monitored.
Advisory	A weakness or opportunity for improvement where the risk poses no great threat and is relatively minor. Consideration should be given to addressing the weakness if there is the appetite and/or capacity to implement the improvements. Actions are not tracked.

3. Stages of An Audit Assignment

Stage 1	The Audit teams have started drawing up the scope of coverage for the assignment.
Stage 2	A scoping meeting has been held with the Sponsor in the client service.
Stage 3	The Terms of Reference for the Assignment have been finalised.
Stage 4	The Auditor has started to deliver the agreed scope of work.
Stage 5	The work completed by the Auditor is being reviewed by their manager.
Stage 6	An exit meeting has been held with the Sponsor giving the preliminary feedback from the work.
Stage 7	Any additional testing identified has been completed.
Stage 8	The draft report has been received by the in-house audit team.
Stage 9	The draft report has been issued to the Service Sponsor and is awaiting their response.
Stage 10	The final report has been issued.

FAREHAM

BOROUGH COUNCIL

Report to Audit and Governance Committee

Date **13 March 2017**

Report of: **Head of Finance and Audit**

Subject: **ANNUAL AUDIT AND GOVERNANCE COMMITTEE REPORT,
WORK PROGRAMME AND TRAINING PLAN**

SUMMARY

This report summarises the work carried out by the Audit and Governance Committee during 2016/17 and proposes the programme of work for 2017/18.

RECOMMENDATION

That the Committee:-

- (a) note the contents of the report; and
- (b) submit the work programme for 2017/18, as shown in [Appendix A](#), to Council for endorsement.

INTRODUCTION

1. This annual report summarises how this Committee has performed during 2016/17 in relation to its purpose and functions set out in the constitution.

COMMITTEE ORGANISATION 2016/17

2. The Committee continued to operate this year in accordance with best practice as detailed in the Chartered Institute of Public Finance and Accountancy (CIPFA) publication "Audit Committees – Practical Guidance for Local Authorities". There is one exception which is that the chairman of the Committee was also the Executive Portfolio holder for Streetscene. The case has been put together, as recommended by CIPFA, as to why this is still a strong pragmatic solution for the Council with a number of recognisable benefits, given the limited number of members available to serve on all the committees.
3. The Committee met four times in the year and reported directly to the Council. It was comprised of seven members who reflect the political balance of the Council. The committee was supported in its work by the Director of Finance and Resources.

COMMITTEE ACTIVITY IN 2016/17

4. The work being carried out by the Committee to fulfil its responsibilities is reported as a work programme to each Committee. The following points should be noted:
 - (a) The Committee was not requested to review any issues by the Chief Executive Officer, any director or Council body during the year.
 - (b) The Committee debated an issue raised by the external auditors in relation to the Council's Risk Management arrangements and requested further briefings on what progress was being made to set the revised policy.
 - (c) A member of the Committee requested further information in respect of the internal audit findings in relation to delays in enforcing Penalty Charge Notices.
5. There were six additional pieces of work carried out by the Committee in addition to the original work programme set in March 2016 which are listed below:

June 2016	Review of latest Counter Fraud and Corruption Policy
November 2016	Update on the work being undertaken to review the Scheme of Delegation Review of latest Local Code of Corporate Governance Updates to Financial Regulations (4, 13) Changes to the arrangements to the appointment of External Auditors
March 2017	Update on the arrangement to appoint the next External Auditors Internal Audit Partnership arrangements

6. There were two reports in the original work programme which were not presented to the Committee for the reasons summarised below.

Report Title	When Due	Reason for Non Completion
Review of Contract Procedure Rules	March 2017	The work challenging the Council's policies for procurement and contracts, using "system thinking" principles is still in progress. This is now in the work programme to be concluded in 2017/18.
Risk Management Progress Report	March 2017	Work to challenge our risk management framework using "system thinking" principles has only just been concluded. This sets out a new approach to the progress reports which needs to be rolled out to managers. A discussion was instead held with members around 5 top risks currently recognised for the Council.

TRAINING EVENTS

7. There have been two training events in the year. The first was delivered by the Council's new Treasury Management advisors in November 2016. The event was well attended.
8. There has also been a general Financial Management refresher briefing for all members held in January 2017.
9. Members of the Committee also received a briefing on current Risk Management arrangements and how these are being challenged, during their meeting in November 2016.

WORK PROGRAMME FOR 2017/18

10. The proposed work plan for the Committee for 2017/18 is attached as [Appendix A](#).

RISK ASSESSMENT

11. There are no significant risk considerations in relation to this report

CONCLUSION

12. There has been a high level of compliance with best practice in the way that the Audit and Governance Committee operates and the reports received.

Appendices

Appendix A – Proposed Work Programme for 2017/18

Background Papers: None

Reference Papers: Minutes of and reports to Audit and Governance Committee for the Municipal Year 2016/17

Enquiries:

For further information on this report please contact Elaine Hammell. (Ext. 4344)

APPENDIX A

PROPOSED WORK PROGRAMME FOR 2017/18

Committee Function and Report Subject		Frequency	Last Covered	July 2017	September 2017	November 2017	March 2018
COMMITTEE WORKING ARRANGEMENTS							
Review of Work Programme and training plan		Quarterly	2016-17	YES	YES	YES	YES and Annual Report
Review of the Functions of the Committee		3 yearly	2016-17				
Review of the Constitution		As needed	2016-17				
ETHICAL FRAMEWORK AND STANDARDS							
Standards of Conduct	Review of Code of Conduct for Members	As needed	2015-16				
	Review of member / officer protocol	As needed	2008-09				
	Overview of Complaints against the Council	Annual	2016-17		YES		
Member Training and Development	Review of Members Training and Development Programme	As needed	2015-16				
GOVERNANCE FRAMEWORK							
Framework	Local Code of Corporate Governance	As needed	2016-17				
	Annual Governance Statement	Annual	2016-17	YES			
Key Policy	Review of Financial Regulations	3 yearly	2016-17			YES – FR15	
	Review of Contract Procedure Rules	3 yearly	2013-14			YES	
	Treasury Management Policy and Strategy	Annual	2016-17			YES	YES- Policy and indicators
Risk Management	Policy	As needed	2016-17				
	Risk Management Monitoring Reports	6 monthly	2014-15		YES		YES
	Business Continuity	3 yearly	2014-15				
	Specific Risk Management topics	As needed	None				
Counter Fraud	Counter Fraud Policy and Strategy	3 yearly	2016-17				
	Anti-Bribery Policy	As needed	2011-12				
	Sanctions and Redress Policy	As needed	2016-17				
	Counter Fraud Progress	Annually	2016-17	YES			
INTERNAL AUDIT ASSURANCE							

Committee Function and Report Subject	Frequency	Last Covered	July 2017	September 2017	November 2017	March 2018
Internal Audit Strategy	3 yearly	2014-15				
Internal Audit Annual Plan	Annual	2015-16				YES
Quarterly Audit Reports	Quarterly	2016-17	YES	YES	YES	YES
Head of Audit's Annual Opinion	Annual	2016-17	YES			
EXTERNAL ASSURANCE						
Update on Arrangements for Appointment of External Auditors	As needed	None		YES		
Annual Plan and Fee	Annual	2016-17				YES
External Audit Progress Update	Annual	New	YES			
Annual Audit Letter	Annual	2016-17			YES	
Annual Certification Report	Annual	2016-17				YES
Specific reports from inspection agencies	As needed	2014-15 (RIPA)				
STATEMENT OF ACCOUNTS						
Statement of Accounts	Annual	2016-17	YES			
External Audit – Audit Results Report	Annual	2016-17		YES		
OTHER						
Updates on legal issues	As needed	2014-15				
Issues referred from the Chief Executive Officer, Directors and Other Council Bodies	As needed	None				
Number of Items			7	6	6	7

FAREHAM

BOROUGH COUNCIL

Report to Audit and Governance Committee

Date **13 March 2017**

Report of: **Head of Finance and Audit**

Subject: **INTERNAL AUDIT PARTNERSHIP**

SUMMARY

This report proposes that the Council enters into a partnership with Portsmouth City Council, using a shared service agreement, for the provision of the Opinion audit work; the arrangement to be formally reviewed in 5 years.

RECOMMENDATION

That authority is delegated to the Head of Finance and Audit, in consultation with the Section 151 Officer, to enter into arrangements as are necessary, and on such terms as are reasonable to develop a partnership with Portsmouth City Council for the provision of Opinion audit work.

INTRODUCTION

1. Under the Accounts and Audit Regulations 2015, the Council has a statutory requirement "*to 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*". However, this service does not have to be provided by an in-house team.
2. In April 2015 members approved the latest Audit Strategy setting out the level and nature of the work that will be delivered in order to deliver the annual Head of Audit's opinion required under the *public sector internal auditing standards*. This strategy recognised 3 streams of work underpinning the annual opinion: **Opinion work** (assignments leading to individual opinions), **Wider work** (assignments targeted at working with services to review risks and/or implement solutions), and **External Assurances** (gathering assurances available from third parties).
3. Since 2005 the "**Opinion work**" element of the internal audit service has been delivered by a number of external contractors, following the completion of a tender exercise. The current contractor is Mazars LLP. The rest of the service including counter fraud, investigation and governance work has been delivered by in-house auditors.
4. It is now proposed that the Council enters into a partnership with Portsmouth City Council, for the provision of the Opinion work part of the audit service.

BENEFITS OF PARTNERSHIP

5. The reasons that the original decision to externalise part of the audit service was taken in 2005 were:
 - To stabilise the resources available to deliver the planned audits and hence reduce the risk of an unfavourable external audit opinion of the audit service (which at that time affected the Council's Use of Resources scoring).
 - To eliminate the cost of using agency staff including officer time spent recruiting and training agency staff.
 - To increase the range of services being provided by the audit and assurance service and stabilise the in-house Council resource available for other services such as risk management support.
6. These objectives have been met with the arrangements that have been place since 2005. However, there are now additional reasons why a partnership model with Portsmouth City Council is recommended, as discussed below.
7. **Independence:** Having the opinion work delivered by a third party helps maintain independence from the in-house audit team who are becoming more involved in helping devise and implement solutions to weaknesses found. The external auditors have also highlighted that since the Head of Audit now also has responsibilities for the Finance service there is an increased need for independence in some of the audit work. Therefore the Chief Internal Auditor at Portsmouth City Council would also be available to the Council and would have direct access to the Section 151 Officer and Chairman of the Audit and Governance Committee if she felt an issue needed escalating.

8. **Cultural Fit:** The latest Audit Strategy seeks to embrace a number of the principles of “Systems Thinking” into how the audit service is delivered; as the service needs to adapt to the changing culture of the organisation as the learning from the Vanguard reviews is embedded. This is a different approach to the traditional auditing style and can be difficult for auditors from other cultures to understand. Portsmouth City Council have also been introducing “Systems Thinking” into its culture and so their auditors are familiar with the audit requirements under this model.

In the past 2 years we have been piloting the use of auditors from Portsmouth City Council in a number of different types of assignment and we have found that their approach fits well with the FBC culture.

9. **Savings:** Unlike in a tender arrangement, under a shared service agreement neither of the parties involved are able to generate profits from the arrangement. The rates that FBC will be required to pay will be contributing to the overheads of Portsmouth City Council and these are likely to come down if other councils enter into shared service agreements with them. We are aware of 2 other large councils who are also considering entering into a shared service agreement with Portsmouth City Council.

There will also be savings for FBC by not needing to undertake a procurement exercise to select a new contractor for the work.

10. **Additional Service Provision:** There are audit services that both Councils may be developing that would be of mutual benefit to each other, as we have common objectives. In particular we are aware of the work Portsmouth City Council are doing on data analytics which would be useful for inclusion into the FBC audit plan. In addition we are working to strengthen the horizon scanning element of our service, which could benefit from both Councils working together to capture new risks and opportunities arising. There are also areas of governance, risk and fraud work where the Councils will benefit from sharing learning through the partnership.

ALTERNATIVE OPTION TO CONTINUE WITH CONTRACTORS

11. Continuing with the current contractor in 2017/18 is not an option as we have already extended the current contract up to the maximum allowed. Given the value of the work, we would therefore be required under the Public Contract Regulations 2015 to retender this contract.
12. Retendering the work is an available option, as is joining a framework agreement with a number of London authorities when their agreement is retendered in 2018/19. The current contractor used by FBC previously won that contract so if they were successful again the service would be similar to that already experienced. The daily rates are likely to be a little lower than current due to economies of scale, but the last rates quoted would still be higher than those that would be expected under the arrangements with Portsmouth City Council.
13. These options are not favoured mainly due to the problems with the cultural fit with the big accountancy firms and the direction the Council’s audit service is going in. As the nature of the relationship is purely contractual we would also lose the potential for the two services to co-operative and develop the service with a common objective which can be obtained from a partnership relationship.

14. We are also aware that one of the weaknesses in the current audit service is the time taken to issue the draft reports once a piece of work has been completed. One of the factors contributing to this is the quality assurance framework that the big accountancy firms have in place as a means to manage potential risks to their reputation and litigation action. For this reason it is anticipated that performance in this area will improve under the partnership arrangement with another Council.

TERMS OF THE SHARED SERVICE AGREEMENT

15. The following arrangements are proposed as the basis of the shared service agreement with Portsmouth City Council:
- (a) The period of the agreement will be five years from April 2017 until March 2023, with an option to extend for a further five years to March 2028. A clause will be included within the agreement specifying the period of notice that either party can give to trigger termination of the agreement.
 - (b) Portsmouth City Council will manage and provide the Opinion audit work with a guaranteed minimum number of chargeable days per year, in line with the FBC Audit Strategy, unless a lower figure is agreed by both parties.
 - (c) Fareham Borough Council will pay the agreed annual charge in quarterly instalments in advance.
 - (d) The annual charge will be reviewed on the 1 April each year.
 - (e) Management of the arrangement will be the responsibility of the Head of Finance and Audit who will meet regularly with the Chief Internal Auditor at Portsmouth City Council. Performance will be monitored against an agreed Internal Audit Quality Assurance and Improvement Programme.

FINANCIAL IMPLICATIONS

16. The rates to be paid under the agreement will result in a saving to the Council as laid out in Appendix A.

LEGAL IMPLICATIONS

17. We are working with the legal services in Portsmouth and Southampton to ensure that the partnership is set up in a way that it does not conflict with the Public Procurement Regulations.
18. We will be entering into a shared service agreement for 5 years with option to extend for a further 5 years.
19. This arrangement would be considered a significant partnership for the Council as it involves a statutory service *which has a risk to the council if there is under performance in this area*. Under Financial Regulation 21, therefore the decision to enter into the partnership needs to be approved by an appropriate committee. This is considered to be the Audit and Governance Committee as they are required to approve the Annual Audit Plan and the resourcing of the Plan.

Background Papers: None

Reference Papers:

Report to the Executive 8 March 2010 – Internal Audit Services Supplier

Report to the Executive Member for Policy and Resources 9 June 2015 – Internal Audit Services Supplier 2015/16

Report to the Audit and Governance Committee 16 April 2015 – Internal Audit Strategy and Annual Plan

Enquiries:

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

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