

AGENDA
AUDIT AND GOVERNANCE COMMITTEE

Date: Monday, 14 March 2016

Time: 6.00 pm

Venue: Collingwood Room - Civic Offices

Members:

Councillor T G Knight (Chairman)

Councillor G Fazackarley (Vice-Chairman)

Councillors C J Wood

P J Davies

Miss T G Harper

D L Steadman

P W Whittle

Deputies: Councillor L Keeble

Councillor D J Norris



1. Apologies

2. Minutes (Pages 1 - 6)

To confirm as a correct record the minutes of the Audit Committee meeting held on 23 November 2015

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. Annual Certification Report (Pages 7 - 18)

To consider a report by the Director of Finance and Resources on the certification work carried out by the External Auditors for 2014-15.

7. Treasury Management Strategy and Prudential Indicators 2016/17 (Pages 19 - 40)

To consider a report by the Director of Finance and Resources on the Treasury Management Strategy and Prudential Indicators for 2016/17.

8. Internal Audit Annual Plan 2016/17 (Pages 41 - 46)

To consider a report by the Head of Finance and Audit on the Internal Audit Annual Plan for 2016/17.

9. Quarterly Internal Audit Report (Pages 47 - 58)

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 progress being made with the delivery of the internal audit plans.

10. Annual Audit and Governance Committee Report, Work Programme and Training Plan (Pages 59 - 64)

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 2016/17.

**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, 23 November 2015

Venue: Collingwood Room - Civic Offices

PRESENT:

Councillor T G Knight (Chairman)

Councillor G Fazackarley (Vice-Chairman)

Councillors: C J Wood, P J Davies, Miss T G Harper, D L Steadman and
P W Whittle, JP

**Also
Present:**



1. APOLOGIES

There were no apologies of absence.

2. MINUTES

RESOLVED that the minutes of the Audit and Governance Committee held on 21 September 2015 be confirmed and signed as a correct record.

3. CHAIRMAN'S ANNOUNCEMENTS

The Chairman welcomed to the meeting Martin Young from Ernst & Young (External Auditors).

4. DECLARATIONS OF INTEREST AND DISCLOSURES OF ADVICE OR DIRECTIONS

In accordance with the Standing Orders and the Council's Code of Conduct, Councillor Whittle, JP declared a non-pecuniary interest for minute 7 – Counter Fraud Progress Report as he is a Justice of the Peace for the South East Magistrates but ensures he doesn't adjudicate in cases within the Borough.

5. DEPUTATIONS

There were no deputations made at this meeting.

MATTERS CONSIDERED FOR CONFIRMATION

6. UPDATES TO THE CONSTITUTION

The Committee received a report from the Monitoring Officer proposing changes to Part 4: Section 2 of the Constitution - Standing Orders for the Appointment, Dismissal and Discipline of Employees, and Part 5: Section 1 – Code of Conduct for Members following a review undertaken by the Member Officer Working Group for Reviewing the Constitution.

RESOLVED that the Audit and Governance Committee recommends to Council;

- (a) that the updated Standing Orders for the Appointment, Dismissal and Discipline of Employees be adopted; and
- (b) the Code of Conduct for Members, as set out in Appendix B of the report, be adopted.

7. UPDATES TO FINANCIAL REGULATIONS

The Committee received a report from the Head of Finance and Audit to consider proposed changes to the Authorisation Limits set out in Financial

Regulation 4 and other minor amendments proposed to reflect recent departmental restructures and in order to comply with the Public Sector Internal Audit Standards.

Members sought clarification on paragraph 5 of the report, as they felt it was unclear as to which officers are able to perform write-offs. The Head of Finance and Audit confirmed that delegated authority to cancel debt had been changed to only include the relevant Head of Service as well as the Director. Members also requested that there should be transparency over the level of debts being written off by officers.

Members queried paragraph 9 of the report which suggested including a new rule in which Officers could approve individuals being given higher limits on their procurement cards where it could be demonstrated that it met a business need. However, there were no restrictions on what these increased limits could be. The Director of Finance and Resources suggested that the rule could stipulate that level should not exceed the maximum limit allowable for Procurement cards. Members agreed that this and the other measures already in place would be satisfactory.

During a discussion on this item it was suggested that, the wording within Appendix 1 relating to employee expenses should read, 'Claims shall not be submitted and authorised by the same person', in place of 'Claims should not be submitted and authorised by the same person',

RESOLVED that the Committee recommends the proposed changes to the Council for approval subject to the following amendments:

- i. that Regulation 19 also requires information regarding the level of write offs carried out under delegated powers to reported annually to the appropriate Committee or Panel for noting;
- ii. that Appendix 1 of the Financial Regulation 4 is reworded to clarify that an individual's transaction limit on a procurement card could only be increased up to the maximum allowable for procurement cards;
- iii. that Appendix 1 of the Financial Regulation 4 should be reworded to read that 'Claims *shall* not be submitted and authorised by the same person'.

DECISIONS MADE UNDER DELEGATED POWERS

8. COUNTER FRAUD PROGRESS

The Committee received a report from the Head of Finance and Audit on the latest work carried out to tackle Fraud and Corruption.

The Head of Finance and Audit highlighted paragraph 2 of the report giving details on the new Smartphone Counter Fraud App which gives customers an additional easy and secure way to report all types of fraud to the Council. The App has been used and seems to be working well.

She also confirmed that the exercise carried out on fraud did not find any cases of fraud. However a few system issues were identified which have been discussed with the service responsible for maintaining the database.

Members discussed the different risks associated with Right to Buy applications, including the need to safeguard the tenant from outside pressure to buy and then leave their home. At the Chairman's invitation, the Head of Finance and Audit confirmed that the proposal was that enhanced preliminary checks would be carried out on all applications looking at the different risks. However, the investigator would only be present at the second stage interview where the checks had given cause for concern.

RESOLVED that the Committee notes the content of the report.

9. ANNUAL AUDIT LETTER

The Committee considered a report by the Director of Finance and Resources on the Annual Audit Letter received from the External Auditors, Ernst and Young LLP.

RESOLVED that the Committee notes the content of the report.

10. TREASURY MANAGEMENT PROGRESS REPORTS

The Committee received a report by the Director of Finance and Resources on the progress being made with implementing the Treasury Management Strategy.

RESOLVED that the Committee notes the content of the report.

11. QUARTERLY AUDIT REPORTS

The Committee received a report from the Head of Finance and Audit that provided the assurances arising from the latest internal audit work and gave an update on the progress being made with the delivery of the audit plans.

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

12. 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 and training plan.

The Chairman suggested that member training should be carried out on Treasury Management as highlighted during item 9.

RESOLVED that the Committee's work programme for 2015/16 is approved, subject to the inclusion of a Treasury Management training session.

(The meeting started at 6.00 pm
and ended at 7.42 pm).

FAREHAM

BOROUGH COUNCIL

Report to Audit and Governance Committee

Date 14 March 2016
Report of: Director of Finance and Resources
Subject: ANNUAL CERTIFICATION REPORT

SUMMARY

This report presents the findings from the 2014-15 certification work carried out by the External Auditors (Ernst and Young). The work covered the Housing Benefit Subsidy Claim.

RECOMMENDATION

That the Committee consider and comment on the information contained in the Annual Certification Report 2014-15 submitted by the Council's external auditors.

Appendix A: [Annual Certification Report 2014-15](#)

Background Papers: None

Reference Papers: Statement of responsibilities of grant-paying bodies, authorities, the Audit Commission and appointed auditors in relation to claims and returns – March 2013

Enquiries:

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

Certification of claims and returns annual report 2014-15

Fareham Borough Council

January 2016

Ernst & Young LLP



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

January 2016
Ref: FBC/Claims/2013-14

Direct line: 02380 832043
Email: KHandy@uk.ey.com

Dear Members

Certification of claims and returns annual report 2014-15 Fareham Borough Council

We are pleased to report on our certification work. This report summarises the results of our work on Fareham Borough Council's 2014-15 claims.

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.

Under section 28 of the Audit Commission Act 1998, as transitionally saved, the Audit Commission made arrangements for certifying claims and returns in respect of the 2014-15 financial year. These arrangements required only the certification of the housing benefits subsidy claim. In certifying this we followed a methodology determined by the Department for Work and Pensions and did not undertake an audit of the claim.

Statement of responsibilities

The Audit Commission's 'Statement of responsibilities of grant-paying bodies, authorities, the Audit Commission and appointed auditors in relation to claims and returns' (statement of responsibilities) applied to this work. It 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

Section 1 of this report outlines the results of our 2014-15 certification work and highlights any significant issues.

We checked and certified the housing benefits subsidy claim with a total value of £19.6m. We met the submission deadline. We issued a qualification letter – details of the issues giving rise to the qualification are included in section 1.

Fees for certification work are summarised in section 2. The fees for 2014-15 were published by the Audit Commission on 27 March 2014 and are now available on the Public Sector Audit Appointments Ltd (PSAA's) website (www.psaa.co.uk).

We have made one recommendation this year, set out in section 4. A similar recommendation was made last year.

We welcome the opportunity to discuss the contents of this report with you at the Audit and Governance Committee on 14 March 2016.

Yours faithfully

Kate Handy
Executive Director
For and on behalf of Ernst & Young LLP
Enc.

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1. Housing benefits subsidy claim

Scope of work	Results
Value of claim presented for certification	£19,646,032
Amended/Not amended	Not amended
Qualification letter	Yes
Fee – 2014-15	£15,080
Fee – 2013-14	£21,278

Recommendations from 2013-14	Findings in 2014-15
<p>The Council should continue to focus on reducing the level of errors to mitigate the risk of exceeding the error threshold and losing subsidy. In particular the Council should focus on:</p> <ul style="list-style-type: none"> reducing errors in calculating income; and reducing errors in calculating eligible rent 	<p>In 2014-15 we detected no further errors in calculating eligible rent. However, we continued to find errors in calculating earnings which required us to ask the Council to carry out additional testing. The results of the additional testing are set out below.</p> <p>The Council needs to maintain an ongoing focus here. Further details of this recommendation are included in section 4.</p>

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 certification guidance 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 as a result of errors that have been identified in the audit of the previous year's claim. We found errors and carried out extended testing in one area, the calculation of earnings.

We have reported underpayments and the extrapolated value of these errors in a qualification letter. The DWP then decides whether to ask the Council to carry our further work to quantify the error or to claw back the benefit subsidy paid. The main issue we reported was:

- From an initial sample of 20 HRA rent rebate cases we identified two errors (total value £111) whereby benefit had been overpaid as a result of earnings being incorrectly calculated. One underpayment was also detected for the same reason (value £6). Testing of a further 40 cases identified no further errors of this type. The extrapolated error of benefit overpaid in our qualification letter was £3,613.

Our initial sample of 20 rent allowances cases identified no errors but because we identified errors in the audit of the previous year's claim we tested a further 40 cases to ensure earnings had been correctly calculated. No errors were detected.

2. 2014-15 certification fees

The Audit Commission determined a scale fee each year for the audit of claims and returns. For 2014-15, these scale fees were published by the Audit Commission on 27 March 2014 and are now available on the PSAA's website (www.psa.co.uk).

Claim or return	2013-14	2014-15	2014-15
	Actual fee £	Indicative fee £	Actual fee £
Housing benefits subsidy claim	21,278	15,080	15,080
Pooling of Housing Capital receipts	921	0	0
Total	22,199	15,080	15,080

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 2015-16 is £15,959. This was prescribed by PSAA in April 2015, based on no changes to the work programme for 2015-16.

Details of individual indicative fees are available at the following web address:
<http://www.psaa.co.uk/audit-and-certification-fees/201516-work-programme-and-scales-of-fees/individual-fees-for-local-government-bodies>

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

4. Summary of recommendations

This section highlights the recommendations from our work and the actions agreed.

Recommendation	Priority	Agreed action and comment	Deadline	Responsible officer
Housing benefits subsidy claim	Medium	The Council should continue to focus on reducing the level of errors to mitigate the risk of losing subsidy. In particular the Council should focus on reducing errors in calculating earnings.	Ongoing	Systems and Support Manager

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BOROUGH COUNCIL

Report to Audit and Governance Committee

Date 14 March 2016

Report of: Director of Finance and Resources

Subject: TREASURY MANAGEMENT STRATEGY AND PRUDENTIAL INDICATORS 2016/17

SUMMARY

Regulations require the Council to prepare and formally approve both an annual Treasury Management Strategy and Prudential Indicators. The document for 2016/17 is attached as Appendix A and was endorsed by the Executive on 8 February 2016 and submitted to Council for approval on 19 February 2016.

Main highlights in the Strategy are:

- a) In 2016 the Council will be switching treasury management consultants from Capita Asset Services to Arlingclose, as a result of a tender exercise.

Capital Issues

- b) The level of capital expenditure estimated for 2016/17 is £20.6 million which is slightly less than in 2015/16. We currently estimate that £5.8 million of this will be met by new borrowing.
- c) There will be a slight increase in the cost of capital as a % of net revenue stream in 2016/17. There is also an increase in the amount of council tax and housing rents that are contributing to the cost of the capital expenditure due to new borrowing in 2016/17.
- d) The Council is required to put aside resources to repay debt used to finance capital expenditure and establish a Minimum Revenue Provision policy statement on how we are going to calculate these resources. This policy has been included for the first time in the Strategy. We are choosing to adopt as our policy: *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.*

Treasury Management Issues

- e) There are no changes to the Council's investment and borrowing policy.
- f) The external fund management service with Tradition will come to an end in April 2016 and therefore all investments will be managed in-house

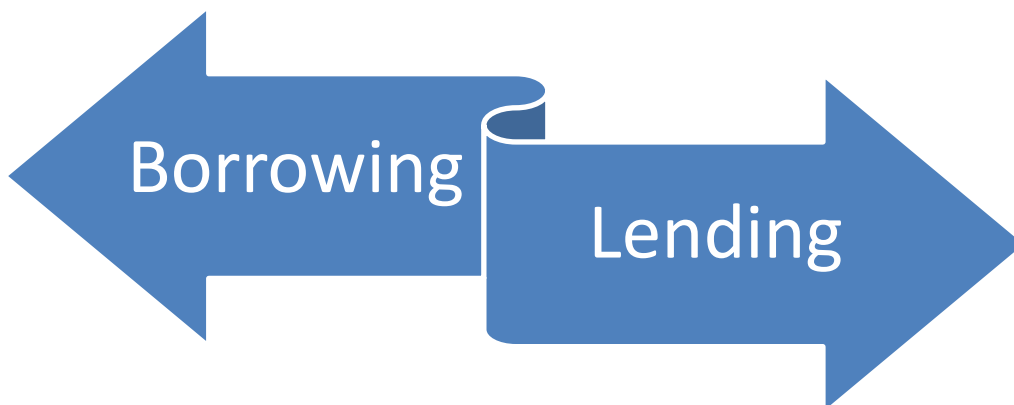
RECOMMENDATION

That the Treasury Management Strategy and Prudential Indicators for 2016/17, attached as Appendix A to this report, be noted.

FAREHAM

BOROUGH COUNCIL

TREASURY MANAGEMENT STRATEGY AND PRUDENTIAL INDICATORS 2016/17



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;

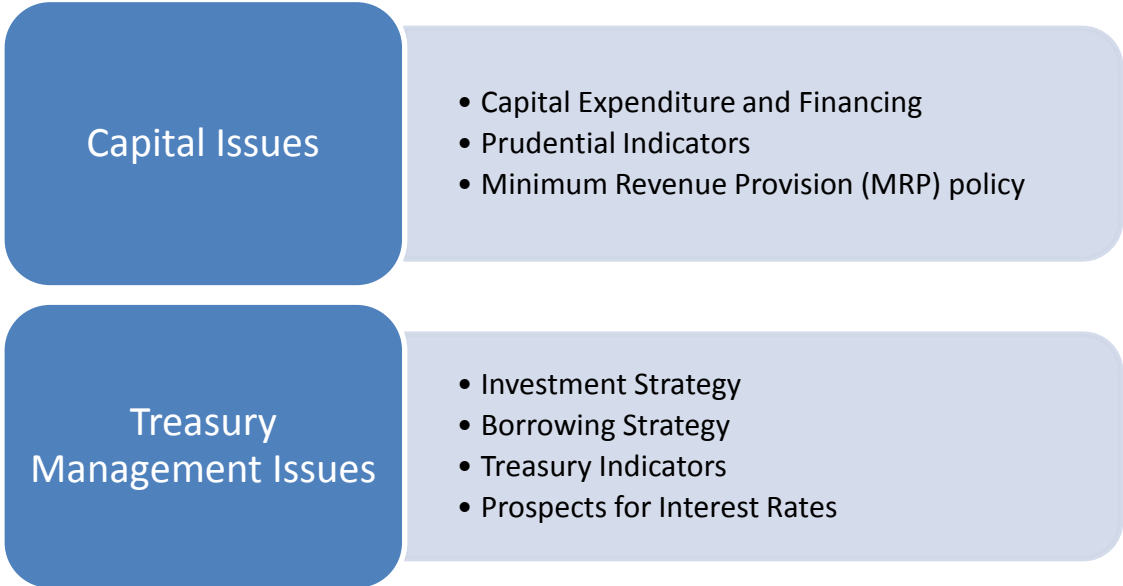
the effective control of the risks associated with those activities and the pursuit of optimum performance consistent with those risks.

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 2016/17 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 currently uses Capita Asset Services as its external treasury management advisors. From July 2016, this will change to Arlingclose, following a recent competitive tender exercise.
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	2015/16 Revised £'000	2016/17 Estimate £'000	2017/18 Estimate £'000	2018/19 Estimate £'000
Public Protection	0	0	0	0
Streetscene	48	434	175	0
Leisure & Community	8,256	1,922	552	0
Health & Housing	1630	560	480	480
Planning & Development	32	48	17	0
Policy & Resources	2,945	11,048	1260	540
Total General Fund	12,911	14,012	2,484	1,020
HRA	10,353	6,621	2,475	2,715
Total Expenditure	23,264	20,633	4,959	3,735
Capital Receipts	5,551	675	230	230
Capital Grants	4,022	4,563	957	250
Capital Reserves	10,810	5,986	2,081	1,324
Revenue	1,381	3,569	1,691	1,931
Borrowing	1,500	5,840	0	0
Total Financing	23,264	20,633	4,959	3,735

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	2015/16 Revised	2016/17 Estimate	2017/18 Estimate	2018/19 Estimate
General Fund	2,872	8,942	9,172	9,402
HRA	52,879	52,649	52,419	52,189
Total CFR	55,751	61,591	61,591	61,591

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.

	2015/16 Revised	2016/17 Estimate	2017/18 Estimate	2018/19 Estimate
General Fund	-8%	-6%	-7%	-7%
HRA	15%	15%	15%	15%
Total	5%	6%	6%	6%

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.

	2015/16 Revised	2016/17 Estimate	2017/18 Estimate	2018/19 Estimate
Council tax band D	£0.34	£2.35	£0.29	£0.00
Weekly housing rent levels	-£0.06	£0.23	£0.02	£0.02

HOUSING REVENUE ACCOUNT (HRA) RATIOS

14. 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.

	2015/16 Revised	2016/17 Estimate	2017/18 Estimate	2018/19 Estimate
HRA debt £'000	49,268	49,268	49,268	49,268
HRA revenues £'000	11,200	11,180	11,271	11,107
Number of HRA dwellings	2,424	2,465	2,454	2,443
Ratio of debt to revenues %	4.40:1	4.41:1	4.37:1	4.44:1
Debt per dwelling £	£20,325	£19,987	£20,077	£20,167

MINIMUM REVENUE PROVISION (MRP) POLICY STATEMENT

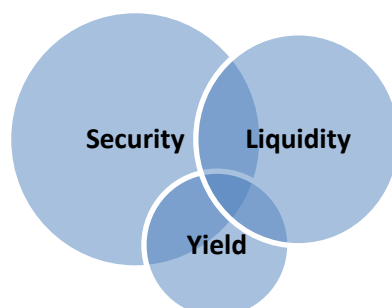
15. Where the Council finances capital expenditure by debt, it must **put aside resources to repay that debt** in later years. The amount charged to the revenue budget for the repayment of debt is known as **Minimum Revenue Provision (MRP)**.
16. The Council is required to set an annual policy on the way it calculates the prudent provision for the repayment of General Fund borrowing. It 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.
17. No MRP will be charged in respect of assets held within the HRA, in accordance with DCLG Guidance and capital expenditure incurred during 2016/17 will not be subject to a MRP charge until 2017/18.

TREASURY MANAGEMENT ISSUES

INVESTMENTS

Investment Policy

18. 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**.



19. 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.

20. The Council applies minimum acceptable credit criteria in order to generate a list of highly creditworthy counterparties which will also enable diversification and avoid concentration risk. The key ratings used to monitor counterparties are the **short term** and **long term** ratings.
21. Ratings will not be the sole determinant of the quality of an institution. It is important to continually assess and monitor the financial sector on both a micro and macro basis and in relation to the economic and political environments in which institutions operate. The assessment will also take account of information that reflects the opinion of the markets. To this end the Council will engage with its advisors to maintain a monitor on market pricing, such as credit default swaps, and overlay that information on top of the credit ratings.
22. Other information sources used will include the financial press, share price and other such information pertaining to the banking sector in order to establish the most robust scrutiny process on the suitability of potential investment counterparties.
23. 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.

Counterparty Selection Criteria

24. The primary principle governing the Council's investment criteria is the security of its investments, although the yield or return on the investment is also a key consideration. After this main principle the Council will ensure that:
 - It maintains a policy covering the **categories of investment types** it will invest in, **criteria for choosing investment counterparties** with adequate security, and **monitoring** their security.
 - It has **sufficient liquidity** in its investments. For this purpose it will set out procedures for determining the maximum periods for which funds may prudently be committed.
25. Officers will **maintain a counterparty list** in compliance with the below criteria and will revise the criteria and submit them to Council for approval as necessary.
26. Credit rating information is supplied by the Council's Treasury Management Consultants on all active counterparties that comply with the criteria below. Any counterparty failing to meet the criteria would be omitted from the counterparty list. Any rating changes, rating watches (notification of a likely change), rating outlooks (notification of a possible longer term change) are provided to officers almost immediately after they occur and this information is considered before dealing.

27. The criteria for providing a pool of high quality investment counterparties (both specified and non-specified investments) is:

- **Banks 1** - good credit quality. The Council will use banks which are UK banks and/or are non-UK and domiciled in a country which has a **minimum sovereign rating of AA** and have, as a minimum, the following Fitch, Moody's and Standard and Poor's credit ratings (where rated):

	Fitch	Moody's	Standard and Poor's
Short Term	F1	P-1	A-1
Long Term	A	A2	A

- **Banks 2** - Part nationalised UK banks (Royal Bank of Scotland). This bank can be included provided it continues to be part nationalised or it meets the ratings in Banks 1 above.
- **Building Societies** - The Council will use all societies which meet the ratings for banks outlined above and/or have **assets in excess of £5 billion**.
- **Other Investment Counterparties** -
 - UK Government (including gilts and the Debt Management Account Deposit Facility)
 - Local authorities
 - Money market funds
 - Enhanced cash funds

28. 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.

Time and Monetary Limits Applying to Investments

29. The time and monetary limits for institutions on the Council's counterparty list are as follows (these will cover both specified and non-specified investments):

	Fitch Long Term Rating	Money Limit	Time Limit
Banks 1 - good credit quality	A	£6m	5 years
Banks 2 - part-nationalised	N/A	£8m	3 years
Building Societies	N/A	£2m	1 year
Debt Management Account Deposit Facility	AAA	Unlimited	6 months
Local Authorities	N/A	Unlimited	5 years
Money Market Funds	AAA	£6m per fund	Liquid
Enhanced Cash Funds	AAA	£6m per fund	Liquid

Country and Sector Considerations

30. Due care will be taken to consider the country, group and sector exposures of the Council's investments.

31. The Council will only use approved counterparties from countries with a minimum **sovereign credit rating of AA from Fitch**. Countries that qualify using these credit criteria, as at the date of this report, are listed in the table below. The list will be added to, or deducted from by officers should ratings change in accordance with this policy:

AAA:	AA+:	AA:
Australia	Finland	Abu Dhabi (UAE)
Canada	UK	France
Denmark	USA	Qatar
Germany		
Netherlands		
Singapore		
Sweden		
Switzerland		

32. In addition, the following sector limits will apply:

- No more than **25%** will be placed with any **non-UK country** at any time.
- No more than **25%** will be placed with **building societies**.
- **Limits** in place will **apply to a group** of companies.
- Sector limits will be monitored regularly for appropriateness.
- As far as possible, the Council will aim to maintain at least **25%** of investments **maturing within 1 year**, and no more than **50% maturing over 1 year**.

Investment Strategy

33. The Council’s in-house managed funds are mainly existing resources earmarked to finance future capital expenditure and resources derived from favourable cash flow, with a **core balance of £10 - £15 million** available for investment over a year.
34. Investments will accordingly be made with reference to the core balance and cash flow requirements and the outlook for short-term interest rates (i.e. rates for investments up to 12 months).
35. The Bank Rate is forecast to remain unchanged at 0.5% before starting to rise from quarter 4 of 2016. The Bank Rate forecasts from Capita Asset Services for financial year ends (March) are:

Year	Bank Rate
2016/17	0.75%
2017/18	1.25%
2018/19	1.75%

36. The overall balance of risks to the above forecasts is currently to the downside (i.e. start of increases in Bank Rate occurs later). However, should the pace of growth quicken and/or forecasts for increases in inflation rise, there could be an upside risk.

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	2015/16 Revised	2016/17 Estimate	2017/18 Estimate	2018/19 Estimate
Principal sums invested > 364 days	22	17	14	14

38. For its cash flow generated balances, the Council will seek to utilise its **call accounts, money market funds and short-dated deposits** (overnight to three months) in order to benefit from the compounding of interest.

External Fund Managers

39. Up to £13 million of the Council's investments are externally managed on a discretionary basis by **Tradition**. This arrangement was put in place in 2000 to improve the financial returns of the Council's core cash balances. This chargeable arrangement will come to an end in April 2016 as the level of financial returns has reduced significantly since the economic crisis.

BORROWING

Current Portfolio Position

40. The Council's treasury portfolio position at 31 March 2015, 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	2015/16 Revised	2016/17 Estimate	2017/18 Estimate	2018/19 Estimate
Debt at 1 April	41,782	43,082	48,722	48,722
Expected change in debt	1,300	5,640	0	0
Gross Debt at 31 March	43,082	48,722	48,722	48,722
Capital Financing Requirement (CFR)	55,751	61,591	61,591	61,591
Under/(Over) Borrowing	12,669	12,869	12,869	12,869
CFR for last, current and next 2 years	233,184	240,524	246,364	246,364

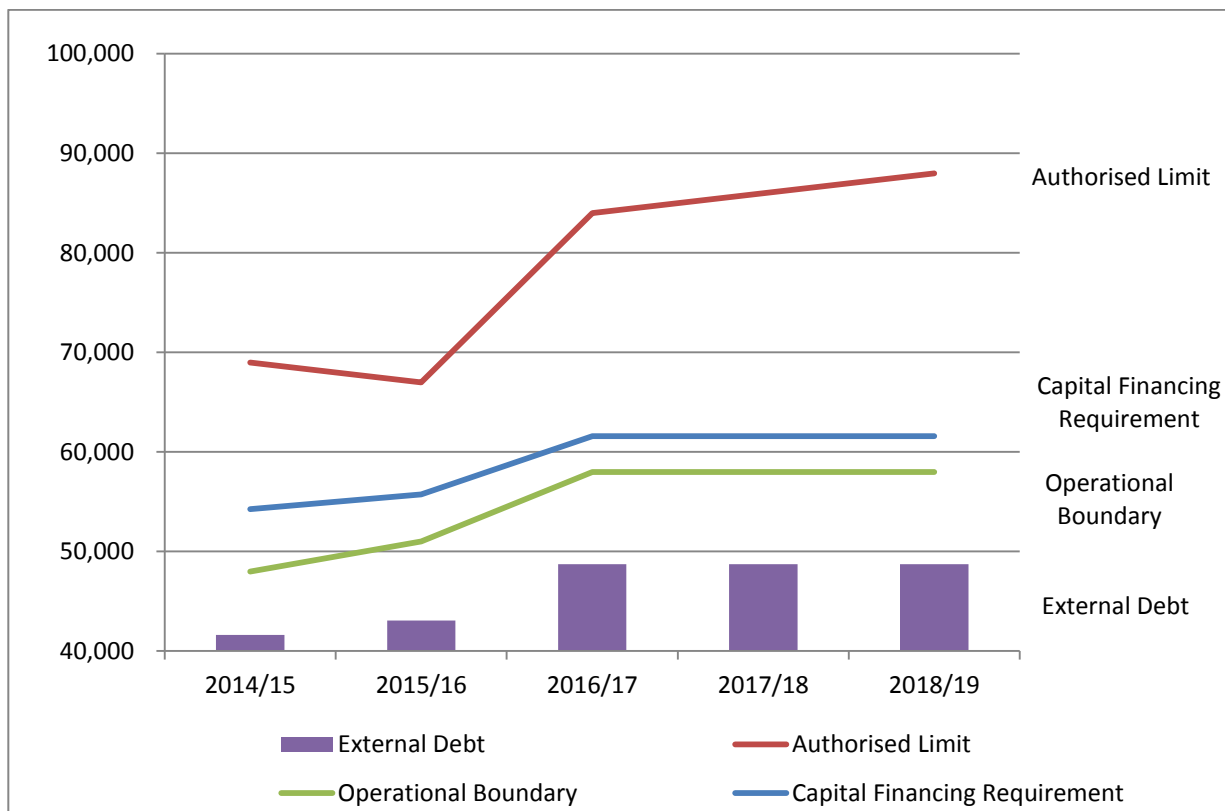
41. The Council is currently maintaining **an under-borrowed position**. This means that the capital borrowing need (the Capital Financing Requirement), has not been fully funded with loan debt as cash supporting the Council's reserves, balances and cash flow has been used as a temporary measure.
42. 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 2016/17 and the following two financial years.
43. 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

44. 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.
45. The limits are:

£'000	2015/16 Revised	2016/17 Estimate	2017/18 Estimate	2018/19 Estimate
Operational Boundary				
Borrowing	47,000	53,000	58,000	58,000
Other long term liabilities	4,000	5,000	5,000	5,000
Total	51,000	58,000	58,000	58,000
Authorised Limit				
Borrowing	61,000	77,000	79,000	81,000
Other long term liabilities	6,000	7,000	7,000	7,000
Total	67,000	84,000	86,000	88,000

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



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

£'000	2015/16 Revised	2016/17 Estimate	2017/18 Estimate	2018/19 Estimate
HRA Debt Cap	56,851	56,851	56,851	56,851
HRA CFR	52,879	52,649	52,419	52,189
HRA Headroom	3,972	4,202	4,432	4,662

Borrowing Strategy

48. 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.
49. 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 such as Holly Hill Leisure Centre, Daedalus and new property investment opportunities.
50. 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.

51. 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.
52. 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 2016/17 with a view to keeping future interest costs low, even if this causes additional cost in the short-term.
53. Alternatively, the Council may arrange forward starting loans during 2016/17, 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.
54. In addition, the Council may borrow short-term loans (normally for up to one month) to cover unexpected cash flow shortages.

Sources of Borrowing

55. 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.
56. 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
57. 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

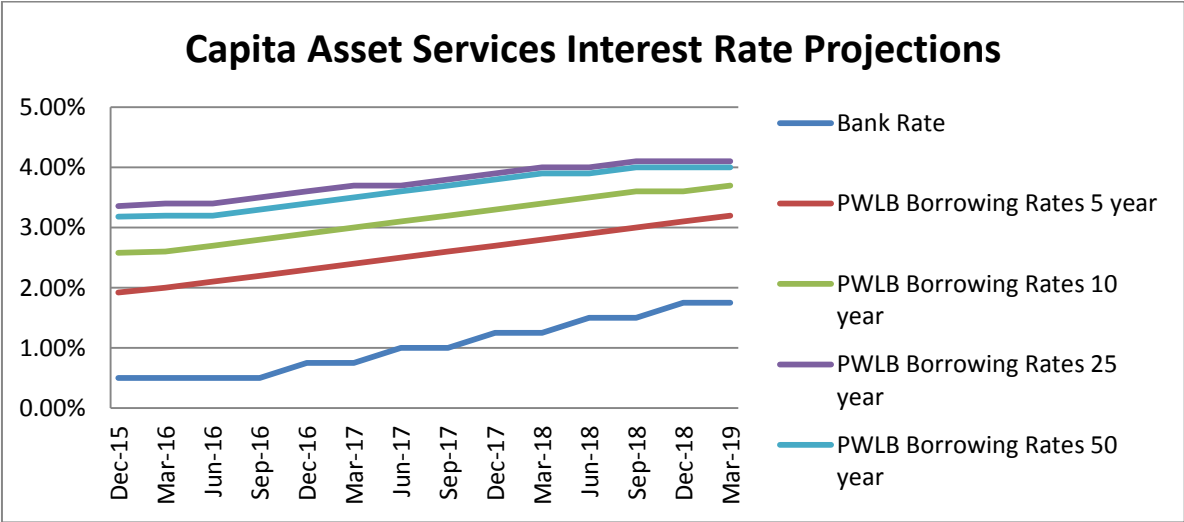
- 58. The Council will not borrow more than or in advance of its needs purely in order to profit from the investment of the extra sums borrowed. Any decision to borrow in advance will be within forward approved Capital Financing Requirement estimates, and will be considered carefully to ensure that value for money can be demonstrated and that the Council can ensure the security of such funds.
- 59. Risks associated with any borrowing in advance of activity will be subject to prior appraisal and subsequent reporting through the mid-year or annual reporting mechanism.

DEBT RESCHEDULING

- 60. 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

- 61. 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 Capita Asset Services is attached at Annex A.
- 62. The following graph and commentary gives the Capita Asset Services central view on interest rates and economic update.



- 63. Investment returns are likely to remain relatively low during 2016/17 and beyond.
- 64. Borrowing interest rates have been highly volatile during 2015 as alternating bouts of good and bad news have promoted optimism, and then pessimism, in financial markets.
- 65. There will remain a cost of carry to any new borrowing which causes an increase in investments as this will incur a revenue loss between borrowing costs and investment returns.

TREASURY MANAGEMENT LIMITS ON ACTIVITY

66. 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.

67. The treasury indicators and limits are:

Upper limits on interest rate exposures	2015/16	2016/17	2017/18	2018/19
	%	%	%	%
- 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

ECONOMIC BACKGROUND BY CAPITA ASSET SERVICES

UK. UK GDP growth rates in 2013 of 2.2% and 2.9% in 2014 were the strongest growth rates of any G7 country; the 2014 growth rate was also the strongest UK rate since 2006 and although the 2015 growth rate is likely to be a leading rate in the G7 again, it looks likely to disappoint previous forecasts and come in at about 2%. Quarter 1 of 2015 was weak at +0.4% (+2.9% y/y) though there was a slight increase in quarter 2 to +0.5% (+2.3% y/y) before weakening again to +0.4% (2.1% y/y) in quarter 3. The November Bank of England Inflation Report included a forecast for growth to remain around 2.5 – 2.7% over the next three years, driven mainly by strong consumer demand as the squeeze on the disposable incomes of consumers has been reversed by a recovery in wage inflation at the same time that CPI inflation has fallen to, or near to, zero since February 2015. Investment expenditure is also expected to support growth. However, since the August Inflation report was issued, most worldwide economic statistics have been weak and financial markets have been particularly volatile. The November Inflation Report flagged up particular concerns for the potential impact of these factors on the UK.

The Inflation Report was also notably subdued in respect of the forecasts for inflation; this was expected to barely get back up to the 2% target within the 2-3 year time horizon. The increase in the forecast for inflation at the three year horizon was the biggest in a decade and at the two year horizon was the biggest since February 2013. However, the first round of falls in oil, gas and food prices over late 2014 and also in the first half 2015, will fall out of the 12 month calculation of CPI during late 2015 / early 2016 but a second, more recent round of falls in fuel and commodity prices will delay a significant tick up in inflation from around zero: this is now expected to get back to around 1% by the end of 2016 and not get to near 2% until the second half of 2017, though the forecasts in the Report itself were for an even slower rate of increase. However, more falls in the price of oil and imports from emerging countries in early 2016 will further delay the pick up in inflation. There is therefore considerable uncertainty around how quickly pay and CPI inflation will rise in the next few years and this makes it difficult to forecast when the MPC will decide to make a start on increasing Bank Rate.

The weakening of UK GDP growth during 2015 and the deterioration of prospects in the international scene, especially for emerging market countries, have consequently led to forecasts for when the first increase in Bank Rate would occur being pushed back to quarter 4 of 2016. There is downside risk to this forecast i.e. it could be pushed further back.

USA. The American economy made a strong comeback after a weak first quarter's growth at +0.6% (annualised), to grow by no less than 3.9% in quarter 2 of 2015, but then pulled back to 2.1% in quarter 3. The run of strong monthly increases in nonfarm payrolls figures for growth in employment in 2015 has prepared the way for the Fed. to embark on its long awaited first increase in rates of 0.25% at its December meeting. However, the accompanying message with this first increase was that further increases will be at a much slower rate, and to a much lower ultimate ceiling, than in previous business cycles, mirroring comments by our own MPC.

EZ. In the Eurozone, the ECB fired its big bazooka in January 2015 in unleashing a massive €1.1 trillion programme of quantitative easing to buy up high credit quality government and other debt of selected EZ countries. This programme of €60bn of

monthly purchases started in March 2015 and it was intended to run initially to September 2016. This appears to have had a positive effect in helping a recovery in consumer and business confidence and a start to an improvement in economic growth. GDP growth rose to 0.5% in quarter 1 2015 (1.0% y/y) but came in at +0.4% (+1.5% y/y) in quarter 2 and +0.3% in quarter 3. However, this lacklustre progress in 2015 together with the recent downbeat Chinese and emerging markets news, has prompted comments by the ECB that it stands ready to strengthen this programme of QE by extending its time frame and / or increasing its size in order to get inflation up from the current level of around zero towards its target of 2% and to help boost the rate of growth in the EZ.

Greece. During July, Greece finally capitulated to EU demands to implement a major programme of austerity and is now cooperating fully with EU demands. An €86bn third bailout package has since been agreed though it did nothing to address the unsupportable size of total debt compared to GDP. However, huge damage has been done to the Greek banking system and economy by the resistance of the Syriza Government, elected in January, to EU demands. The surprise general election in September gave the Syriza government a mandate to stay in power to implement austerity measures. However, there are major doubts as to whether the size of cuts and degree of reforms required can be fully implemented and so Greek exit from the euro may only have been delayed by this latest bailout.

Portugal and Spain. The general elections in September and December respectively have opened up new areas of political risk where the previous right wing reform-focused pro-austerity mainstream political parties have lost power. A left wing / communist coalition has taken power in Portugal which is heading towards unravelling previous pro austerity reforms. This outcome could be replicated in Spain. This has created nervousness in bond and equity markets for these countries which has the potential to spill over and impact on the whole Eurozone project.

China and Japan. Japan is causing considerable concern as the increase in sales tax in April 2014 suppressed consumer expenditure and growth. In Q2 2015 quarterly growth shrank by -0.2% after a short burst of strong growth of 1.1% during Q1, but then came back to +0.3% in Q3 after the first estimate had indicated that Japan had fallen back into recession; this would have been the fourth recession in five years. Japan has been hit hard by the downturn in China during 2015 and there are continuing concerns as to how effective efforts by the Abe government to stimulate growth, and increase the rate of inflation from near zero, are likely to prove when it has already fired the first two of its 'arrows' of reform but has dithered about firing the third, deregulation of protected and inefficient areas of the economy.

As for China, the Government has been very active during 2015 and the start of 2016 in implementing several stimulus measures to try to ensure the economy hits the growth target of about 7% for 2015. It has also sought to bring some stability after the major fall in the onshore Chinese stock market during the summer and then a second bout in January 2016. Many commentators are concerned that recent growth figures could have been massaged to hide a downturn to a lower growth figure. There are also major concerns as to the creditworthiness of much of bank lending to corporates and local government during the post 2008 credit expansion period. Overall, China is still expected to achieve a growth figure that the EU would be envious of. Nevertheless, there are growing concerns about whether the Chinese economy could be heading for a hard landing and weak progress in rebalancing the economy from an over dependency on manufacturing and investment to consumer demand led services.

There are also concerns over the volatility of the Chinese stock market, which was the precursor to falls in world financial markets in August and September and again in January 2016, which could lead to a flight to quality to bond markets. In addition, the international value of the Chinese currency has been on a steady trend of weakening and this will put further downward pressure on the currencies of emerging countries dependent for earnings on exports of their commodities.

Emerging Countries. There are also considerable concerns about the vulnerability of some emerging countries and their corporates which are getting caught in a perfect storm. Having borrowed massively in dollar denominated debt since the financial crisis (as investors searched for yield by channelling investment cash away from western economies with dismal growth, depressed bond yields and near zero interest rates into emerging countries) there is now a strong flow back to those western economies with strong growth and an imminent rise in interest rates and bond yields.

This change in investors' strategy, and the massive reverse cash flow, has depressed emerging country currencies and, together with a rise in expectations of a start to central interest rate increases in the US, has helped to cause the dollar to appreciate significantly. In turn, this has made it much more costly for emerging countries to service their dollar denominated debt at a time when their earnings from commodities are depressed. There are also likely to be major issues when previously borrowed debt comes to maturity and requires refinancing at much more expensive rates.

Corporates (worldwide) heavily involved in mineral extraction and / or the commodities market may also be at risk and this could also cause volatility in equities and safe haven flows to bonds. Financial markets may also be buffeted by the sovereign wealth funds of those countries that are highly exposed to falls in commodity prices and which, therefore, may have to liquidate investments in order to cover national budget deficits.

CAPITA ASSET SERVICES FORWARD VIEW

Economic forecasting remains difficult with so many external influences weighing on the UK. Capita Asset Services undertook its last review of interest rate forecasts on 19 January 2016. Our Bank Rate forecasts, (and also MPC decisions), will be liable to further amendment depending on how economic data evolves over time. There is much volatility in rates and bond yields as news ebbs and flows in negative or positive ways. This latest forecast includes a first increase in Bank Rate in quarter 4 of 2016.

The overall trend in the longer term will be for gilt yields and PWLB rates to rise when economic recovery is firmly established accompanied by rising inflation and consequent increases in Bank Rate, and the eventual unwinding of QE. At some future point in time, an increase in investor confidence in eventual world economic recovery is also likely to compound this effect as recovery will encourage investors to switch from bonds to equities.

The overall balance of risks to economic recovery in the UK is currently to the downside, given the number of potential headwinds that could be growing on both the international and UK scene. Only time will tell just how long this current period of strong economic growth will last; it also remains exposed to vulnerabilities in a number of key areas.

However, the overall balance of risks to our Bank Rate forecast is probably to the downside, i.e. the first increase, and subsequent increases, may be delayed further if recovery in GDP growth, and forecasts for inflation increases, are lower than currently expected. Market expectations in January 2016, (based on short sterling), for the first Bank Rate increase are currently around quarter 1 2017.

Downside risks to current forecasts for UK gilt yields and PWLB rates currently include:

- Emerging country economies, currencies and corporates destabilised by falling commodity prices and / or US Federal Reserve rate increases, causing a flight to safe havens (bonds).
- Geopolitical risks in Eastern Europe, the Middle East and Asia, increasing safe haven flows.
- UK economic growth and increases in inflation are weaker than we currently anticipate.
- Weak growth or recession in the UK's main trading partners - the EU and US.
- A resurgence of the Eurozone sovereign debt crisis.
- Recapitalisation of European banks requiring more government financial support.
- Monetary policy action failing to stimulate sustainable growth and combat the threat of deflation in western economies, especially the Eurozone and Japan.

The potential for upside risks to current forecasts for UK gilt yields and PWLB rates, especially for longer term PWLB rates include:

- Uncertainty around the risk of a UK exit from the EU.
- The pace and timing of increases in the US Federal Reserve funds rate causing a fundamental reassessment by investors of the relative risks of holding bonds as opposed to equities and leading to a major flight from bonds to equities.
- UK inflation returning to significantly higher levels than in the wider EU and US, causing an increase in the inflation premium inherent to gilt yields.

FAREHAM
BOROUGH COUNCIL

**Report to
Audit and Governance Committee**

Date **14 March 2016**

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

Subject: **INTERNAL ANNUAL AUDIT PLAN 2016/17**

SUMMARY

This report presents a draft plan of Internal Audit Work for delivery in 2016/17, for approval.

RECOMMENDATION

That the draft plan for 2016/17, 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 get 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. 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.
3. A draft plan of Internal Audit Work for 2016/17 has been collated using these principles, and following discussions with the service managers of the Council.

DRAFT PLAN FOR 2016/17

4. The draft plan prepared for 2016/17 is shown in [Appendix A](#). The following should be noted:
 - (a) **Level of Opinion Audit:** There is provision in the plan for 200 days of individual audit opinion work plus an additional contingency of 50 days for the in-house team to support these audits.
 - (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 13% 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.
5. The plan will be delivered by a mixture of in-house audit resource and bought-in resource from an external contractor and a neighbouring Council. The bought-in resource will particularly focus on the Opinion work to strengthen the independence of the assurance provided.
6. Two 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 carrying out one of these audits each and providing their conclusions to the other audit team, in order to reduce the costs to each Council.

RISK ASSESSMENT

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

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)

Draft Internal Audit Plan for 2016/17

	Type	Title	Days
	OPINION WORK		
1	Fundamental System	Payroll and Employee Expenses	10
2	Fundamental System	Accounts Payable	10
3	Fundamental System	Treasury Management	10
4	Fundamental System	Banking	10
5	Fundamental System	Housing Rents	15
6	Computer	Technology Forge (Estates IT system)	15
7	Computer	Cloud Based Computing	15
8	Services and Systems - High Risk	Building Control	15
9	Services and Systems - High Risk	Sheltered Housing	15
10	Services and Systems - High Risk	Trade Waste & Recycling	15
11	Services and Systems - High Risk	Outdoor Sport and Recreation	15
12	Services and Systems – High Risk	The Daedalus Project	12
13	Services and Systems - Other	Air Quality & Pollution (V)	15
14	Services and Systems - Other	Neighbourhood Working, Public Relations & Consultation	10
15	Services and Systems - Other	Countryside Management	8
	Contingency		10
	In-house support		50
	Total Opinion Work		250

Reason for Inclusion in Plan
Annual Audit under agreement with External Audit
Annual Audit under agreement with External Audit
Fundamental System - Cyclical Coverage. Last opinion given in 2013/14.
Fundamental System with system changes in 2015/16.
Fundamental System - Cyclical Coverage. Last opinion given in 2013/14.
Significant IT system for Cyclical Coverage. Last opinion given in 2009/10.
Change in IT Strategy in 2015/16. Early audit needed to give assurance on the arrangements in place for the security of the Council's data.
High risk on basis of Gross Expenditure and Gross Income for Partnership. Last audited 2010/11. Joint Assurance for Gosport BC and Portsmouth BC.
High risk on basis of Higher Risk Expenditure and Higher Risk Income. Last opinion given 2006/7.
High risk on basis of Gross Income. Also system changes to income collection using direct debits.
High risk on basis of Higher Risk expenditure (including capital spend). Last opinion given 2007/08.
New high risk audit on basis of Higher Risk expenditure (including capital spend) and reputation risks. Focus to be on the management contracts.
No previous audit opinion given. Service has undergone a Vanguard intervention. Reciprocal audit for Gosport BC
Key system for the Annual Governance Statement. No previous audit opinion and very little other coverage.
No previous audit opinion and very little other coverage of this service in previous audit plans.

	WIDER WORK		
16	Joint Working Project	Leaseholders Charges	
17	Joint Working Project – Corporate System	Employee Performance Management	
18	Joint Working Project	Data Protection	
19	New process	Risk Management Approach	
20	Thematic Review	Effectiveness of Ethics related activities (Part 2)	
21	Follow Up / Joint Working Project	Building Health and Safety Risks	

Joint project with service to confirm that the system is still appropriate and transparent after a number of system changes to responsive repairs service.
Joint project with service to carry out a post implementation review of the revised process. Action for the Annual Governance Statement.
Annual coverage of key governance system to support the Information Governance Opinion.
Work to develop a new Risk Management approach for the Council
Annual coverage to support the Ethics Opinion.
To assist with implementing outstanding audit recommendations in relation to reporting arrangements on the work done to manage these risks.

FAREHAM

BOROUGH COUNCIL

Report to Audit and Governance Committee

Date **14 March 2016**

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

Subject: **QUARTERLY INTERNAL AUDIT REPORT**

SUMMARY

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

RECOMMENDATION

That the Committee notes the progress and findings arising from the 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 THE 2014/15 AUDIT PLAN

2. The current status of the 5 audits remaining from the 2014/15 Internal Audit Plan in the last report is detailed in [Appendix One](#). A draft report has been received by the in-house audit team for all of these audits. They are now awaiting review and update for any additional testing which has been carried out. Two reports have yet to be discussed with the service sponsor.

DELIVERY OF THE 2015/16 AUDIT PLAN

3. There have been 3 changes to the original plan set for 2015/16:
 - (a) The Right to Buy audit has been changed from an Opinion Audit to a wider piece of work concentrating on the Council's vetting procedures.
 - (b) The Vehicle Parts Procurement Follow up Work has been cancelled as the Council is now reviewing the processes that it uses for the procurement and processing of invoices for lower value spend. This follow up work will be carried out in the context of this review, once completed.

The time was used instead to carry out a piece of wider work instead looking into the causes of a problem a debtor had experienced in paying monies owed to the Council.

4. Work has now started on 85% of the audits in the 2015/16 plan as detailed in [Appendix Two](#) and five audits have been completed.

FINDINGS FROM COMPLETED AUDITS

5. Since the previous Audit and Governance Committee, four reports have been issued in final version as listed below with the opinions given and number of recommendations made:

Audit	Assurance	Recommendations Made		
		New Essential	New Important	Outstanding Previous Essential or Important
2015/16 Plan				
Right To Buy	Not applicable	-	1	-
Problem with Debt Repayment	Not applicable	-	2	-
Individual Electoral Registration	Strong	-	-	-
Software Control	Limited	-	5	1

RISK ASSESSMENT

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

Appendices

Appendix One - Update on Outstanding Audits from the 2014/15 Plan

Appendix Two - Progress on Delivering the 2015/16 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 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 Internal Audit Strategy and Annual Audit Plan 2015/16

Enquiries:

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

Update on Outstanding Audits from the 2014/15 Plan

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
Benefits	Fundamental (V)	30	Stage 8							
Income Collection & Banking	Fundamental	15	Stage 8							
Contract Completion	Corporate, Specialist, Governance	10	Stage 8							
Information Governance Opinion	Computer	6	Stage 5							
Data Protection	Corporate, Specialist, Governance	5	Stage 5							

* 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

Progress on Delivering the 2015/16 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
1	Express (Electoral Register)	Computer	5	Stage 10	Reasonable	1	-	-	-	-	-
2	Individual Electoral Registration (new)	Service and Systems - Other	7	Stage 10	Strong	-	-	-	-	-	-
3	Local Tax Collection	Fundamental System	15	Stage 7							
4	Capital Expenditure and Accounting	Fundamental System	10	Stage 6							
5	Fixed Assets	Fundamental System	10	Stage 5							
6	Parking Enforcement	Service and Systems – HR (V)	15	Stage 6							
7	Contract Deeds Management	Thematic Review	15	Not started							
8	Land Charges	Service and Systems – HR	12	Stage 5							
9	Payroll	Fundamental System	15	Stage 6							
10	Accounts Payable	Fundamental System	10	Stage 5							
11	Software Control (new)	Computer	10	Stage 10	Limited	-	5	1	1	-	1
12	Recruitment and Selection	Corporate, Specialist, Governance (V)	15	Stage 4							
13	Right to Buy (new)	Wider Work (change)	10	Stage 10	Not applicable	-	1	-	-	-	-
14	Effectiveness of Ethics	Thematic Review	15	Stage 4							

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
	Related Activities										
	Vehicle Repairs Procurement	Wider Work – Follow Up	-8	Cancelled							
15	Recycling	Service and Systems – HR	10	Stage 2							
16	Household Waste Collection	Service and Systems – HR	10	Stage 2							
17	IT Disaster Recovery	Computer	15	Stage 1							
18	Data Protection	Wider Work – Follow Up	7	Not started							
19	Protection of Trees	Service and Systems - Other	8	Stage 4							
20	Problem with Debt Repayment (new)	Wider Work	8	Stage 10	Not applicable	-	2	2	-	-	-
	Contingency		13								
	In-house team support		50								
	Total Planned Time		285								

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

** V denotes this audit is covering a service which has been subject to a Vanguard intervention. HR denotes this audit was assessed as meeting the High Risk criteria so is a priority for completion this year.

Findings from the Latest Completed Audits

APPENDIX THREE

Audit Title	Right To Buy	<p>Overview of Subject: The Right to Buy scheme allows tenants to buy their council homes if they have lived in the property as a tenant for between 2 to 5 years depending on their type of tenancy. The tenants obtain a discount on the sale price of the house depending on how long they have lived there.</p> <p>From 2014, the maximum discount for a house increased from 60% to 70% of its value. Consequently fraud within the Right to Buy scheme has been reported as being on the increase and Councils are being encouraged to carry out additional vetting of applications.</p> <p>This work, carried out jointly with the investigations team, looked at what controls the Council had in place and what additional vetting could be introduced to reduce the risk of a fraudulent sale. Tests were also carried out to confirm tenants who had purchased their properties in the last 5 years still owned their properties, or, if they didn't, they had paid back the required portion of the discount.</p>
Year of Audit	2015/16	
Type of Audit	Wider Work	

Weaknesses identified during the audit and the proposed action (Essential and Important only)	
Important	<p>Weaknesses were found in the Council's vetting procedures. An enhanced vetting procedure is therefore being piloted which includes:</p> <ul style="list-style-type: none"> • Additional initial Application checks by the Investigations Officer • Enhanced interviews where the initial assessment identified some concerns • Unannounced visits where there are residency or welfare concerns • Post –sale checks

Audit Title	Problem with Debt Repayment	Overview of Subject: A problem was identified where a customer had come into the Civic offices to pay off monies he owed, but we were not able to identify the amount that he needed to pay.
Year of Audit	2015/16	
Type of Audit	Wider Work	

Weaknesses identified during the audit and the proposed action (Essential and Important only)	
Important	Weaknesses were found in the systems of the originating service to ensure that similar debts were getting recorded in the Council's debt management system. Discussions have been held with that team to strengthen their systems and awareness.
Important	Weaknesses were found with the use of the cash receipting system where debtor details are not known. The Customer Services team have now been briefed on how to take payments in these circumstances.

Audit Title	Individual Electoral Registration	<p>Overview of Subject: The Electoral Registration Officer has a duty to take all steps that are necessary for the purposes of maintaining an Electoral Register of potential voters in the borough. From June 2014 there was change in the process in which the register was compiled. Instead of relying on the household completing a form for each property, a return is now needed for each resident of the property.</p>
Year of Audit	2015/16	
Type of Work	Opinion audit	
Assurance Opinion Given	Strong	
Direction of Travel	↔	

Areas of Scope	Adequacy and Effectiveness of Controls		New Recommendations Raised			Previous Rec Implementation		
			Essential (🔴)	Important (🟡)	Advisory (🟢)	Implemented	Cancelled	Non Implemented
Maintenance of Register on Express (Full and Open)			-	-	-	-	-	-
Registration Process (On-line and Manual)			-	-	-	-	-	-
Management of the Annual Canvass			-	-	-	-	-	-
Publication & Sale of Registers			-	-	-	-	-	-

Audit Title	Software Control	Overview of Subject: Organisations are required to have procedures in place to prevent or detect the use of unlicensed software or the unauthorised downloading, sharing, selling, or the installing of multiple copies of licensed software.
Year of Audit	2015/16	
Type of work	Opinion Audit (Computer)	
Assurance Opinion Given	Limited	
Direction of Travel	↔	

Areas of Scope	Adequacy and Effectiveness of Controls		New Recommendations Raised			Previous Rec Implementation		
			Essential (🔴)	Important (🟡)	Advisory (🟢)	Implemented	Cancelled	Non Implemented
Software Policies			-	3	-	-	-	-
Software Inventory			-	1	-	1	-	1 (superseded by new rec)
Security of Software			-	-	-	-	-	-
Software Copyright			-	1	-	-	-	-
Software Licensing Procurement			-	-	1	-	-	-

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Weaknesses identified during the audit and the proposed action (Essential and Important only)	
Important (New and previous)	Software Inventory – The Council makes use of a software manager tool. This tool acts as the software inventory and stores and reports on information relating to software installed on PCs. However, as also observed in previous audits, this central register of software is not sufficiently complete to be able to be used to monitor and reconcile the software installations on Council devices against the licenses held. A central register will now be developed to record who is assigned to carry out licensing checks on each type of software. The Technical staff will be instructed to check with that person before the installation takes place. Work has already been carried out to develop a central storage location for installation guides and copies of licensing agreements but it is not yet complete.

Weaknesses identified during the audit and the proposed action (Essential and Important only)	
Important	Installation Request Process –The processes that Technical staff should be following for the installation or removal of software, following requests from users, had not been specified. This would include confirming the licensing arrangements and what the settings need to be on the APPLocker software to prevent unauthorised installations (e.g. individual, group or whole organisation permissions). A checklist is now being developed.
Important	Software Audits – Software sweeps are not currently carried out to identify any unauthorised or unlicensed software of devices in the Council buildings or at employees' homes. However, key risks have been addressed by other means and there is just a residual risk for minor software installed more than 2 years ago. A check on 5 PCs during the audit did not identify any concerns. However, it has been agreed that this will be widened to a larger sample to confirm whether a full sweep of PCs would be valuable.
Important (2)	Software Policy and Awareness – There is an ICT security policy dating back to 2007. However, this needs to be reviewed and updated to include: responsibilities and accountability for the management of software copyright, acquisition, software register, licences and software auditing. At the time of the audit it was not clear who was responsible for maintaining the policy and keeping employees informed of any issues around its implementation. Responsibility has now been established and an updated Policy is being produced.

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 **14 March 2016**

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 2015/16 and proposes the programme of work for 2016/17.

RECOMMENDATION

- (a) The Council is recommended to note the report; and
- (b) That the Committee work programme for 2016/17, as shown in [Appendix A](#), be approved.

INTRODUCTION

1. This annual report summarises how this Committee has performed during 2015/16 in relation to its purpose and functions set out in the constitution.

COMMITTEE ORGANISATION 2015/16

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".
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 chairman of the Committee for the year had no Executive responsibilities and was not required to deputise at the Scrutiny Board during the year. The committee was supported in its work by the Director of Finance and Resources.

COMMITTEE ACTIVITY IN 2015/16

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) There were no issues arising from the review of the Statement of Accounts and subsequent external audit report that the Committee felt needed to be brought to the attention of the Council.
 - (c) The Committee requested further information twice in respect of:
 - What happens to cases sent to the Department of Works and Pensions Fraud and Error team which are assessed for compliance review rather than fraud investigation.
 - How many times a year that a household might receive a financial penalty for council tax discount and council tax support fraud.
5. There were two additional pieces of work carried out by the Committee in addition to the original work programme set in March 2015 which are listed below:

November 2015	Review of the Constitution – Standing Orders for the Appointment, Dismissal and Discipline of Employees Updates to Financial Regulations (2, 4, 10, 19)
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6. There were three 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 the Sanctions and Redress Policy	June 2014	This was deferred from last year but still needs to be completed to update the Policy for the impact of transferring housing benefit investigations to the Department of Works and

Report Title	When Due	Reason for Non Completion
		Pensions. It is now planned to produce this for the June 16 meeting.
Review of Contract Procedure Rules	September 2014	The work challenging the Council's policies for procurement and contracts, using "system thinking" principles is still in progress and no changes are yet being proposed.
Risk Management Progress Reports	September 2015	We are currently challenging our risk management framework using "system thinking" principles, such that the content and frequency of these reports is likely to change.

TRAINING EVENTS

7. There has been one training event in the year covering the Annual Governance Statement which was delivered in September. The event was well attended.
8. A further training event is planned for 2016/17 in November, which is to be delivered by the Council's new Treasury Management advisors.
9. Members of the Audit and Governance Committee also attend training as part of the general members' training and development programme, which includes coverage of the members' Code of Conduct.
10. Personal briefings by the Director of Finance and Resources and/or the Head of Finance and Audit will also be provided to any new members of the Audit and Governance Committee in 2016/17.

WORK PROGRAMME FOR 2016/17

11. The proposed work plan for the Committee for 2016/17 is attached as [Appendix A](#).

RISK ASSESSMENT

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

CONCLUSION

13. 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 2016/17

Background Papers: None

Reference Papers: Minutes of and reports to Audit and Governance Committee for the Municipal Year 2015/16

Enquiries:

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

PROPOSED WORK PROGRAMME FOR 2016/17

Committee Function and Report Subject		Frequency	Last Covered	June 2016	September 2016	November 2016	March 2017
COMMITTEE WORKING ARRANGEMENTS							
Review of Work Programme and training plan		Quarterly	2015-16	YES	YES	YES	YES and Annual Report
Review of the Functions of the Committee		3 yearly	2013-14		YES		
Review of the Constitution		As needed	2013-14				
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	2015-16		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	2012-13				
	Annual Governance Statement	Annual	2015-16		YES		
Key Policy	Review of Financial Regulations	3 yearly	2015-16				
	Review of Contract Procedure Rules	3 yearly	2013-14				YES
	Treasury Management Policy and Strategy	Annual	2015-16			YES-implementation	YES- Policy and indicators
Risk Management	Policy	As needed	2012-13			YES	
	Risk Management Progress Reports	TBC	2014-15				YES
	Business Continuity	3 yearly	2014-15				
	Specific Risk Management topics	As needed	None				
Counter Fraud	Benefits Anti-Fraud and Corruption Policy	As needed	2013-14				
	Counter Fraud Policy and Strategy	3 yearly	2013-14				
	Anti-Bribery Policy	As needed	2011-12				
	Sanctions and Redress Policy	As needed	2008-09	YES			
	Counter Fraud Progress	6 monthly	2015-16	YES		YES	
INTERNAL AUDIT ASSURANCE							

Committee Function and Report Subject	Frequency	Last Covered	June 2016	September 2016	November 2016	March 2017
Internal Audit Strategy	3 yearly	2014-15				
Internal Audit Annual Plan	Annual	2015-16				YES
Quarterly Audit Reports	Quarterly	2015-16	YES	YES	YES	YES
Head of Audit's Annual Opinion	Annual	2015-16	YES			
EXTERNAL ASSURANCE						
Annual Plan and Fee	Annual	2015-16	YES			
Annual Audit Letter	Annual	2015-16			YES	
Annual Certification Report	Annual	2015-16				YES
Specific reports from inspection agencies	As needed	2014-15 (RIPA)				
STATEMENT OF ACCOUNTS						
Statement of Accounts	Annual	2015-16		YES		
External Audit – Audit Results Report	Annual	2015-16		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			6	7	6	7