Governance, Audit, Risk Management and Standards Committee AGENDA

DATE: Thursday 28 January 2016

TIME: 7.30 pm

VENUE: Committee Room 5,
Harrow Civic Centre

MEMBERSHIP (Quorum 3)

Chair: Councillor Antonio Weiss

Councillors:

Ghazanfar Ali
Ms Pamela Fitzpatrick
Nitin Parekh
Barry Macleod-Cullinane (VC)
Amir Moshenson
Bharat Thakker

Reserve Members:

1. Adam Swersky
2. Jeff Anderson
3. Kairul Kareema Marikar
4. Barry Kendler

1. Kanti Rabadia
2. Pritesh Patel
3. Chris Mote

Contact: Alison Atherton, Senior Professional - Democratic Services
Tel: 020 8424 1266 **E-mail:** alison.atherton@harrow.gov.uk

Harrow COUNCIL
LONDON

AGENDA - PART I

1. ATTENDANCE BY RESERVE MEMBERS

To note the attendance at this meeting of any duly appointed Reserve Members.

Reserve Members may attend meetings:-

(i) to take the place of an ordinary Member for whom they are a reserve;
(ii) where the ordinary Member will be absent for the whole of the meeting; and
(iii) the meeting notes at the start of the meeting at the item 'Reserves' that the Reserve Member is or will be attending as a reserve;
(iv) if a Reserve Member whose intention to attend has been noted arrives after the commencement of the meeting, then that Reserve Member can only act as a Member from the start of the next item of business on the agenda after his/her arrival.

2. DECLARATIONS OF INTEREST

To receive declarations of disclosable pecuniary or non pecuniary interests, arising from business to be transacted at this meeting, from:

(a) all Members of the Committee;
(b) all other Members present.

3. MINUTES (Pages 5 - 10)

That the minutes of the meeting held on 8 December 2015 be taken as read and signed as a correct record.

4. PUBLIC QUESTIONS *

To receive any public questions received in accordance with Committee Procedure Rule 17 (Part 4B of the Constitution).

Questions will be asked in the order notice of them was received and there be a time limit of 15 minutes.

[The deadline for receipt of public questions is 3.00 pm, Monday 25 January 2016. Questions should be sent to publicquestions@harrow.gov.uk

No person may submit more than one question].

5. PETITIONS

To receive petitions (if any) submitted by members of the public/Councillors under the provisions of Committee Procedure Rule 15 (Part 4B of the Constitution).

6. DEPUTATIONS

To receive deputations (if any) under the provisions of Committee Procedure Rule 16 (Part 4B) of the Constitution.

7. REFERENCES FROM COUNCIL AND OTHER COMMITTEES/PANELS

To receive references from Council and any other Committees or Panels (if any).

8. EXTERNAL AUDIT PLAN 2015-16 (Pages 11 - 30)

Report of the Director of Finance

9. CORPORATE ANTI-FRAUD TEAM MID-YEAR REPORT 2015/16 (Pages 31 - 48)

Report of the Corporate Director of Resources and Commercial

10. INTERNAL AUDIT MID-YEAR REPORT AND 2015/16 PLAN UPDATE (Pages 49 - 62)

Report of the Corporate Director of Resources and Commercial

11. IT CONTRACT MANAGEMENT TERMS OF REFERENCE REPORT (Pages 63 - 68)

Report of the Corporate Director of Resources and Commercial

12. TREASURY MANAGEMENT STRATEGY STATEMENT INCLUDING PRUDENTIAL INDICATORS, MINIMUM REVENUE PROVISION POLICY STATEMENT AND ANNUAL INVESTMENT STRATEGY FOR 2016-17 (Pages 69 - 106)

Report of the Director of Finance

13. ANY OTHER URGENT BUSINESS

Which cannot otherwise be dealt with.

AGENDA - PART II

14. RIPA AUTHORISATIONS UPDATE (Pages 107 - 124)

Report of the Director of Legal and Governance Services

*** DATA PROTECTION ACT NOTICE**

The Council will audio record item 4 (Public Questions) and will place the audio recording on the Council's website, which will be accessible to all.

[**Note:** The questions and answers will not be reproduced in the minutes.]

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GOVERNANCE, AUDIT, RISK MANAGEMENT AND STANDARDS COMMITTEE

MINUTES

8 DECEMBER 2015

Chair:	* Councillor Antonio Weiss	
Councillors:	* Ghazanfar Ali	* Amir Moshenson
	* Ms Pamela Fitzpatrick	* Nitin Parekh
	* Barry Macleod-Cullinane	* Bharat Thakker

* Denotes Member present

80. Attendance by Reserve Members

RESOLVED: To note that there were no Reserve Members in attendance.

81. Declarations of Interest

RESOLVED: To note that the following interest was declared:

<u>Agenda Item 10 - Information Report - Business Continuity/IT Disaster Recovery and IT Data Centre Audit Report Update</u>
Councillor Antonio Weiss declared a non-pecuniary interest in that he had a lead role in the digital practice of 2020 Delivery. He would remain in the room whilst the matter was considered and voted upon.

82. Minutes

Having requested a follow up on the action that the Corporate Director of Resources and Commercial on social media training for staff it was

RESOLVED: That the minutes of the meeting held on 10 September 2015, be taken as read and signed as a correct record.

83. Public Questions

RESOLVED: To note that no public questions were received.

84. Petitions

RESOLVED: To note that no petitions had been received.

85. Deputations

RESOLVED: To note that no deputations were received at the meeting under the provisions of Committee Procedure Rule 16.

86. References from Council and other Committees/Panels

RESOLVED: To note that no references were received.

RESOLVED ITEMS

87. Information Report - Annual Audit Letter

Members received, in accordance with the Accounts and Audit (England) Regulations 2011, the Annual Audit Letter from the Council's external auditors, Deloittes.

The Chair welcomed Paul Schofield and Sybil Muller of Deloittes to the meeting. The auditors presented their key findings, reporting that there was no substantive new content since the last meeting. An unqualified opinion on all accounts had been issued. The only issue remaining was an outstanding objection from a member of the public in relation to expenditure amounting to £57,000 on Pinner Park Farm. A separate certification would be issued once the objection had been resolved.

Members questioned the length of time it would take to resolve the objection and the fees for investigating the objection. The auditor advised that the fee in relation to the objection was not included in this year's letter as it was yet to be resolved and that a period of nine months was permitted to resolve an objection.

The Chair thanked the auditors for their presentation and for their work over the years.

RESOLVED: That the report be noted.

88. Exclusion of Press and Public

RESOLVED: That in accordance with Part I of Schedule 12A to the Local Government Act 1972, the press and public be excluded from the meeting for the following item(s) for the reasons set out below:

Item	Title	Reason
10.	Information Report – Business Continuity/IT Disaster Recovery and it Data Centre Audit Report Update	Information under paragraph 3 (contains information relating to the financial or business affairs of any particular person (including the authority holding that information).

89. Information Report - Business Continuity/IT Disaster Recovery and IT Data Centre Audit Report Update

Members received a report and confidential appendices which provided the latest position of the red/amber and red assurance audit reviews that together were reported as a 'significant governance gap' in the 2014/15 Annual Governance Statement.

The Head of Internal Audit outlined the content of the report and advised that all of the recommendations had been agreed in relation to business continuity management. In terms of the IT Data Centre, seven of the eight recommendations had been fully agreed and one had been substantially agreed.

Members received updates from officers in relation to the confidential appendices and on the work being done by the Council's new IT supplier. Members discussed and raised questions in relation the previous IT service provider, the contract management and whether there was any obligation to use a standard contract. The Corporate Director of Resources and Commercial confirmed that Sopra Steria were aware of the decisions in relation to the move to a new Civic Centre.

Members discussed the remit of the Committee and whether it would be appropriate for scrutiny to consider the IT contract arrangements. The Chair stated that whilst there were elements of concern, progress was being made, contracts had changed and it was an important to learn the lessons. He proposed that the Committee should gain a greater understanding of the contract management review and discuss the scope at the next meeting.

RESOLVED: That

(1) the report be noted; and

(2) the Head of Internal report submit the terms of reference for the contract management review to the next meeting.

90. Re-admittance of the Press and Public

RESOLVED: That the press and public be re-admitted for the remainder of the meeting.

91. Treasury Management Strategy Statement and Annual Investment Strategy: Mid-year review 2015-16

Members received a report which set out the mid-year review of treasury management activities for 2015/16.

In responses to Members questions, officers advised that

- the loan to the West London Waste Authority was being re-paid on an annuity basis although payments would not commence until June 2016;

- investments were monitored on a daily basis;

- in terms of whether the increase in the Housing Revenue Account rent policy was sustainable, this would need to be considered in relation to the changes proposed.

RESOLVED: That the Treasury Management Mid-Year Report for 2015/16 be noted.

92. Minimum Revenue Provision Policy Statement - Revision

Members received a report which outlined proposals for the revision of the Minimum Revenue Provision Policy in respect of capital expenditure incurred before 1 April 2008.

Members supported the use of the straight line method but some of the reporting mechanisms were challenged. A Member indicated that consideration also needed to be given to the depreciation of the Council's IT and the life of property/ assets. Another Member questioned the methodology of depreciation and stated that there should be a uniform policy for all buildings. The Director of Finance undertook to report back on how the Council's assets were valued.

RESOLVED: That the report be noted.

93. Information Report - Internal Audit and Corporate Anti-Fraud Update

Members received an update on progress made by Internal Audit and the Corporate Anti-Fraud team in the current financial year and were advised that the formal mid-year reports would be submitted to the January meeting.

A Member questioned the robustness of the Council's systems in terms of No Recourse to Public Funds (NRPF)stating that the chance of recovery appeared to be low. The officer advised that he was working with the manager of the NRPF team.

A Member expressed concern in relation to the alleged fraud in terms of accommodation and subsistence costs based on the number of dependants in a household. She stated that the majority of cases in Harrow might be due to a spouse fleeing domestic violence or be an asylum. The officer advised that misrepresentation was the issue.

RESOLVED: That the report be noted.

(Note: The meeting, having commenced at 7.30 pm, closed at 9.28 pm).

(Signed) COUNCILLOR ANTONIO WEISS
Chair

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REPORT FOR:	**GOVERNANCE, AUDIT, RISK MANAGEMENT AND STANDARDS COMMITTEE**
Date of Meeting:	28 January 2016
Subject:	**INFORMATION REPORT** External Audit Plan 2015/16
Responsible Officer:	Dawn Calvert, Director of Finance
Exempt:	No
Wards affected:	All
Enclosures:	External Audit Plan 2015/16

Section 1 – Summary and Recommendations

This report provides the Committee with an opportunity to consider the External Audit Plan 2015/16 from the Council's external auditors

Recommendation

The Committee is asked to note the External Audit Plan

Reason

To keep the Committee informed of the planned external audit work

Harrow COUNCIL LONDON

Section 2 – Report

Background

External Audit Plan for 2015/16

1. The External Audit Plan provides the Council with clarity about how the external audit of the Council's accounts and Pension Fund accounts for 2015/16 will be conducted. The audit plan sets out the following :-

   a. Estimated overall materiality – this has been set at £6.0m for the General Fund and £7.0m for the Pension Fund;

   b. Impact on the Council's Statement of Accounts resulting from the developments and changes from the 2015/16 Code of Practice on Local Authority Accounting of which there are no significant changes;

   c. Scope of audit work and approach;

   d. Significant and other audit risks as summarised below:-

      i. Management override of controls – which would include testing of journals, significant accounting estimates and any unusual transactions;

      ii. Potential for fraudulent revenue recognition - this is not considered a high risk as there are limited incentives and opportunities to manipulate the way income is reported. Standard fraud procedures will be undertaken.

      iii. Valuation of property, plant and equipment;

      iv. Valuation of investments – Pension Fund;

      v. Financial Planning – The Authority has significant saving targets for future years;

      vi. Pension liability assumptions;

      vii. Grant income recognition; and

      viii. Calculation of benefits – Pension Fund

   e. Value for Money conclusion;

   f. Auditors responsibilities; and

   g. Audit fees and Timetable.

2. The Committee is asked to consider the plan.

Financial Implications

There are no direct financial implications arising from this report.

Risk Management Implications

The receipt of the audit plan is included within the closure of accounts timetable for officers to ensure the plan has been received.

Equalities implications

There are no equalities implications.

Council Priorities

The Statement of Accounts provides assurance that the Council has managed its finances and delivered value for money in accordance with Council's corporate vision and priorities.

Section 3 - Statutory Officer Clearance

Name: Dawn Calvert	√	Chief Financial Officer
Date: 18th January 2016		

Ward Councillors notified:	**n/a**

Section 4 - Contact Details and Background Papers

Contact: Paul Gower (Interim Technical Accounting Manager) Tel: 020-8424-1335 /
Email: paul.gower@harrow.gov.uk

Background Papers:
None

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External Audit Plan 2015/2016

London Borough of Harrow and Pension Fund

14 January 2016

Headlines

Financial Statement Audit

There are no significant changes to the Code of Practice on Local Authority Accounting in 2015/16, which provides stability in terms of the accounting standards the Authority need to comply with.
This plan sets out our approach for auditing the Authority financial statements and the Pension Fund financial statements.

Materiality

Materiality for planning purposes has been set at **£6 million** for the Authority and **£7 million** for the Pension Fund.

We are obliged to report uncorrected omissions or misstatements other than those which are ‘clearly trivial’ to those charged with governance and this has been set at **£300,000** for the Authority and for the Pension Fund.

Significant risks

Those risks requiring specific audit attention and procedures to address the likelihood of a material financial statement error for the Authority have been identified as:

- Management override of controls,
- Fraudulent revenue recognition; and
- Valuation of Property, Plant and Equipment.
- Investment valuation (Pension Fund)

Other areas of audit focus

Those risks with less likelihood of giving rise to a material error but which are nevertheless worthy of audit understanding have been identified as:

- Financial Planning,
- Pension Liability assumptions;
- Grant income recognition; and
- Calculation of benefits (Pension Fund).

See pages 4 to 6 for more details.

Value for Money Arrangements work

The National Audit Office has issued new guidance for the VFM audit which applies from the 2015/16 audit year. The approach is broadly similar in concept to the previous VFM audit regime, but there are some notable changes:

- There is a new overall criterion on which the auditor’s VFM conclusion is based; and
- This overall criterion is supported by three new sub-criteria.

Our risk assessment is ongoing and we will report VFM significant risks during our audit.

See pages 8 to 10 for more details.

Logistics

Our team is:

- Andy Sayers, Partner
- Emma Larcombe, Manager
- Jess Hargreaves, Assistant Manager

More details are on **page 13.**

Our work will be completed in four phases from January to September and our key deliverables are this Audit Plan and a Report to Those Charged with Governance as outlined on **page 12.**

Our fee for the audit is £150,725 for the Authority and £21,000 for the Pension Fund see **page 11.**

Introduction

Background and Statutory responsibilities

This document supplements our Audit Fee Letter 2015/16 provided in April 2015, which also sets out details of our appointment by Public Sector Audit Appointments Ltd (PSAA).

Our statutory responsibilities and powers are set out in the Local Audit and Accountability Act 2014 and the National Audit Office's Code of Audit Practice.

Our audit has two key objectives, requiring us to audit/review and report on your:

- *Financial statements (including the Annual Governance Statement):* Providing an opinion on your accounts; and
- *Use of resources:* Concluding on the arrangements in place for securing economy, efficiency and effectiveness in your use of resources (the value for money conclusion).

This plan considers both the Authority financial statements as well as the Pension Fund financial statements.

The audit planning process and risk assessment is an on-going process and the assessment and fees in this plan will be kept under review and updated if necessary.

Acknowledgements

We would like to take this opportunity to thank officers and Members for their help and co-operation throughout our initial work with the Authority.

Financial Statements Audit

Our financial statements audit work follows a four stage audit process which is identified below. Appendix 1 provides more detail on the activities that this includes. This report concentrates on the Financial Statements Audit Planning stage of the Financial Statements Audit.

1. Financial Statements Audit Planning
2. Control Evaluation
3. Substantive Procedures
4. Completion

Value for Money Arrangements Work

Our Value for Money (VFM) Arrangements Work follows a five stage process which is identified below. Page 7 provides more detail on the activities that this includes. This report concentrates on explaining the VFM approach for the 2015/16. As this is our first year as auditors our VFM risk assessment is ongoing and we report any matters in this regard as the audit progresses and/or in our Report to Those Charged with Governance.

1. Risk Assessment
2. Identification of significant VFM risks
3. VFM audit work
4. Conclude
5. Reporting

Financial Statements Audit Planning

Our planning work takes place during December 2015 to February 2016. This involves the following key aspects:

- Risk assessment;
- Determining our materiality level; and
- Issuing this audit plan to communicate our audit strategy.

Risk assessment

Professional standards require us to consider two standard risks for all organisations. We are not elaborating on these standard risks in this plan but consider them as a matter of course in our audit and will include any findings arising from our work in our ISA 260 Report. These risks are:

- Management override of controls – Management is typically in a powerful position to perpetrate fraud owing to its ability to manipulate accounting records and prepare fraudulent financial statements by overriding controls that otherwise appear to be operating effectively. Our audit methodology incorporates the risk of management override as a default significant risk. In line with our methodology, we carry out appropriate controls testing and substantive procedures, including over journal entries, accounting estimates and significant transactions that are outside the normal course of business, or are otherwise unusual.
- Fraudulent revenue recognition – We do not consider this to be a significant risk for local authorities as there are limited incentives and opportunities to manipulate the way income is recognised. We therefore rebut this risk and do not incorporate specific work into our audit plan in this area over and above our standard fraud procedures.

The diagram opposite identifies, significant risks and other areas of audit focus, which we expand on overleaf. The diagram also identifies a range of other areas considered by our audit approach. Areas relating to the Pension Fund are identified by PF.

As this is our first year as auditors our risk assessment will be kept under review and we will report any amendments as the audit progresses and/or in our Report to Those Charged with Governance.

Keys: ● Significant risk ● Other area of audit focus ● Example other areas considered by our approach

Financial statements audit planning (cont.)

Significant Audit Risks

Those risks requiring specific audit attention and procedures to address the likelihood of a material financial statement error.

Valuation of PPE

Issue:

In 2014/15 the Authority reported Property, Plant and Equipment in its financial statements of £871m. The Authority must exercise judgement in determining the fair value of the different classes of assets held and the methods used to ensure that the carrying values recorded each year reflect those fair values.

Given the materiality in value and the judgement involved in determining the carrying amounts of assets we consider this to be a significant audit risk for 2015/16.

Approach:

We will undertake detailed testing of Property, Plant and Equipment as part of our final accounts audit, including specific detailed testing of the asset valuation. We will critically analyse the valuation methodology adopted by the Authority's valuer and benchmark this against national indices in order to confirm that the valuation is reasonable.

We will consider the basis on which the valuation has been carried out to ensure it is in line with *The Code of Practice on Local Authority Accounting in the United Kingdom 2015-16*. We will carry out detailed testing to ensure that revaluation gains and losses have been correctly reflected in the financial statements.

Valuation of investments – Pension Fund

Issue:

At the 31 March 2015 the Pension Fund had investments of £670 million. The investment portfolio includes private equity and derivatives both of which are complex to value and, in the case of private equity, include a degree of judgement from the Fund Manager. Given the complexity surrounding the investment portfolio we consider this to be a significant audit risk for 2015/16.

Approach:

We will undertake detailed testing of investments as part of our final accounts audit, including assessing the design and operation of controls in place, obtaining independent confirmations from Fund Managers to verify year end balances, undertake substantive testing over sales and purchases made in the year, reviewing year on year movements and comparing performance to known benchmarks and if appropriate engaging our specialist valuation team.

Financial statements audit planning (cont.)

Other areas of audit focus

Those risks with less likelihood of giving rise to a material error but which are nevertheless worthy of audit understanding.

Financial Planning

Issue:

The Authority has significant savings targets to achieve in the coming years, The 15/16 MTFP taken to the February 2015 Council meeting highlighted a funding gap of c.£23 million for 2016/17 and c.£15 million and c.£14 million in 2017/18 and 2018/19 respectively, we are aware that work has been done on identifying savings to address these funding gaps with a balance budget being proposed for 2016/17. In addition the Authority has low general fund reserves of £10 million. These savings need to be achieved in a environment where external funding is decreasing and pressure on service is increasing. The Authority needs to ensure that it has robust financial planning arrangements in place.

Approach:

In conjunction with our VFM work we will critically assess the controls the Authority has in place to ensure a sound financial standing, specifically that its Medium Term Financial Plan has duly taken into consideration the potential funding reductions and that it is sufficiently robust to ensure that the Authority can continue to provide services effectively.

Pension Liability assumptions

Issue:

The Authority is required to provide the value of the pension fund asset/liability as at the reporting date, taking into account numerous and complex assumptions. This creates a risk that the financial statements may be materially misstated.

Small changes to these assumptions can have a large effect on the reported value and the Authority should ensure that the information provided to the actuary is up to date and complete to ensure the values reported in the accounts take into account all requisite information.

Approach:

We will review the instructions provided to the actuary and the information supplied to the Actuary to come to their conclusions. We will also undertake tests of detail on the accounting entries performed as a result of the information returned from the actuary.

Financial statements audit planning (cont.)

Other areas of audit focus

Grant income recognition

Issue:

In 2014/15 the total government grants and contributions recognised was £405 million, and total capital grants deferred was £23.4 million. Accounting for grant income is complex as the basis for revenue recognition in the financial statements will vary depending on the individual conditions associated with each grant. In addion Management must apply judgement to determine if such conditions are attached to a grant and if they have been met.

Approach:

We will perform substantive testing over a sample of revenue and capital grants received during the year. We will review grant correspondence and assess if the Authority has recognised the income in accordance with the CIPFA Code and grant agreement.

Calculation of benefits – Pension Fund

Issue:

21 calculation of benefits can be complex. In 2014/15 a total of £32 million was paid out by the fund. Given the quantity and complexity of these calculations there is a risk of statement.

Approach:

We will review the process and controls in place over the calculation of benefits to ensure that they are robust. In addition we will perform substantive testing of the calculation of benefits to confirm their accuracy.

Financial statements audit planning (cont.)

Materiality

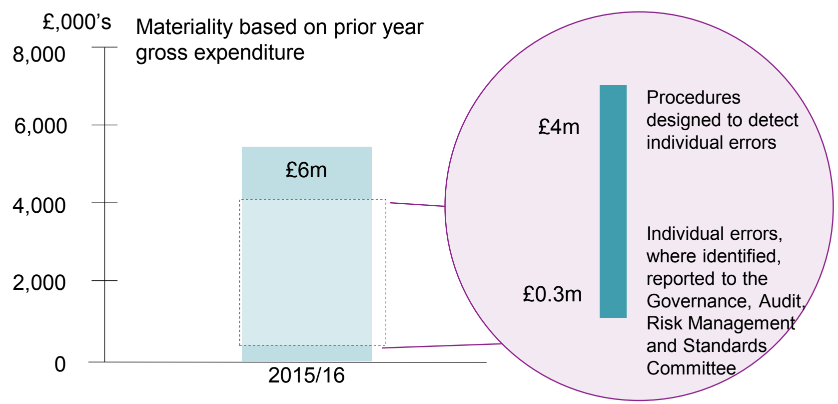
We are required to plan our audit to determine with reasonable confidence whether or not the financial statements are free from material misstatement. An omission or misstatement is regarded as material if it would reasonably influence the user of financial statements. This therefore involves an assessment of the qualitative and quantitative nature of omissions and misstatements.

Generally, we would not consider differences in opinion in respect of areas of judgement to represent 'misstatements' unless the application of that judgement results in a financial amount falling outside of a range which we consider to be acceptable.

For the Authority, materiality for planning purposes has been set at £6 million for the Authority's standalone accounts, which equates to just over 1 percent of gross expenditure.

For the Pension Fund, materiality for planning purposes has been set at £7 million.

design our procedures to detect errors in specific accounts at a lower level of precision.



Reporting to the Governance, Audit, Risk Management and Standards Committee

Whilst our audit procedures are designed to identify misstatements which are material to our opinion on the financial statements as a whole, we nevertheless report to the Governance, Audit, Risk Management and Standards Committee any unadjusted misstatements of lesser amounts to the extent that these are identified by our audit work.

Under ISA 260(UK&I) 'Communication with those charged with governance', we are obliged to report uncorrected omissions or misstatements other than those which are 'clearly trivial' to those charged with governance. ISA 260 (UK&I) defines 'clearly trivial' as matters that are clearly inconsequential, whether taken individually or in aggregate and whether judged by any quantitative or qualitative criteria.

In the context of the Authority, we propose that an individual difference could normally be considered to be clearly trivial if it is less than £300,000.

Similarly in the context of the Pension Fund, we propose that an individual difference could normally be considered to be clearly trivial if it is less than £300,000.

If management have corrected material misstatements identified during the course of the audit, we will consider whether those corrections should be communicated to the Governance, Audit, Risk Management and Standards Committee to assist it in fulfilling its governance responsibilities.

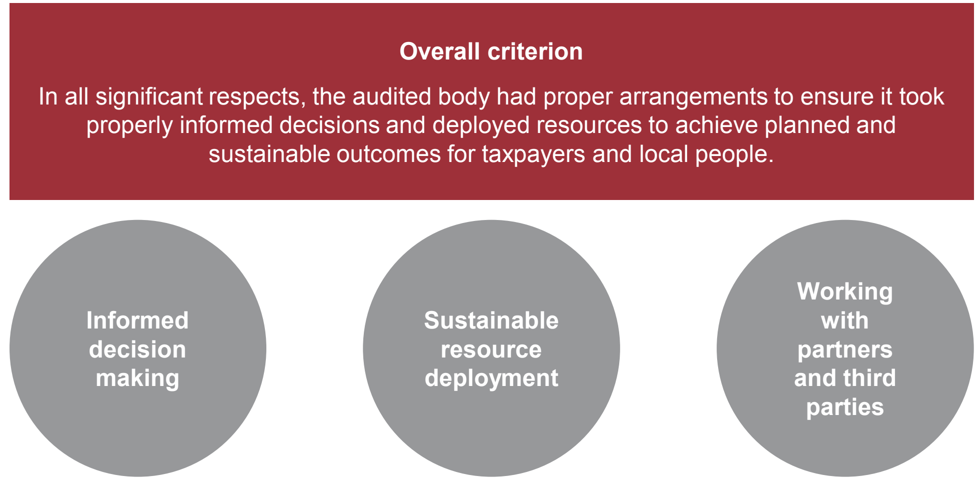
Value for money arrangements work

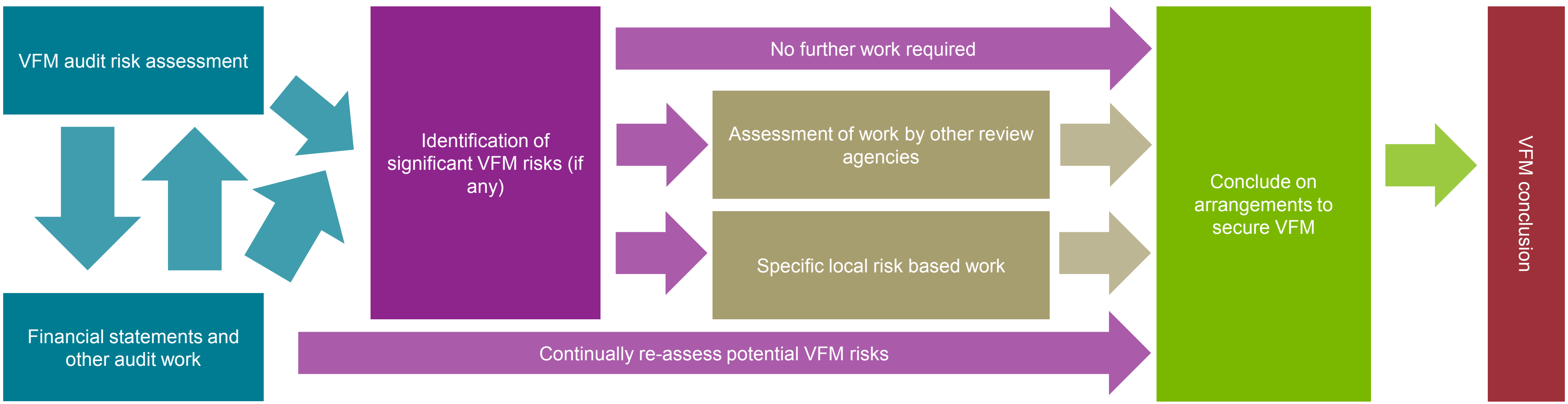
Background to approach to VFM work

The Local Audit and Accountability Act 2014 requires auditors of local government bodies to be satisfied that the authority 'has made proper arrangements for securing economy, efficiency and effectiveness in its use of resources'.

This is supported by the Code of Audit Practice, published by the NAO in April 2015, which requires auditors to 'take into account their knowledge of the relevant local sector as a whole, and the audited body specifically, to identify any risks that, in the auditor's judgement, have the potential to cause the auditor to reach an inappropriate conclusion on the audited body's arrangements.'

The VFM approach is fundamentally unchanged from that adopted in 2014/2015 and the process is shown in the diagram below. However, the previous two specified reporting criteria (financial resilience and economy, efficiency and effectiveness) have been replaced with a single criteria supported by three sub-criteria. These sub-criteria provide a focus to our VFM work at the Authority. The diagram to the right shows the details of these criteria.





Value for money arrangements work (cont.)

VFM audit stage	Audit approach
VFM audit risk assessment	We consider the relevance and significance of the potential business risks faced by all local authorities, and other risks that apply specifically to the Authority. These are the significant operational and financial risks in achieving statutory functions and objectives, which are relevant to auditors' responsibilities under the *Code of Audit Practice.* In doing so we consider: ■ The Authority's own assessment of the risks it faces, and its arrangements to manage and address its risks; ■ Information from the Public Sector Auditor Appointments Limited VFM profile tool; ■ Evidence gained from previous audit work, including the response to that work; and ■ The work of other inspectorates and review agencies.
kages with financial tements and other dit work	There is a degree of overlap between the work we do as part of the VFM audit and our financial statements audit. For example, our financial statements audit includes an assessment and testing of the Authority's organisational control environment, including the Authority's financial management and governance arrangements, many aspects of which are relevant to our VFM audit responsibilities. We have always sought to avoid duplication of audit effort by integrating our financial statements and VFM work, and this will continue. We will therefore draw upon relevant aspects of our financial statements audit work to inform the VFM audit.
Identification of significant risks	The Code identifies a matter as 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. Significance has both qualitative and quantitative aspects.'* If we identify significant VFM risks, then we will highlight the risk to the Authority and consider the most appropriate audit response in each case, including: ■ Considering the results of work by the Authority, inspectorates and other review agencies; and ■ Carrying out local risk-based work to form a view on the adequacy of the Authority's arrangements for securing economy, efficiency and effectiveness in its use of resources.

Value for money arrangements work (cont.)

VFM audit stage	Audit approach
Assessment of work by other review agencies **and** **Delivery of local risk based work**	Depending on the nature of the significant VFM risk identified, we may be able to draw on the work of other inspectorates, review agencies and other relevant bodies to provide us with the necessary evidence to reach our conclusion on the risk. If such evidence is not available, we will instead need to consider what additional work we will be required to undertake to satisfy ourselves that we have reasonable evidence to support the conclusion that we will draw. Such work may include: ■ Meeting with senior managers across the Authority; ■ Review of minutes and internal reports; ■ Examination of financial models for reasonableness, using our own experience and benchmarking data from within and outside the sector.
Concluding on VFM arrangements	At the conclusion of the VFM audit we will consider the results of the work undertaken and assess the assurance obtained against each of the VFM themes regarding the adequacy of the Authority's arrangements for securing economy, efficiency and effectiveness in the use of resources. If any issues are identified that may be significant to this assessment, and in particular if there are issues that indicate we may need to consider qualifying our VFM conclusion, we will discuss these with management as soon as possible. Such issues will also be considered more widely as part of KPMG's quality control processes, to help ensure the consistency of auditors' decisions.
Reporting	We will report on the results of the VFM audit through our ISA 260 Report. This will summarise any specific matters arising, and the basis for our overall conclusion. If considered appropriate, we may produce a separate report on the VFM audit, either overall or for any specific reviews that we may undertake. The key output from the work will be the VFM conclusion (i.e. our opinion on the Authority's arrangements for securing VFM), which forms part of our audit report.

Whole of government accounts (WGA)

We are required to review your WGA consolidation and undertake the work specified under the approach that is agreed with HM Treasury and the National Audit Office. Deadlines for production of the pack and the specified approach for 2015/16 have not yet been confirmed.

Elector challenge

The Local Audit and Accountability Act 2014 gives electors certain rights. These are:

- The right to inspect the accounts;
- The right to ask the auditor questions about the accounts; and
- The right to object to the accounts.

As a result of these rights, in particular the right to object to the accounts, we may need to undertake additional work to form our decision on the elector's objection. The additional work could range from a small piece of work where we interview an officer and review evidence to form our decision, to a more detailed piece of work, where we have to interview a range of officers, review significant amounts of evidence and seek legal representations on the issues raised.

The costs incurred in responding to specific questions or objections raised by electors is not part of the fee. This work will be charged in accordance with the PSAA's fee scales.

Our audit team

Our audit team will be led by Andy Sayers and supported by Emma Larcombe and Jessica Hargreaves, and as we are a new audit team for the Authority we will bring a fresh perspective to the accounts. Appendix 2 provides more details on specific roles and contact details of the team.

Reporting and communication

Reporting is a key part of the audit process, not only in communicating the audit findings for the year, but also in ensuring the audit team are accountable to you in addressing the issues identified as part of the audit strategy. Throughout the year we will communicate with you through meetings with the Finance Team and the Governance, Audit, Risk Management and Standards Committee. Our communication outputs are included in Appendix 1.

Independence and Objectivity

Auditors are also required to be independent and objective. Appendix 3 provides more details of our confirmation of independence and objectivity.

Audit fee

Our Audit Fee Letter 2015/2016 presented to you in April 2015 first set out our fees for the 2015/2016 audit. This letter also sets out our assumptions. We have not considered it necessary to make any changes to the agreed fees at this stage.

The planned audit fee for 2015/16 is £150,725 for the Authority. The planned audit fee for 2015/16 is £21,000 for the Pension Fund.

Appendix 1: Key elements of our financial statements audit approach

Communication

Continuous communication involving regular meetings between Governance, Audit, Risk Management and Standards Committee, Senior Management and audit team

- Audit strategy and plan (Jan)
- Interim report (if required) (May)
- ISA 260 (UK&I) Report (Sep)
- Annual Audit Letter (Oct)

Jan | Feb | Mar | Apr | May | Jun | Jul | Aug | Sep | Oct | Nov | Dec

Audit workflow

- Initial planning meetings and risk assessment (Jan)
- Interim audit (Mar)
- Year end audit of financial statements and annual report (Jul)
- Sign audit opinion (Sep)

Planning

- Perform risk assessment procedures and identify risks
- Determine audit strategy
- Determine planned audit approach

Control evaluation

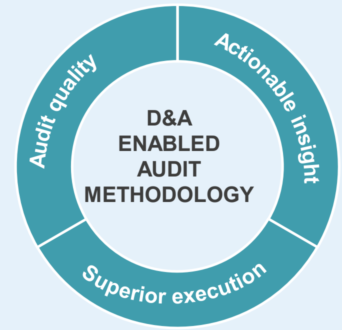
- Understand accounting and reporting activities
- Evaluate design and implementation of selected controls
- Test operating effectiveness of selected controls
- Assess control risk and risk of the accounts being misstated

Substantive testing

- Plan substantive procedures
- Perform substantive procedures
- Consider if audit evidence is sufficient and appropriate

Completion

- Perform completion procedures
- Perform overall evaluation
- Form an audit opinion
- Governance, Audit, Risk Management and Standards Committee reporting



Driving more value from the audit through data and analytics

Technology is embedded throughout our audit approach to deliver a high quality audit opinion. Use of Data and Analytics (D&A) to analyse large populations of transactions in order to identify key areas for our audit focus is just one element. We strive to deliver new quality insight into your operations that enhances our and your preparedness and improves your collective ‘business intelligence.’ Data and Analytics allows us to:

- Obtain greater understanding of your processes, to automatically extract control configurations and to obtain higher levels assurance.
- Focus manual procedures on key areas of risk and on transactional exceptions.
- Identify data patterns and the root cause of issues to increase forward-looking insight.

We anticipate using data and analytics in our work around key areas such as accounts payable and journals. We also expect to provide insights from our analysis of these tranches of data in our reporting to add further value from our audit.

Your audit team has been drawn from our specialist public sector assurance department.

Name	Andy Sayers
Position	Partner
	‘My role is to lead our team and ensure the delivery of a high quality, value added external audit opinion. I will be the main point of contact for the Governance, Audit, Risk Management and Standards Committee and the Chief Executive,’

Andy Sayers
Partner
Tel: 07802 975 171

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Name	Emma Larcombe
Position	Manager
	‘I provide quality assurance for the audit work and specifically any technical accounting and risk areas. I will work closely with Andy to ensure we add value. I will liaise with Dawn Calvert and other Executive Directors.’

Emma Larcombe
Manager
Tel: 07920 257 310

Name	Jessica Hargreaves
Position	Assistant Manager
	‘I will be responsible for the on-site delivery of our work and will supervise the work of our audit assistants.’

Jessica Hargreaves
Assistant Manager
Tel: 07468 740 813

Appendix 3: Independence and objectivity requirements

Independence and objectivity

Professional standards require auditors to communicate to those charged with governance, at least annually, all relationships that may bear on the firm's independence and the objectivity of the audit engagement partner and audit staff. The standards also place requirements on auditors in relation to integrity, objectivity and independence.

The standards define 'those charged with governance' as 'those persons entrusted with the supervision, control and direction of an entity'. In your case this is the Governance, Audit, Risk Management and Standards Committee.

KPMG LLP is committed to being and being seen to be independent. APB Ethical Standard 1 Integrity, Objectivity and Independence requires us to communicate to you in writing all significant facts and matters, including those related to the provision of non-audit services and the safeguards put in place, in our professional judgement, may reasonably be thought to bear on KPMG LLP's independence and the objectivity of the Engagement Lead and the audit team.

Further to this auditors are required by the National Audit Office's Code of Audit Practice to:

- Carry out their work with integrity, independence and objectivity;
- Be transparent and report publicly as required;
- Be professional and proportional in conducting work;
- Be mindful of the activities of inspectorates to prevent duplication;
- Take a constructive and positive approach to their work;
- Comply with data security and other relevant requirements relating to the security, transfer, holding, disclosure and disposal of information.

PSAA's Terms of Appointment includes several references to arrangements designed to support and reinforce the requirements relating to independence, which auditors must comply with. These are as follows:

- Auditors and senior members of their staff who are directly involved in the management, supervision or delivery of PSAA audit work should not take part in political activity.
- No member or employee of the firm should accept or hold an appointment as a member of an audited body whose auditor is, or is proposed to be, from the same firm. In addition, no member or employee of the firm should accept or hold such appointments at related bodies, such as those linked to the audited body through a strategic partnership.
- Audit staff are expected not to accept appointments as Governors at certain types of schools within the local authority.
- Auditors and their staff should not be employed in any capacity (whether paid or unpaid) by an audited body or other organisation providing services to an audited body whilst being employed by the firm.
- Auditors appointed by the PSAA should not accept engagements which involve commenting on the performance of other PSAA auditors on PSAA work without first consulting PSAA.
- Auditors are expected to comply with the Terms of Appointment policy for the Engagement Lead to be changed on a periodic basis.
- Audit suppliers are required to obtain the PSAA's written approval prior to changing any Engagement Lead in respect of each audited body.
- Certain other staff changes or appointments require positive action to be taken by Firms as set out in the Terms of Appointment.

Confirmation statement

We confirm that as of January 2016 in our professional judgement, KPMG LLP is independent within the meaning of regulatory and professional requirements and the objectivity of the Engagement Lead and audit team is not impaired.

This report is addressed to the Authority and has been prepared for the sole use of the Authority. We take no responsibility to any member of staff acting in their individual capacities, or to third parties. We draw your attention to the Statement of Responsibilities of auditors and audited bodies, which is available on Public Sector Audit Appointment's website (www.psaa.co.uk).

External auditors do not act as a substitute for the audited body's own responsibility for putting in place proper arrangements to ensure that public business is conducted in accordance with the law and proper standards, and that public money is safeguarded and properly accounted for, and used economically, efficiently and effectively.

We are committed to providing you with a high quality service. If you have any concerns or are dissatisfied with any part of KPMG's work, in the first instance you should contact Andy Sayers the engagement lead to the Authority, who will try to resolve your complaint. If you are dissatisfied with your response please contact the national lead partner for all of KPMG's work under our contract with Public Sector Audit Appointments Limited, Andrew Sayers, by email to Andrew.Sayers@kpmg.co.uk After this, if you are still dissatisfied with how your complaint has been handled you can access PSAA's complaints procedure by emailing generalenquiries@psaa.co.uk by telephoning 020 7072 7445 or by writing to Public Sector Audit Appointments Limited, 3rd Floor, Local Government House, Smith Square, London, SW1P 3HZ.

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REPORT FOR: **GOVERNANCE, AUDIT, RISK MANAGEMENT AND STANDARDS COMMITTEE**

Date of Meeting:	28th January 2016
Subject:	**INFORMATION REPORT** Corporate Anti-Fraud Team Mid Year Report 2015-16
Responsible Officer:	Tom Whiting – Corporate Director of Resources & Commercialisation
Exempt:	No
Wards affected:	All wards
Enclosures:	Appendix 1

Section 1 – Summary

This report sets out the mid year progress of the Corporate Anti-Fraud Team against its fraud plan objectives for the 2015-16 financial year and a general update in relation to financial savings and structural changes.

FOR INFORMATION

Harrow COUNCIL
LONDON

Section 2 – Report

This is an information report and details the mid year performance progress outcomes for the Corporate Anti-Fraud Team against the Service Plan 2015-16 and also provides an update on recruitment issues and structural changes to the team in year and for 2016-17 brought about by the need to deliver savings.

2015-16 progress against plan

2.1 Of the 13 objectives in the CAFT Service Plan 2015-16, five have been met, three are on target, two are behind target and three are not being met. See Appendix 1 for full financial supporting details and commentary surrounding the objectives.

2.2 Of particular note was the financial income target (objective 10) which has been surpassed and came about following an ongoing Council Tax Support investigation generating income for Housing Benefit amounting to £39,000 in the repayment of a large overpayment of benefit.

2.3 On another positive note, the housing hub has now been fully rolled out and the authority will continue to submit data each month in terms of its council tax support, housing tenancy and waiting list data. It is hoped that fraudulent cases will start to be identified either at the gateway to services or certainly much sooner than would have happened had the authority not have joined the hub. Preventing fraud entering the authority's housing and council tax support system is central to the work of the hub.

2.4 The Experian data match project was complete, but did not produce the results that had been achieved in the previous exercise in 2011. The matches produced far too many exceptions that appeared to be indicating a fraud but resulted in no further action. Introducing greater localised parameters will be key to running any future similar projects.

2.5 The piece of work assisting school admissions equipped them with evidence to challenge applicants on the accuracy of their applications. This resulted in a number of applications being amended and withdrawn.

2.6 Good progress is being made in terms of Council Tax Support, blue badge fraud work, housing application/waiting list and the National Fraud Initiative (NFI). Even though work on tenancy fraud is behind target, there is sufficient work at an advanced stage for the results to come through in the latter part of the year.

2.7 The work involving the main Registered Social Landlord's (RSL) in Harrow will be targeted before the end of the financial year to discuss setting up an agreement to work closer together on fraud, particularly given the Right to Buy (RTB) fraud risks they will be facing when the government introduces legislation allowing their tenants to purchase properties. Not all RSL's have the right skills, knowledge and expertise to validate RTB applications and undertake resulting investigation work. There is real potential for the authority to undertake this work on behalf of the RSLs if the associations would consider combining forces and jointly funding this ringfenced work where the post could tap into the resources and intelligence networks already in place and being used by the team.

2.8 A campaign of fraud awareness will be picked up as part of the CIPFA Code on Managing the Risk of Fraud & Corruption project and both of these objectives will not be fully achieved in 2015-16 and will transfer over to 2016-17.

2.9 Fraud work on direct payments which continues to be classed as high risk for Councils given the amount of spend, continues to be challenging as gaining access to the relevant data is difficult, but it is hoped that progress will be made in the latter part of the year.

Recruitment issues in 2015-16 and structural changes 2016-17

2.10 From April 2015 the team has been operating running with a vacancy which had become difficult to recruit to and this has impacted on the team, particularly following the transfer of staff under SFIS in October 2014.

2.11 The vacancy was eventually filled temporarily in early October 2015 but the employee left after 9 weeks. A four week delay in replacement followed as the Council reviewed its mid year budget forecast and put in place plans to respond to spending pressures.

2.12 The Internal Audit & CAFT section of the Resources Directorate is faced with making a £45,000 contribution towards the overall savings required by the Council for 2016-17 and 2017-18. This saving is to be delivered in two tranches of £30,000 in 2016-17 and a further £15,000 in 2017-18.

2.13 Given the position that a permanent post in the CAFT was vacant and only filled in October 2015 for a period of 9 weeks, a decision was made to delete the post and offer this up to meet the savings target. This move, whilst regrettable, avoids redundancies impacting both the CAFT and Internal Audit permanent establishment. Please see Appendix 2 for CAFT structure comparison for 2015-16 and 2016-17.

2.14 The post funded by the Housing Revenue Account (HRA) for 1 year responsible for undertaking fraud work involving housing applications and the waiting list became vacant in December 2015 and is currently being recruited to on a temporary basis until the end of the year. It is unlikely that this post will continue to be funded in 2016-17 due to budget constraints within Housing.

2.15 The net result of the above difficult financial decisions and structural changes will mean that for the 2016-17, the team is likely to be reduced by two FTE's.

Financial Implications

The financial implications have been shown where appropriate in the report

Risk Management Implications

None

Equalities implications

None

Council Priorities

The performance of the Corporate Anti-Fraud Team contributes to all of the corporate priorities by preventing, detecting and investigating fraud affecting the authority.

Section 3 - Statutory Officer Clearance

Name: Dawn Calvert	X	on behalf of the Chief Financial Officer
Date:19th January 2016		

Ward Councillors notified:	**NO**

Section 4 - Contact Details and Background Papers

Contact: Justin Phillips, Corporate Anti-Fraud Manager

Background Papers: None

If appropriate, does the report include the following considerations?

1.	Consultation	NO
2.	Priorities	NO

Appendix 1

Corporate Anti-Fraud Team Mid Year Performance Progress update 2015-16

	Project Number, Name & Description	Expected Outcome	Actual Outcome	Number of cases (if relevant)	Value of fraud identified/fraud loss/fraud prevention (if relevant)	Commentary
1.	Council Tax Support (CTS) Fraud	The identification of 12 positive outcomes and/or £15,000 CTS fraud identified including awareness raised within the service area	On target (subject to resources)	9 (75% complete)	£15,192.85	A total of 9 cases have been investigated to date by officers and these are currently awaiting a management decision on further case disposal action. Where fraud is proven, disposal options include offering the suspect a caution (with a voluntary £200 contribution towards investigation costs), a financial penalty (50% of the overpayment laid down by law) or prosecution. The fraudulently overpaid Council Tax Support is being recovered through usual channels. There are a further 8 cases under investigation at various stages and 9 other cases ready to be allocated to officers to investigate.

2.	Housing Tenancy Fraud	Identification of 12 positive outcomes of housing tenancy fraud (including RTB, succession and assignment applications) and where appropriate possession and/or criminal action sought	Behind target	4 (30%)	£153,000	4 properties have been successfully recovered working in partnership with housing resident services at the mid year point. This is behind where we should be at the mid point, however, at present there are a further 21 live tenancy fraud investigations at various stages. Of the 21 cases, there are a number that are at advanced stages and solicitors have been instructed to seek possession on 3 cases. In addition to the above activity, a total of 34 fraud checks were complete on Right to Buy applications received (100% check) and as a result 4 investigations have been launched as there are doubts over both the validity of the application and the tenant's occupation of the address as their principle home which is a condition of the RTB. Given the current level and status of live casework and outcomes known in quarter 3, it is envisaged that this objective will be met.

3.	Experian Housing Tenancy fraud data match exercise	Completion of Experian Housing Tenancy data match	Met	2	£108,000 (2 tenancies recovered and acknowledged in 2014/15) (loss prevention amount generated by freeing up council tenancies and removing families earlier than normal from B&B/Temp accommodation)	All very high and high matches were processed and a 10% sample of the medium risk matches were undertaken. Based on the findings of the medium risk sample, a decision was taken not to review the low risk matches. A further datamatch exercise on the housing stock will be considered in 2016/17 using the Call Credit housing hub as a vehicle rather than Experian as the quality of the matches in this exercise was not as good as the previous exercise undertaken in 2011 where 9 properties were recovered. See 4 below.
4.	Pan London Housing Fraud Hub	Embed the Housing Fraud Hub within Housing Needs to support front line service delivery	Met	0	£0	Hub training was delivered to housing resident services, housing needs and housing benefit in July and September 15. All have a number of staff within each department with access to the hub to utilise as a preventative tool when validating applications for services. The hub will continue to be developed by the suppliers to hopefully include additional data sets such as blue

						badges, social care and residents parking during 16/17. To date no cases have yet been identified and referred to the CAFT for investigation as a result of an inter borough match.
5.	Explore & develop MOU's with local Registered Social Landlords (RSL's)	Agree MOU's with at least 3 RSL's to generate new work streams in relation to housing tenancy fraud	Behind target	N/A	N/A	Will be developed during the second part of the year to coincide with the governments Housing & Planning Bill which is likely to offer the Right to Buy (RTB) to RSL's. This could potentially see an area of growth for the authority to undertake this RTB validation work on behalf of RSLs and generate income for the authority.
6.	Blue badge fraud	Identification of 12 positive outcomes through responsive work and proactive fraud drives working with Met Police SNT's and in conjunction with the Council's Day of Action	On target	4 blue badge enforcement operations implemented resulting in the identification of 10 suspected instances of badge misuse	No widely available formula to measure the cost of badge misuse but TFL estimate that it could be in the region of £5,000-£10,000 per annum in	At the mid way point:- 10 instances of suspected badge misuse identified during 4 proactive operations. 12 cases are awaiting management decision on case disposal following the above and other reactive work. 2 cautions have been

		Programme in each quarter			terms of lost parking revenue per badge. Taking the conservative £5,000 loss fraud value of 10 cases could be something in the region of £50,000 fraud loss	administered 1 warning issued 1 successful prosecution.
7.	Direct payment fraud	Identification of £50K of direct payment fraud/financial irregularity through a sample review of high risks cases including awareness raised within service area	Not met	0	0	Challenges in accessing relevant and necessary data and capacity issues have impacted upon this objective, e.g. accessing budget monitoring information has been difficult due to the paper forms being stored off the Civic Centre site and not indexed in any order. This has meant that targeting the right cases for review has been a challenge. It is unlikely that this will be met even if sampling is commenced in second part of the year. See report paras 2.9 – 2.11.
8.	School application fraud	Identification of school admission fraud/financial	Met	5 instances where applications were	Unable to quantify the financial value	A sample of 43 rising five school application cases were validated where school admissions were

		irregularity through a sample review of high risk cases provided by the admission team including awareness raised within service area		corrected/withdrawn	to the authority as there is no formula. Objective is focussed on protecting the integrity of the school admissions system to ensure fairness for all.	unable to verify if the applicants resided at the application address. This resulted in the following:- Green 25 – verified as all OK. Amber 13 – were verified as all OK after further checks were undertaken. Red 5 – high risk. Application information conflicting with intelligence gathered. These resulted in offers being withdrawn or made based on different information to that which was supplied, e.g. some individuals applied from addresses that they were going to reside in the future which is contrary to the rules. There were no instances of cases where false information was deliberately provided to mislead the authority into offering a school place incorrectly.
9.	NFI 14/15 exercise	Supporting service areas in the timely processing of high risks matches to satisfactory	Met	225	£640,760.48	**a) <u>Blue badges</u>** 4 reports, 273 matches, 165 badges cancelled due to the authority not being notified of the

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<td>death of a customer. Fraud risk removed.

b) <u>Housing Benefit</u>

48 reports, 4419 matches and 59 errors resulting in overpayments amounting to £634,718.75 to date. High percentage of processing still to be undertaken but capacity issues in Housing Benefit impacting upon ability to complete this work. This was historically undertaken by the CAFT pre SFIS transfer so no additional resources were made available to Housing Benefit.

c) <u>Housing Tenancy & RTB</u>

16 reports, 60 matches, all processed and no issues

d) <u>Insurance claims</u>

6 reports, 570 matches, all processed and no issues

e) <u>Personal budgets</u>

6 reports, 259 matches, no issues to date although 2 reports still</td>
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						outstanding. **f) <u>Pensions</u>** 4 reports, 195 matches, all processed, resulting in 1 overpayment amounting to £6041.73. **g) <u>Payroll</u>** 8 reports, 166 matches, all processed no issues. **h) <u>Private Residential Care Homes</u>** 1 report, 25 matches, 50% processed no issues to date.
10.	Income opportunities/ generation	£10K income generated through administrative penalties and recovery of investigation costs	Met	1	£39,000	This sum of money represented a lump sum repayment to Housing Benefit of an individual under investigation for Council Tax Support fraud which also impacted the housing benefit. The CTS investigation is awaiting management decision for case disposal.
11.	Deliver fraud awareness campaign	Deliver fraud awareness campaign and co-	Not met	N/A	N/A	This objective was to be co-ordinated with the outcomes driven out of the CIPFA Code

		ordinate communications prior in conjunction with International Fraud Awareness Week 15/11/15 - 21/11/15				work (objective 13). The CIPFA Code work had not commenced in the first part of the year as the authority was still awaiting for the release of the self assessment tool kit. The toolkit was released in October 2015, therefore this objective will not be met and will form part of the action plan to be developed in 2016-17.
12.	Fraud risk review of waiting list/temporary accommodation cases	Identification of fraudulent housing applications / interception of cases before permanent allocation of tenancy through sample review including raising awareness within service area	On target	0	0	Thirteen cases have been fraud validated of those individuals set live on the Council's waiting list. Some minor issues were identified with two cases and a recommendation made to housing needs to clarify with the applicants. No further issues have been raised with these. There are two historical cases identified in 2014/15 that have been referred to HB Law, one of which is due for trial in April 2016 and the other is awaiting legal advice. This objective has been impacted in quarter 3 by a member of staff

						leaving in December 2015 and the role has not been filled. See Report para 2.14.
13.	Review and implement CIPFA Code of Practice on Managing the Risk of Fraud & Corruption	• Self assess against the Code performance statements • Develop action plan to meet the gaps identified • Implement action plan • Review progress	Not met	N/A	N/A	This had not commenced at the mid way point as per 11 above. Currently, the self-assessment on 4 out of the 5 CIPFA Code principles have been complete. Once the self-assessment is complete, an action plan to meet the gaps will be developed and steps taken to begin implementation in 2016-17. This will feature heavily in the CAFT Service Plan for 2016-17.

Other areas of reactive fraud risk investigations with positive outcomes achieved

Employment with the Council and Blue badge fraud

Three agency employees identified as committing blue badge abuse against the authority on and around the Civic Centre site were removed from their contracts with the authority and one former agency employee was successfully prosecuted for blue badge abuse. One employee of a school was dismissed from post for committing benefit fraud against the authority

- Employee one was identified through reactive reconnaissance of blue badge use on the Civic Centre site and surrounding roads. The agency employee was apprehended on Milton Road in a restricted zone displaying a badge registered to a family member who was not present. They had displayed the badge on a number of occasions. The individual admitted wrongdoing at the first opportunity and was subsequently removed from their contract. A decision on further criminal action is yet to be made.

- Employee two was again identified through the same technique as above. The agency employee was apprehended displaying a badge registered to a family member who was not present on Milton Road in a pay and display bay and in a restricted zone, but denied wrongdoing and provided an account that was unreliable and inconsistent with the facts that were established. The individual was subsequently removed from their contract and a decision on further criminal action is yet to be made.

- Employee three was identified following an anonymous e-mail into the team. The agency employee was apprehended displaying a badge registered to a family member who was not present, parked in a disabled bay on the Civic Centre. The agency employee admitted wrongdoing on a number of occasions and was subsequently removed from their contract. A decision of further criminal action is yet to be made.

- Employee four was employed in a school and was historically investigated for benefit fraud committed against both the Council and the DWP. The Council had issued her with a financial penalty and the DWP had prosecuted her for a £15,000 ‘living together’ fraud. Following a disciplinary hearing she was dismissed from post.

- A former agency employee who had been dismissed from their contract in 2014/15 for displaying a badge in a pay and display bay registered to a family member who was not present, was successfully prosecuted in July 2015. They pleaded guilty and were given a £135 fine, £1,375 costs and a £20 victim surcharge.

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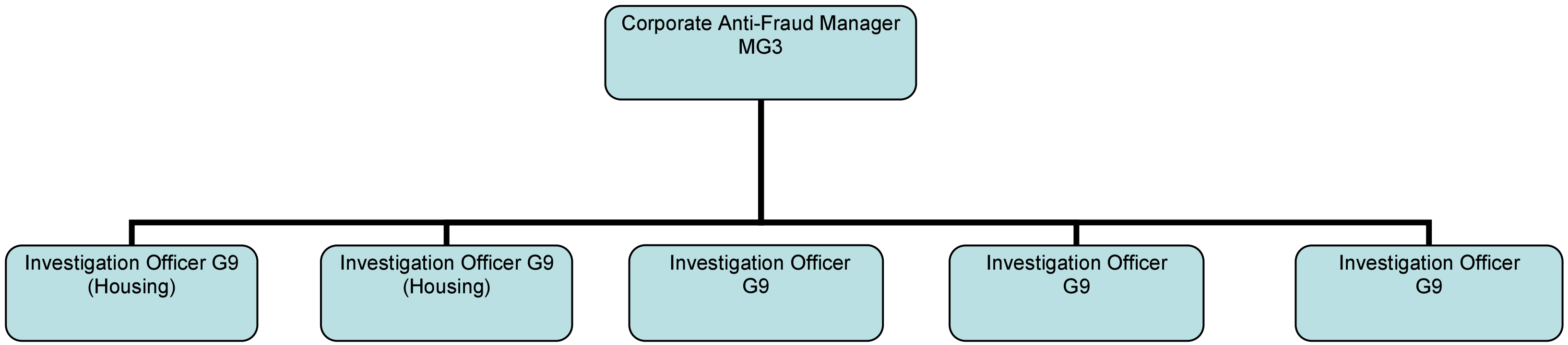
Appendix 2

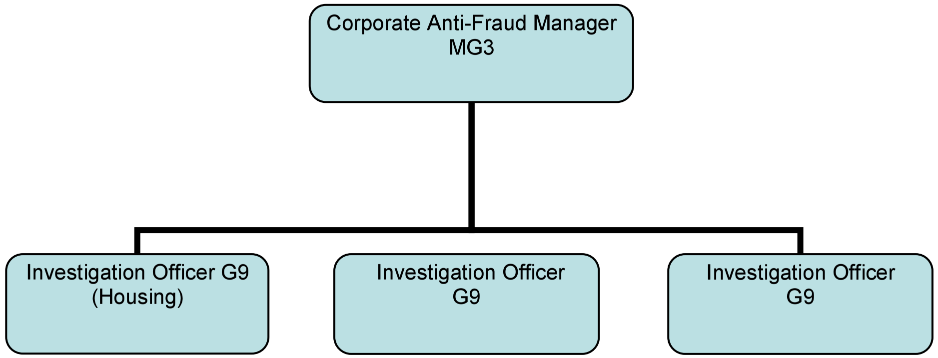
HARROW COUNCIL

CAFT TEAM STRUCTURE 2015/16



HARROW COUNCIL

CAFT TEAM STRUCTURE 2016/17



REPORT FOR:	**GOVERNANCE, AUDIT, RISK MANAGEMENT AND STANDARDS COMMITTEE**
Date of Meeting:	28 January 2016
Subject:	**INFORMATION REPORT – Internal Audit Mid-Year Report and Plan Update 2015/16**
Responsible Officer:	Tom Whiting – Corporate Director Resources and Commercial
Exempt:	No
Enclosures:	Appendix 1 – 2015/16 Internal Audit Mid-Year Report + Quarter 3 & Plan Update

Section 1 – Summary

This report sets out progress against the 2015/16 Internal Audit plan.
FOR INFORMATION

Section 2 – Report

Introduction

2.1. Annually the GARMS Committee considers a mid and full year Internal Audit Report covering progress against the Internal Audit plan. This is the mid-year report for 2015/16 and also covers progress in Quarter 3 and an update on the annual plan (Appendix 1).

Mid-year Results

2.2 As reported at the last GARMS Committee overall 37% of the plan was completed at mid-year 8% lower than the target (45%) however:

- the budget from the two temporarily vacant posts (maternity leave + a secondment) has been added to the budget for external internal audit provision however the resulting work is not due to be undertaken until Quarter 4;
- IT reviews in the plan due to be undertaken by PwC (under the shared service framework) are yet to be started;
- there have been a number of emerging risks e.g. the CIPFA Delivering Good Governance in Local Government consultation and suspected financial irregularities (examples can be provided verbally under part II);
- there has been a higher than anticipated level of input required to finalise work undertaken under the 2014/15 plan, in particular reviews undertaken by PwC;
- a change in reporting lines resulting in an increased workload for the Head of Internal Audit.

However:

- all of the Core Financial Systems work has been completed;
- the Annual Governance Review and Statement have been completed; and
- progress has been made with the new approach to the audit of schools.

2.3 In the first quarter of every financial year the work of the Internal Audit team concentrates on the authority's core financial systems. The systems are reviewed on a 3 year risk based cycle. Three of the 9 systems were reviewed in the first quarter of 2015/16 and control self-assessments were completed for the other 6 systems. In addition, to satisfy the requirements of the External Auditors, managers were asked to review and update systems documentation and Internal Audit undertook walkthrough tests to confirm the actual system in operation for all core financial systems. Out of a total of 32 controls reviewed, 27 (84%) were fully operating, 3 (10%) were substantially operating and 2 (6%) were partially operating.

2.4 Overall 4 (57%) of the Internal Audit performance targets have been met or exceeded. Three (43%) of the performance targets have been exceeded, 1 (14%) have been fully met and 3 (43%) targets have not been met. Performance indicator 3 (projects completed within budgeted timescale) has not been met due to a decision during the development of the audit plan to minimise audit days wherever possible resulting in fewer targets being met; performance indicator 5 (follow-up undertaken) has not been met as follows ups were suspended in the first half of the year to enable the reduced team to concentrate on reviews required to be completed in the first half of the year i.e. core financial systems and the annual governance review; performance indicator 7 – (plan achieved) whilst 11% lower than the target was achieved with 33% reduced resources (see 2.2 above).

2.5 Insufficient data has been collected to enable reporting on the Corporate Indicators for the first half of the year as data is collected for these during follow-up i.e. actual number of audit recommendations implemented and auditee response times. These will be reported for the full year in the year-end report.

2.6 The most significant pieces of work undertaken in quarters one and two of 2015/16, in terms of risk to the Council, are the reviews of Business Continuity & IT Disaster Recovery and the IT Data Centre which were reported to GARMS at the last meeting.

Quarter Three Update

2.7 The completion of a number of pieces of work in quarter 3 have been delayed due resources being diverted to work on 2 suspected financial irregularities and an emerging risk. One suspected financial irregularity involved an allegation of corruption which at the conclusion of the allegation was unproven and the other involves whistleblowing allegations against a Headteacher that are currently still being investigated (we are working with the National College of Teaching & Learning on this). The emerging risk resulting in a review of Harrow School Improvement Partnership is also still ongoing.

2015/16 Plan Update

2.8 During the development of the 2015/16 audit plan it was known that one member of the team would be on maternity leave for the whole year and another was seconded for the first half of the year (this was later extended for a further 2.5 months). However the costs of externally provided internal audit provision whether via our Shared Service Contract with PwC or via the employment of temporary staff is higher than the in-house provision leading to a gap in audit days achievable.

2.9 As in past years a number of factors have emerged during the course of the year resulting in the need to include additional work in some areas e.g. emerging risks, changes to grant conditions etc.

2.10 The combined result of these two elements has resulted in 165 audit days taken out of the original 2015/16 plan (table 9 – Appendix 1). However as 72 audit days have been added in (table 8 – Appendix 1) overall this equates to a reduction of 97 audit days which is equivalent to 54% of 1 x FTE . Overall, due to maternity leave and a secondment the team resources for 2015/16 were reduced by 315 audit days (35% of original plan days). The budget for these posts (less maternity pay) has been used to purchase external audit and risk days however this is more expensive than in-house resources hence the need to reduce the overall plan by 97 audit days which equates to an 11% reduction of the original plan of 902 audit days.

2.11 Reviews taken out of the 2015/16 plan will automatically be considered for inclusion in the 2016/17 audit plan.

Section 3 – Further Information

3.1 The next report on the performance of the Internal Audit team will be the 2015/16 Year-End Report to be submitted to GARM Committee in July 2016.

Section 4 – Financial Implications

4.1 There are no financial implications to this report.

Section 5 - Equalities implications

5.1 There are no equalities implications.

Section 6 – Corporate Priorities

6.1 Internal Audit contributes to all the corporate priorities by enhancing the robustness of the control environment and governance mechanisms that directly or indirectly support these priorities.

Section 3 - Statutory Officer Clearance

Name: Dawn Calvert	✓	Chief Financial Officer
Date: 19/01/16		

Section 7 - Contact Details and Background Papers

Contact: Susan Dixson, Head of Internal Audit, Tel: 0208 424 1420

Background Papers: None

2015/16 INTERNAL AUDIT MID-YEAR REPORT + QUARTER 3 & PLAN UPDATE

APPENDIX 1

KEY
RED assurance = 0-50% controls operating (O)/substantially operating (SO)
RED/AMBER assurance = 51-60% controls operating/substantially operating
AMBER assurance = 61-70% controls operating/substantially operating
AMBER/GREEN assurance = 71-80% controls operating/substantially operating
GREEN assurance = 81-100% controls operating/substantially operating
(D) = Assurance ratings that have been downgraded due to the high number of high risk recommendations made (with the agreement of the Head of Internal Audit)

Mid-year Results

1. Table 1 below details all the reports issued in Q1/Q2 of 2015/16 from the 2014/15 audit plan with the report assurance rating.

Table 1 – 2014/15 Plan Reports Issued in Q1&2 of 2015/16

Review	Audit Coverage	Assurance Rating		Follow-up Due
Business Continuity & IT Disaster Recovery	A review of controls over the arrangements that are in place for the prevention of system downtime through adequate resilience.	**RED 20% O**	**AMBER 42% SO (D)**	January 2016. 23 recommendations made, 19 high risk, all agreed for implementation.
Council Tax Discounts	A review of the controls in place to prevent fraud within Council Tax Discounts for single persons' discounts, student discounts and disabled band reductions.	**AMBER 56 % O 11% SO**		December 2015. 4 recommendations made, 1 high risk, all agreed for implementation.

Review	**Audit Coverage**	**Assurance Rating**	**Follow-up Due**
Highways Contract Management	To ensure robust monitoring systems are in place, the services obtained are as agreed in the contracts and value for money is achieved. Furthermore to ensure the efficiency, effectiveness and economy of the services is optimised.	**GREEN** **97% O**	None required. 1 medium risk recommendation made and agreed for implementation.
Whitchurch Junior School Investigation – 2nd Follow-up	Initial follow-up (Dec 14) assurance improved from red to red/amber. Therefore 2nd follow-up undertaken (July 15).	**GREEN** **74% Recs fully implemented** **19% Substantially implemented**	No further follow-up required
Data Centre Landlord Risks Review	Review of the environment and physical security controls over the IT data centre which support Harrow Council's core IT infrastructure and systems.	**RED** **7% O**	January 2016

2. Table 2 below details the completed assurance report reviews issued in Q1/Q2 of 2015/16 from the 2015/16 Plan and the assurance rating.

Table 2 – 2015/16 Plan Completed Assurance Report Reviews in Q1/Q2 of 2015/16

Review	**Audit Coverage**	**ASSURANCE RATING**	**Follow-up Due**
Housing Rents	Key Control Review + system notes	**GREEN** **86% O 11%SO**	None required. 4 recommendations made, none high risk, all agreed for implementation.

APPENDIX 1

Corporate Accounts Payable	Key Control Review + system notes	**AMBER 94% O**	**GREEN (D)**	April 2016. 1 high risk recommendation agreed for implementation.
Corporate Accounts Receivable	Key Control Review + system notes	**GREEN 88% O 4% SO**		None required. I medium risk recommendation made and agreed for implementation.

3. Table 3 below details the completed assurance non report reviews undertaken in Q1/Q2 of 2015/16 from the 201516 Plan.

Table 3 – 2015/16 Plan Completed Assurance Non Report Reviews/work in Q1/Q2 of 2015/16

Review	Audit Coverage	Comments
Payroll	System notes, walkthrough. CRSA	Complete – GREEN assurance
Treasury Management	System notes, walkthrough. CRSA	Complete – GREEN assurance
Council Tax	System notes, walkthrough. CRSA	Complete – GREEN assurance
Capital Expenditure	System notes, walkthrough. CRSA	Complete – GREEN assurance
NDR	System notes, walkthrough. CRSA	Complete – GREEN assurance
Housing Benefits	System notes, walkthrough. CRSA	Complete – GREEN assurance
Corporate Governance	Annual Governance review, drafting AGS, AGS Action Plan	Complete to end of Q2
Information Governance Board (IGB)	To ensure that the Council has effective polices & management arrangements covering Information Governance	Complete to end of Q2
Bus Subsidy Grant	Audit and sign-off of claim	Complete
Suspected Financial Irregularities + Control	• 40 Laptops stolen - see CAFT report	Complete to end of Q2

Reviews	• School Purchase Card misuse – advice to Headteacher on investigation • Public Health Income – in- adequate record keeping by officer no longer working for Council	
Professional Advice	Advice on risk mitigation & control	Complete to end of Q2
Liaison with External Audit	On-going liaison throughout the year	Complete to end of Q2
Audit Management	e.g. planning, GARM reporting	Complete to end of Q2

Internal Audit Performance Indicators

4. Table 4 below outlines the seven Internal Audit indicators agreed for the year, including the key indicator covering achievement of the IA annual plan. These indicators cover performance on projects from the 2014/15 plan and the 2015/16 plan issued in the first half of the year (i.e. up to 30/09/14).

Table 4 – Internal Audit Performance Indicator Results

	Performance Indicator	Target	Mid Year Result
1	Recommendations agreed for implementation	95%	100%
2	Final reports issued on / ahead of time	85%	100%
3	Projects completed within budgeted time allowance	85%	70%
4	Target met for issue of draft report after end of fieldwork	85%	100%
5	Follow up undertaken	100%	0%
6	Plan achieved for key control reviews	100%	100%
7	Plan achieved overall (key indicator)	37%	48%

Analysis of Results

5. Overall 4 (57%) of the performance targets have been met or exceeded. Three (43%) of the performance targets have been exceeded, 1 (14%) has been fully met.

6. Three (43%) targets were not met. All of these are a direct result of reduced Internal Audit resources. Target 3 – projects completed within budgeted timescale has not been met due to a decision during the development of the audit plan to minimise audit days wherever possible resulting in fewer targets being met; Target 5 – follows ups were suspended in the first half of the year to enable the reduced team to concentrate on reviews required to be completed in the first half of the year i.e. core financial systems and the annual governance review; Target 7 – plan achieved, whilst 11% lower than the target was achieved with 33% reduced resources.

7. In the second half of the year target 5 and 7 are expected to improve as a seconded member of the team is returning and will be tasked with completing follow-ups and PwC will be undertaking a number of IT audit reviews.

Corporate Performance Indicators Results

8. Insufficient data has been collected to enable reporting on the Corporate Indicators for the first half of the year as data is collected for these during follow-up i.e. actual number of audit recommendations implemented and auditee response times. These will be reported for the full year in the year-end report.

Quarter Three Update

9. Table 5 below details the reviews completed in Q3 2015/16.

Table 5 –2015/16 Plan Completed Assurance Report Reviews in Q3 of 2015/16

Review	Audit Coverage	ASSURANCE RATING	Follow-up Due
Leaseholders Charges	To review the adequacy, application and efficiency of the processes in place to ensure that leaseholder service charges are accurate and correctly accounted for.	AMBER 61% O	April 2016

Freedom of Information	To review the policy and process employed by the Council for dealing with Freedom of Information requests to ensure that they are appropriate and proportionate. This was a joint review with the Lean team.	AMBER 31% O 38% SO	April 2016

10. Table 6 below details the reviews in progress during Q3 2015/16

Table 6 –2015/16 Plan Reviews in Progress in Q3 of 2015/16

Review	Audit Coverage	Progress
SIMS Personnel	C/f from 2014/15 plan. To ensure robust controls are in place in schools for the accuracy of the processing of Payroll through the SIMS Personnel system and to prevent or detect fraud.	4 school visit complete – summary of findings and conclusions to be drafted.
Stanburn Primary School		Draft report issued and 1st response to recommendations received but need more information/ detail to finalise report (new HT in place). Significant changes in the school and they have been seeking advice on various matters.
Whitchurch First - SFI	C/f from 2014/14	Witness statement and evidence for NCTL being prepared (hearing due sometime between March and Sept 2016)
Schools HR Policies and Procedures		2 schools visited out of 4 – 2 others booked but cancelled because of Planning Enf SFI and now being re-booked.

Planning Enforcement SFI	Investigation of corruption allegations against a Planning Enforcement Officer undertaken jointly by Internal Audit and Corporate Fraud – no evidence of corruption found however a number of recommendations made to improve system/process.	Draft report issued.
Blocked Invoices	Identification/elimination of causes	Fieldwork ongoing
Fixed Assets	Ensure records on Northgate (Dwellings & Garages) and on SAP (Shops & Community Halls) are up to date and accurate	Fieldwork ongoing
Mandate Fraud Risk	A review of controls in place to prevent fraud	Planning in progress
School whistleblowing investigation - SFI	An investigation into recruitment practices and use of special needs funding following a whistleblowing allegation.	Fieldwork ongoing
HSIP	To confirm HSIP's status and to ensure that there is transparency in financial balances and the income and expenditure accounts including compliance with Council policy and procedures	Testing
Tenancy Changes	To ensure appropriate checks undertaken when there is a change of tenancy	Preparing draft report
Procurement Fraud	Assessing risk of procurement fraud and preventative controls in place	Draft report awaiting review
Right to Buy	A review of controls in place to prevent fraud	Draft report awaiting review
CIPFA Fraud Code	Self –assessment against code	On-going

11. Table 7 below shows work on the 2015/16 Plan not yet started that will be carried out in Q4 2015/16

Review	Audit Coverage
Risk Management	Maintenance and update of Corporate Risk Registers + Corporate Risk Appetite Statement – external expertise being brought in.
Follow-ups	Standard follow-ups of Red, Red/Amber & Amber reports – to be undertaken by Assistant Auditor returning from secondment.

Debt Management	To ensure that a joined up corporate approach is taken to debt management – to be undertaken by PwC
Northgate Housing Repairs – Application Review	Covering access controls, data entry, processing, output, interfaces, back-up and recovery – to be undertaken by PwC
SAP	Targeted review of parameters – to be undertaken by PwC
IT Change Management	Review of system in place to manage IT change – to be undertaken by PwC
E-invoicing	Post implementation review
Public Health Checks Follow-up	Follow-up of Audit Briefing note issued 2013/14
Audit Plan 2016/17	Consultation on and risk assessment of reviews to be included in the 2016/17 annual audit plan.

12. Table 8 below shows reviews that have been added or extended in the 2015/16 plan

Table 8 – Additional/Extended reviews in the 2015/16 Plan

Review	Reason Added/Extended
Corporate Governance	New Governance Framework guidance about to be issued by CIPFA , Harrow Code of Corporate Governance to be reviewed and updated in line with new guidance for 2016/17 plus accounts deadline being brought forward requires governance review to be started in Q4 2015/16 instead of Q1 2016/17.
Risk Management	Review & update of policy & procedures which are out of date – to make best use of expertise being employed.
HSIP	Concerns raised by management – emerging risk
Families First	Change in the grant conditions requires a more active Internal Audit involvement.
IT Data Centre Follow-up	Due to the complex nature and profile of the review a more detailed follow-up is required.
BC& IT DR Follow-up	Due to the complex nature and profile of the review a more detailed follow-up is required.
Peer Review	We are required to have an external assessment against the PSIAS once every five years – London Boroughs have agreed to undertake peer reviews to achieve this at minimum cost. HIA to undertake peer review of Croydon in February 2016.
Schools HR Policies and	Div Dir of HR & Shared Services has also sought advice/ audit perspective on which schools policies

Procedures	have the highest priority for update. Preparing some advice on this.
IT Contract Management	Pro-active element of proposed 2016/17 review.

13. This equates to an estimated 72 extra audit days.

14. Table 9 below shows reviews in the 2015/16 Plan that will no longer be undertaken

Table 9 – Reviews in 2015/16 Plan no longer to be undertaken

Review	Audit Coverage	Reason Omitted
Help2Let	Risk based systems review.	Resource constraint
Cabinet Decisions	A review of the quality/robustness of information supplied in Cabinet reports to support key recommendations and ensure sound decisions.	Resource constraint
Income Maximisation (incl. Trading Standards)	A check to ensure that Council is charging for everything it current should be charging for ahead of commercialisation	Resource constraint
Project Assurance/Management	Input to process for new construction delivery unit	New construction delivery unit no longer going ahead
Legal Services Company	Review of governance, income and accounting arrangements	Resource constraint
Pertemps Contract	Contract Management (inc. goods receipting)	Resource constraint
MyCep - PayPal, Claw Back of Surpluses	To ensure adequacy, application and effectiveness of controls in place for commercialisation	Resource constraint
Cash Payments	Review of cash payments made to identify alternative suitable methods where possible	Dealt with by management
Headteachers' Remuneration	Review of Headteachers' Remuneration across the borough	Resource constraint
Schools Expansion Programme Phase 3	Programme Management Assurance	Resource constraint

Trade Waste	Assurance re progress made to improve processes and reduce fraud risk	Resource constraint
Grants	Compliance check on grant conditions	Resource constraint
HR Self-service	Review of the controls in place to ensure changes to payment details are not open to fraud and error	Resource constraint
Homelessness Data on Northgate	Information Security, data quality, information sharing	Resource constraint

15. This equates to 165 audit days taken out of the original 2015/16 plan. However as 72 audit days have been added in (Table 8 above) overall this equates to a reduction of 97 audit days which is equivalent to 54% of 1 x FTE[1]. Overall, due to maternity leave and a secondment[2] the team resources for 2015/16 were reduced by 315 audit days (35% of original plan days). The budget for these posts (less maternity pay) has been used to purchase external audit and risk days however this is more expensive than in-house resources hence the need to reduce the overall plan by 97 audit days which equates to an 11% reduction of the original plan of 902 audit days.

16. Reviews taken out of the 2015/16 plan will automatically be considered for inclusion in the 2016/17 audit plan.

Susan Dixson
Head of Internal Audit
13/01/16

[1] 1 x Full Time Equivalent = 180 audit days
[2] 1 x 180 audit days + 1 x 135 audit days = 315 audit days

REPORT FOR:	**GOVERNANCE, AUDIT, RISK MANAGEMENT AND STANDARDS COMMITTEE**
Date of Meeting:	28 January 2016
Subject:	**INFORMATION REPORT – IT Contract Management Terms of Reference Report**
Responsible Officer:	Tom Whiting – Corporate Director Resources and Commercial
Exempt:	No
Enclosures:	Appendix 1 – IT Contract Management Terms of Reference

Section 1 – Summary

This report sets out the Terms of Reference for the Internal Audit Review of IT Contract Management.

FOR INFORMATION

Section 2 – Report
Introduction

2.1 This review was proposed as a result of a review undertaken of the IT Data Centre as part of the 2014/15 risk based annual audit plan. The IT Data Centre review was highlighted to the GARMS Committee as part of the 2014/15 Annual Governance Statement and the full report presented at the last GARMS Committee meeting in December 2015.

2.2 At the last meeting the GARMS Committee expressed an interest in the proposed review and asked that the Terms of Reference for the review be presented to the next meeting (Terms of Reference attached – Appendix 1).

Development of Audit Objective and Scope

2.3 The audit objective and scope of the review has been developed in consultation with the Head of Business Transformation Partnership taking into account previous contract management reviews, the CIPFA Contract Audit Toolkit and the Council's Contract Management Procedures.

2.4 The objective of the review will be:

- to ensure that effective contract management is in place for the IT Contract with Sopra Steria, that services are obtained in accordance with the contract and that value for money is achieved.

2.5 The scope will be:

- Skills and level of resources in place to monitor the contract
  Covering controls in place to ensure that adequate skills and resource levels are in place to monitor the contract
- Risk Management
  Covering controls in place to manage and mitigate risks throughout the life of the contract
- Performance monitoring/quality assurance
  Covering controls in place to monitor performance, taking action/escalation of poor performance and ensuring quality
- Financial management
  Covering controls in place for budget management and to ensure that expenditure is in line with the contract and services provided
- Relationship management
  Covering controls in place to facilitate mutual trust and understanding, openness and good communications including clear roles and responsibilities
- Governance and reporting
  Covering controls in place to ensure appropriate governance and reporting of the contract e.g. at key milestones; of performance and variances

Methodology

2.6 The review will be split into two parts. The first part will be undertaken as part of the 2015/16 Internal Audit Plan and will involve Internal Audit working pro-actively with management providing advice on the controls expected to be incorporated into a robust Contract Management process.

2.7 The second part of the review will be undertaken as part of the 2016/17 Internal Audit Plan and will involve the normal risk based approach that will include the identification, sample testing and evaluation of key internal controls within the system. Sufficient testing will be undertaken to enable Internal Audit to provide managers with a balanced view and appropriate assurance as to the adequacy and application of the key internal controls.

Section 3 – Further Information

3.1 An update of progress will be provided at the next GARMS Committee meeting and the assurance outcome of the second part of the review will be reported in the 2016/17 mid-year report.

Section 4 – Financial Implications

4.1 There are no financial implications to this report.

Section 5 - Equalities implications

5.1 There are no equalities implications.

Section 6 – Corporate Priorities

6.1 Internal Audit contributes to all the corporate priorities by enhancing the robustness of the control environment and governance mechanisms that directly or indirectly support these priorities.

Name: Dawn Calvert	✓	Chief Financial Officer
Date: 19/01/16		

Section 7 - Contact Details and Background Papers

Contact: Susan Dixson, Head of Internal Audit, Tel: 0208 424 1420

Background Papers: None

RESOURCES DIRECTORATE
IT CONTRACT MANAGEMENT REVIEW

TERMS OF REFERENCE
Audit Plan – 2015/16 & 2016/17

1 INTRODUCTION

This review forms part of the above years' Internal Audit annual plan and was proposed as a result of a review undertaken of the IT Data Centre as part of the 2014/15 risk based annual audit plan. The review links to the all council's corporate priorities as IT is a key element of the achievement of the Council's objectives.

2 AUDIT OBJECTIVE AND SCOPE

The objective is to ensure that effective contract management is in place for the IT Contract with Sopra Steria, that services are obtained in accordance with the contract and that value for money is achieved.

Scope (Agreed Key Risk Areas)

- Skills and level of resources in place to monitor the contract
- Risk Management
- Performance monitoring/quality assurance
- Financial management
- Relationship management
- Governance and reporting

3 METHODOLOGY

The review will be split into two parts. The first part will be undertaken as part of the 2015/16 Internal Audit Plan and will involve Internal Audit working pro-actively with management providing advice on the controls expected to be incorporated into a robust Contract Management process.

The second part of the review will be undertaken as part of the 2016/17 Internal Audit Plan and will involve the normal risk based approach that will include the identification, sample testing and evaluation of key internal controls within the system. Sufficient testing will be undertaken to enable Internal Audit to provide managers with a balanced view and appropriate assurance as to the adequacy and application of the key internal controls.

4 REPORTING

Audit findings will be verbally reported to the Head of Business Transformation Partnership and a written draft report issued within one week of this meeting. An Action Planning Meeting will be held with the client within 2 weeks of the issue of the draft report to obtain agreed actions to the recommendations.

A final report will be issued within two weeks of the client's response to the draft report. The final report will include agreed action for the implementation of recommendations, including timescales and responsible officers.

The report will provide:

An overall opinion of the system audited, highlighting key strengths and weaknesses in internal control;

An explanation of the risks associated with identified weaknesses in internal controls to enable the client to clearly identify the priority that they should afford to each issue;

Any necessary recommendations for enhancing the internal control system categorised to indicate significance.

5 REPORT DISTRIBUTION

The draft report will be issued to the:

- Head of Business Transformation Partnership; and
- Director of Customer Services & Business Transformation

The final report will be issued to:

- Head of Business Transformation Partnership;
- Director of Customer Services & Business Transformation; and
- Corporate Director Resources & Commercial
- Director of Finance

6 RESOURCES

The first part of the audit will be undertaken by the Head of Internal Audit

Who can be contacted on extension 2420

7 CLIENT SIDE AGREEMENT

I agree to the above terms of reference and undertake to ensure that:
Internal Audit is provided with access to records and personnel necessary for the purpose of the audit;

The audit findings will be discussed with Internal Audit and that the proposed action and timescale for the implementation of recommendations is confirmed promptly.

REPORT FOR:	**GOVERNANCE, AUDIT, RISK MANAGEMENT AND STANDARDS COMMITTEE**
Date of Meeting:	28 January 2016
Subject:	Treasury Management Strategy Statement including Prudential Indicators, Minimum Revenue Provision Policy Statement and Annual Investment Strategy for 2016/17
Responsible Officer:	Dawn Calvert, Director of Finance
Exempt:	No
Wards affected:	All
Enclosures:	Appendix 1 – Legislation and Regulations Impacting on Treasury Management Appendix 2 – Treasury Management Delegations and Responsibilities Appendix 3 – Economic Background

Harrow COUNCIL LONDON

Section 1 – Summary and Recommendation

<u>Summary:</u>

This report sets out the Council's Treasury Management Strategy Statement including Prudential Indicators, Minimum Revenue Provision Policy Statement and Annual Investment Strategy for 2016/17.

<u>Recommendation:</u>

The Committee is requested to review and comment on:

- Treasury Management Strategy Statement and Prudential Indicators for 2016/17;
- Minimum Revenue Provision Policy Statement for 2016/17;
- Annual Investment Strategy for 2016/17.
- That the maximum total investment in the Investment Property Strategy be set at £20m
- That the limit of investments for over 364 days be increased to £60m.

<u>Reason</u>

To promote effective financial management and comply with the Local Authorities (Capital Finance and Accounting) Regulations 2003 and other relevant guidance.

The Committee is responsible for ensuring effective scrutiny of the Treasury Management Strategy and associated strategies and policies.

Section 2 – Report

1. INTRODUCTION

1.1 Background

1. The Chartered Institute of Public Finance and Accountancy (CIPFA) defines Treasury Management as:

   "The management of the local authority's investments and 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."

   The Council has adopted this definition.

2. The Council is required to operate a balanced budget, which broadly means that cash raised during the year will meet cash expenditure. The first main function of the treasury management operation is to ensure that this cash flow is adequately planned, with cash being available when it is needed. Surplus monies are invested with low risk counterparties or instruments commensurate with the Council's low risk appetite, providing adequate liquidity initially before considering investment return.

3. The second main function of the Treasury Management service is the funding of the Council's capital programme. This programme provides a guide to the borrowing need of the Council, essentially the longer term cash flow planning, to ensure that the Council can meet its capital spending obligations. This 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.

4. The Local Government Act 2003 and supporting regulations require the Council to 'have regard to' the Prudential Code (The Prudential Code for Capital Finance in Local Authorities [CIPFA 2011 Edition]) and Treasury Management Code (Treasury Management in the Public Services: Code of Practice and Cross-Sectoral Guidance Notes [CIPFA 2011 Edition]), in setting Treasury and Prudential Indicators for the next three years and in ensuring that the Council's capital investment programme is affordable, prudent and sustainable.

5. The Act, the Codes and Department for Communities and Local Government Investment Guidance (2010) require the Council to set out its Treasury Strategy for Borrowing and to prepare an Annual Investment Strategy that establishes the Council's policies for managing its investments and for giving priority to the security and liquidity of those investments. A summary of the relevant legislation, regulations and guidance is included as Appendix 1.

6. The budget for each financial year includes the revenue costs that flow from capital financing decisions. Under the Treasury Management Code, increases in capital expenditure should be limited to levels whereby increases in interest charges and running costs are affordable within the projected income of the Council for the foreseeable future.

7. The Council regards the successful identification, monitoring and control of risk to be the prime criteria by which the effectiveness of its treasury management activities will be measured. Accordingly, the analysis and reporting of treasury management activities will focus on their risk implications for the organisation.

8. The Council recognises that effective treasury management will provide support towards the achievement of its business and service objectives. It is therefore committed to the principles of achieving value for money in treasury management, and to employing suitable comprehensive performance measurement techniques, within the context of effective risk management.

1.2 CIPFA Requirements

9. The Council has formally adopted the Treasury Management Code, the primary requirements of which are as follows:

    - Creation and maintenance of a Treasury Management Policy Statement which sets out the policies and objectives of the Council's treasury management activities.

    - Creation and maintenance of Treasury Management Practices ("TMPs") that set out the manner in which the Council will seek to achieve those policies and objectives.

    - Receipt by the full Council and/or Cabinet of an annual Treasury Management Strategy Statement - including the Annual Investment Strategy and Minimum Revenue Provision Policy - for the year ahead, a Half-year Review Report and an Annual Report (stewardship report) covering activities during the previous year.

    - Delegation by the Council of responsibilities for implementing and monitoring treasury management policies and practices and for the execution and administration of treasury management decisions.

    - Delegation by the Council of the role of scrutiny of treasury management strategy and policies to a specific named body.

1.3 Reporting Requirements

10. As introduced above, the Council and/or Cabinet are required to receive and approve, as a minimum, three main reports each year, which incorporate a variety of policies, estimates and actuals.

    Treasury Management Strategy Statement report (this report) - The first, and most important report is presented to the Council in February and covers:

    - the capital programme (including Prudential Indicators);
    - a Minimum Revenue Provision (MRP) policy (how residual capital expenditure is charged to revenue over time);
    - the Treasury Management Strategy (how the investments and borrowings are to be organised) including treasury indicators; and
    - an investment strategy (the parameters on how investments are to be managed).

    Mid-year Review report – This is presented to Cabinet in the autumn and updates Members on the progress of the capital position, reporting on Prudential Indicators and identifying whether the treasury strategy is meeting the objectives or whether any policies require revision.

Treasury Management Outturn report – This is presented to Cabinet in June/July and provides details of a selection of actual prudential and treasury indicators and actual treasury operations compared to the estimates within the Strategy.

Scrutiny - The above reports are required to be adequately scrutinised with the role being undertaken by the the Governance, Audit, Risk Management and Standards Committee (GARMSC).

11. The Council has delegated responsibility for the implementation and regular monitoring of its treasury management policies and treasury management practices to the Section 151 officer. The Section 151 Officer chairs the Treasury Management Group (TMG), which monitors the treasury management activity and market conditions.

12. Further details of responsibilities are given in Appendix 2.

1.4 Training

13. The Treasury Management Code requires the responsible officer to ensure that Members with responsibility for treasury management receive adequate training in this area. This especially applies to Members responsible for scrutiny.

14. The Council's Treasury Management Advisers will provide an updated training session for all Members of GARMSC and other interested Members and other training opportunities will be offered as appropriate.

15. The training needs of Treasury Management officers are periodically reviewed as part of the Learning and Development programme with appropriate training and support provided.

1.5 Treasury Management Advisers

16. The Council has engaged Capita Asset Services, Treasury Solutions as its external Treasury Management Advisers.

17. However, the Council recognises that responsibility for treasury management decisions remains with itself at all times and will ensure that undue reliance is not placed upon external service providers.

18. 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 is assessed are properly agreed and documented, and subjected to regular review.

1.6 Treasury Management Strategy for 2016/17

19. The Strategy covers:-

Capital Issues (Paragraph 2)

- Capital programme and Prudential Indicators (Paragraph 2.1);
- Capital Financing Requirement (Paragraph 2.2);
- Minimum Revenue Provision Policy (Paragraph 2.3).

Treasury Management Issues (Paragraph 3)

- Affordability Prudential Indicators (Paragraph 3.1);
- Borrowing and Investments (Paragraph 3.2);
- Prospects for Interest Rates and Economic Commentary (Paragraph 3.3);
- Borrowing Strategy (Paragraph 3.4);
- Treasury Management Limits on Activity (Paragraph 3.5);
- Policy on borrowing in advance of need (Paragraph 3.6);
- Debt rescheduling (Paragraph 3.7);
- Annual Investment Strategy (Paragraph 3.8).

20. These elements cover the requirements of the Local Government Act 2003, the CIPFA Prudential Code, the Department for Communities and Local Government (DCLG) Minimum Revenue Provision Guidance, the CIPFA Treasury Management Code and DCLG Investment Guidance.

21. It is not considered necessary to produce a separate treasury strategy for the Housing Revenue Account (HRA) in light of the co-mingling of debt and investments between HRA and the General Fund. Where appropriate, details of allocations of balances and interest to HRA are contained in this report.

2. CAPITAL ISSUES

22. The Council's capital expenditure programme is the key driver of treasury management activity. The output of the programme is reflected in the Prudential Indicators, which are designed to assist Members' overview and confirm the capital expenditure programme. The values shown in the tables for 2014-15 and 2015-16 are actual and estimated outturn respectively and not the strategy for those years.

2.1 Capital Programme and Prudential Indicators

23. The first prudential indicator is a summary of the Council's capital expenditure based on the approved capital programme. Amendments may be necessary in the light of decisions taken during the budget cycle. The table below summarises the capital expenditure programme and the ways in which it will be financed. Any shortfall of resources results in a financing need.

Table 1 Capital Expenditure and Funding

	2014/15	2015/16	2016/17	2017/18	2018/19
	Actual	Estimate	Estimate	Estimate	Estimate
	£'000	£'000	£'000	£'000	£'000
Expenditure					
Community Health & Wellbeing	3,443				
Children & Families	23,057				
Environmen & Enterprise	21,915				
Resources	9,512	16,917	20,525	8,249	3,193
Adults		721	1,750	2,640	1,540
Schools		52,134	16,170	15,465	10,110
Environmental Services		18,867	15,520	23,508	22,408
Community and Culture		1,449	6,490	1,650	460
Housing General Fund		5,199	16,970	9,470	1,970
Regeneration		3,416	25,480	14,250	250
Infrastructure			5,000		
HRA	4,443	18,264	25,550	17,038	9,139
TOTAL	**62,370**	**116,967**	**133,455**	**92,270**	**49,070**
Funding:-					
Grants	27,779	56,060	25,759	20,115	19,553
Capital receipts	179	3,312	10,398	4,935	1,045
Revenue financing	5,534	11,853	9,987	11,103	8,024
Section 106 / Section 20	553	1,606	1,565	1,000	0
TOTAL	**34,045**	**72,831**	**47,709**	**37,153**	**28,622**
Net financing need for the year	**28,325**	**44,136**	**85,746**	**55,117**	**20,448**

2.2 Capital Financing Requirement

24. The second prudential indicator is the Council's Capital Financing Requirement (CFR). The CFR is the total 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 new capital expenditure, which has not immediately been paid for, will increase the CFR.

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

26. The CFR includes any other long term liabilities (e.g. PFI schemes, finance leases). Whilst these increase the CFR, and therefore the Council's borrowing requirement, these types of scheme include a funding facility and so the Council is not required to borrow separately for them. The Council currently has £17m of such schemes within the CFR.

27. CFR projections are included in the table below.

Table 2 Capital Financing Requirement

	2014/15	2015/16	2016/17	2017/18	2018/19
	Actual	Estimate	Estimate	Estimate	Estimate
	£'000	£'000	£'000	£'000	£'000
CFR as at 31 March					
Non – HRA	256,390	286,943	356,142	396,779	401,829
HRA	149,507	151,213	154,783	154,753	154,723
TOTAL	**405,897**	**438,156**	**510,925**	**551,532**	**556,552**
Annual change in CFR					
Capital expenditure	62,370	116,967	133,455	92,270	49,070
Non-borrowing sources of funding	- 34,045	- 72,831	- 47,709	- 37,153	- 28,622
Lease liability	500	500	389	410	456
Less MRP	- 16,681	- 12,377	- 13,365	- 14,920	- 15,884
TOTAL	**12,144**	**32,259**	**72,769**	**40,607**	**5,020**

The Non-HRA CFR increases over the five years from £256m to £402m reflecting the existing regeneration programme, the property investment portfolio, the schools expansion, re-building and improvements programme, the renewal and replacement of highways, footways and streetlighting, the purchase of properties for temporary accommodation and upgrades and enhancements to ICT systems. Through a special determination the debt limit for the HRA has been increased to £154.8m and work will be carried out in line with this increase.

2.3. Minimum Revenue Provision Policy

28. Capital expenditure is generally defined as expenditure on assets that have a life expectancy of more than one year e.g. buildings, vehicles, machinery etc. The accounting approach is to spread the cost over the the estimated useful life of the asset. The mechanism for spreading these costs is through an annual MRP. The MRP is the means by which capital expenditure, which is financed by borrowing or credit arrangements, is funded by Council Tax and housing rents.

29. The Local Authorities (Capital Finance and Accounting) (England) (Amendment) Regulations 2008 (the Regulations) require the Council to approve a Minimum Revenue Provision (MRP) Statement setting out what provision is to be made in the General Fund for the repayment of debt, and how the provision is to be calculated. The purpose of the Statement is to ensure the provision is prudent, allowing the debt to be repaid over a period reasonably commensurate with that over which the capital expenditure benefits. The first point in the Statement is the subject of a separate report to Council and, subject to their agreement, the Council is recommended to approve the following MRP Statement:

- For capital expenditure incurred before 1 April 2008 or which in the future will be Supported Capital Expenditure, the MRP policy will be the equal annual reduction of 2% of the outstanding debt at 1 April 2015 for the subsequent 50 years.

- For all capital expenditure financed from unsupported (prudential) borrowing (including PFI and finance leases), MRP will be based upon an asset life method in accordance with Option 3 of the guidance.

- In some cases where a scheme is financed by prudential borrowing it may be appropriate to vary the profile of the MRP charge to reflect the future income streams associated with the asset, whilst retaining the principle that the full amount of borrowing will be charged as MRP over the asset's estimated useful life.

- A voluntary MRP may be made from either revenue or voluntarily set aside capital receipts.

- Estimated life periods and amortisation methodologies will be determined under delegated powers. To the extent that expenditure is not on the creation of an asset and is of a type that is subject to estimated life periods that are referred to in the guidance, these periods will generally be adopted by the Council. However, the Council reserves the right to determine useful life periods and prudent MRP in exceptional circumstances where the recommendations of the guidance would not be appropriate.

- Freehold land cannot properly have a life attributed to it, so for the purposes of Asset Life method it will be treated as equal to a maximum of 50 years. But if there is a structure on the land which the authority considers to have a life longer than 50 years, that same life estimate will be used for the land.

- As some types of capital expenditure incurred by the Council are not capable of being related to an individual asset, asset lives will be assessed on a basis which most reasonably reflects the anticipated period of benefit that arises from the expenditure. Also, whatever type of expenditure is involved, it will be grouped together in a manner which reflects the nature of the main component of expenditure and will only be divided up in cases where there are two or more major components with substantially different useful economic lives.

- Repayments included in annual PFI or finance leases are applied as MRP.

- Where borrowing is undertaken for the construction of new assets, MRP will only become chargeable once such assets are completed and operational.

- Under Treasury Management best practice the Council may decide to defer borrowing up to the capital financing requirement (CFR) and use internal resources instead. Where internal borrowing has been used, the amount chargeable as MRP may be adjusted to reflect the deferral of actual borrowing.

3. TREASURY MANAGEMENT ISSUES

3.1 Affordability Prudential Indicators

30. The previous sections cover the overall capital and control of borrowing Prudential Indicators but within this framework Prudential Indicators are also required to assess the affordability of the capital investment programme. These provide an indication of the impact of the programme on the Council's overall finances.

3.1.1 Ratio of Financing Costs to Revenue Stream

31. This indicator 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 estimates of financing costs include current commitments and the proposals in the budget report.

Table 3 Ratio of Financing Costs to Revenue Stream

	2014/15	2015/16	2016/17	2017/18	2018/19
	Actual	Estimate	Estimate	Estimate	Estimate
	%	%	%	%	%
Non - HRA	14	13	13	15	17
HRA	48	41	40	45	45

3.1.2 Incremental Impact of Capital Investment Decisions on Council Tax and Housing Rents

32. This indicator identifies the revenue costs associated with proposed capital programme and the impact on Council Tax and Housing Rents.

Table 4 Incremental Impact of Capital Investment Decisions

	2014/15	2015/16	2016/17	2017/18	2018/19
	Actual	Estimate	Estimate	Estimate	Estimate
	£	£	£	£	£
Increase in Council Tax (band D) per annum	33.32	36.62	62.02	58.03	30.66
Increase in average housing rent per week	0.11	- 1.71	- 1.33	4.14	- 0.01

3.1.3 Local HRA indicators

33. The Council should also be aware of the following ratios when making its treasury management decisions.

Table 5 HRA Ratios

	2014/15	2015/16	2016/17	2017/18	2018/19
	Actual	Estimate	Estimate	Estimate	Estimate
Debt (CFR) (£m)	149.5	151.2	154.8	154.8	154.7
Gross Revenue Stream (£m)	31.8	32.2	32.2	32.3	32.0
Ratio of Gross Revenue Stream to Debt (%)	**21**	**21**	**21**	**21**	**21**
Average Number of Dwellings	4,892	4,867	4,816	4,860	4,845
Debt outstanding per dwelling (£)	**30,565**	**31,069**	**32,143**	**31,846**	**31,935**

Rents in the Housing Revenue Account are projected to reduce by 1% each year for four years commencing in 2016/17, in line with the provisions of the Welfare reform and Work Bill, which is anticipated to have been enacted before the start of the new financial year. The reduction in income is expected to be mitigated over the next two years by additional rent income generated as a result of an increase in HRA property numbers from the Council's HRA new build and purchase and repair programmes.

3.2 Borrowing and Investments

34. The capital expenditure programme set out in Paragraph 23 provides details of the service activity of the Council. The treasury management function ensures that the Council's cash is organised in accordance with the relevant professional codes, so that sufficient cash is available to meet the activities of the Council. This involves both the organisation of the cash flow and, where the capital programme requires it, the organisation of approporiate borrowing facilities. The strategy covers the relevant treasury indicators, the current and projected debt positions and the annual investment strategy.

3.2.1 Current portfolio position

35. The Council's borrowing position at 31 December 2015 is summarised below.

Table 6 Summary Borrowing & Investment Position at 31 December 2015

		Principal		Ave. rate
		£m	£m	%
Fixed rate funding	PWLB	218.5		
	Market	116.0	334.5	4.25
Variable rate funding			0	
Other long term liabilities (PFI & leases)			18.0	
Total Debt			352.5	
Total Investments at 31.12.2015			109.2	0.8

36. The Council has borrowed £83.8 million under Lender Option, Borrower Option (LOBO) structures with maturities between 2050 and 2078. In exchange for an interest rate that was below that offered on long term debt by the PWLB, the lender has the option at the end of five years (and half yearly thereafter) to reset the interest rate. If the rate of interest changes, the Council is permitted to repay the loan at no additional cost.

37. The Council's borrowing position with forward projections is summarised below. The table shows the actual external debt, against the underlying capital borrowing need, highlighting any under or over borrowing.

Table 7 Changes to Gross Debt

	2014/15	2015/16	2016/17	2017/18	2018/19
	Actual	Estimate	Estimate	Estimate	Estimate
	£'000	£'000	£'000	£'000	£'000
External Debt					
Debt at 1 April	340,293	334,460	359,466	445,181	500,267
Expected change in Debt	- 5,833	25,007	85,715	55,086	20,417
Other long-term liabilities (OLTL) 1st April	21,841	18,534	17,733	16,907	16,161
Expected change in OLTL	- 3,307	- 801	- 826	- 746	- 593
Actual gross debt at 31 march	352,994	377,199	462,088	516,428	536,252
Capital financing requirement	405,897	438,156	510,925	551,532	556,552
Under / (Over) borrowing	**52,903**	**60,957**	**48,837**	**35,104**	**20,300**

38. The expected change in debt in 2015/16, 2016/17, 2017/18 and 2018/19 reflects the anticipated borrowing necessary to meet the capital programme described in Table 1.

39. Debt outstanding should not normally exceed CFR.

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 2016/17 and the following two financial years. This allows some flexibility for limited early borrowing for future years, but ensures that borrowing is not undertaken for revenue purposes.

41. The Director of Finance reports that 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 programmes and the proposals in the budget report.

42. The table below shows the net borrowing after investment balances are taken into account.

Table 8 Net Borrowing

	2014/15	2015/16	2016/17	2017/18	2018/19
	Actual	Estimate	Estimate	Estimate	Estimate
	£'000	£'000	£'000	£'000	£'000
Gross Borrowing brought forward 1 April	362,134	352,994	377,199	462,088	516,428
Changes to Gross Borrowing	-9,140	24,206	84,889	54,340	19,824
Carry Forward 31st March	352,994	377,199	462,088	516,428	536,252
Investment brought forward 1 April	-130,833	-119,078	-60,000	-60,000	-60,000
Changes to Gross Borrowing	-11,755	-59,078	0	0	0
Carry Forward 31st March	-119,078	-60,000	-60,000	-60,000	-60,000
Total Net Borrowing	233,916	317,199	402,088	456,428	476,252
Change in net borrowing	**2,615**	**83,284**	**84,889**	**54,340**	**19,824**

The change in net borrowing in 2015/16 arises mainly from the reduction in cash balances of £59m and in subsequent years from additional borrowing.

3.2.2 Treasury Indicators: limits to borrowing activity

The Operational Boundary

43. This is the limit which external debt is not normally expected to exceed.

44. The boundary is based on current debt plus anticipated net financing need for future years.

The Authorised Limit for External Debt.

45. This is a further key prudential indicator which represents a control on the maximum level of borrowing. It represents a limit beyond which external debt is prohibited. It reflects the level of external debt which, while not desired, could be afforded in the short term, but may not be sustainable in the longer term. It relates to the financing of the capital programme by both external borrowing and other forms of liability, such as credit arrangements.

46. This is the statutory limit determined under section 3 (1) of the Local Government Act 2003. The Government retains an option to control either the total of all councils' programmes, or those of a specific council, although this power has not yet been exercised.

Table 9 Operational boundary and authorised limit

	2014/15	2015/16	2016/17	2017/18	2018/19
	£m	£m	£m	£m	£m
Authorised Limit for external debt					
Borrowing and finance leases	406	438	511	552	557
Operational Boundary for external debt					
Borrowing	334	359	445	500	521
Other long term liabilities	19	18	17	16	16
Total	353	377	462	516	536
Upper limit for fixed interest rate exposure					
Net principal re fixed rate borrowing	334	359	445	500	521
Upper limit for variable rate exposure					
Net principal re variable rate borrowing	-	-	-	-	-
Upper limit for principal sums invested over 364 days*	28	41	60	60	60

As shown in table 13 below, the Council may wish to make additional investments of over 364 days. The current limit for such investments is £40m. To respond to potential new initiatives it is recommended that at this stage the limit for investments over 364 days be set at £60m.

HRA Debt Limit

47. Separately, the Council is also limited to a maximum HRA debt limit through the HRA self-financing regime. This limit and the HRA CFR are shown in the table below.

Table 10 HRA Debt Limit and CFR

	2014/15	2015/16	2016/17	2017/18	2018/19
	Actual	Estimate	Estimate	Estimate	Estimate
	£'000	£'000	£'000	£'001	£'002
HRA Debt Limit	149,648	151,337	154,937	154,937	154,937
HRA CFR	149,526	151,213	154,783	154,753	154,723
Headroom	122	124	154	184	214

3.3 Prospects for Interest Rates and Economic Commentary

48. The Treasury Management Adviser has provided the commentary in the remainder of this section 3.3 and a more detailed economic commentary is included as Appendix 3.

The Council has appointed Capita Asset Services as its treasury advisor and part of their service is to assist the Council to formulate a view on interest rates. The following table gives our central view.

Capita Asset Services Interest Rate View														
	Dec-15	Mar-16	Jun-16	Sep-16	Dec-16	Mar-17	Jun-17	Sep-17	Dec-17	Mar-18	Jun-18	Sep-18	Dec-18	Mar-19
Capita Asset Services View	0.50%	0.50%	0.75%	0.75%	1.00%	1.00%	1.25%	1.50%	1.50%	1.75%	1.75%	2.00%	2.00%	2.00%
5yr PWLB Rate	2.30%	2.40%	2.60%	2.70%	2.80%	2.80%	2.90%	3.00%	3.20%	3.30%	3.40%	3.50%	3.50%	3.60%
10yr PWLB View	2.90%	3.00%	3.10%	3.20%	3.30%	3.40%	3.50%	3.60%	3.70%	3.80%	3.90%	4.00%	4.10%	4.10%
25yr PWLB View	3.60%	3.70%	3.80%	3.90%	4.00%	4.10%	4.10%	4.20%	4.30%	4.30%	4.40%	4.40%	4.40%	4.50%
50yr PWLB Rate	3.50%	3.60%	3.70%	3.80%	3.90%	4.00%	4.00%	4.10%	4.20%	4.20%	4.30%	4.30%	4.30%	4.40%

United Kingdom

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 the 2015 growth rate is likely to be a leading rate in the G7 again, probably being second to the US. However, quarter 1 of 2015 was weak at +0.4% (+2.9% y/y) though there was a rebound in quarter 2 to +0.7% (+2.4% y/y) before weakening again to +0.5% (2.3% 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 this year. Investment expenditure is also expected to support growth. However, since the August Inflation report was issued, worldwide economic statistics have distinctly weakened and the November Inflation Report flagged up particular concerns for the potential impact on the UK.

The Inflation Report was 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. However, once the falls in oil, gas and food prices over recent months fall out of the 12 month calculation of CPI, there will be a sharp tick up from the current zero rate to around 1 percent in the second half of 2016. 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. There is considerable uncertainty around how quickly 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.

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 weakened again to 2.1% in quarter 3. The downbeat news in late August and in September about Chinese and Japanese growth and the knock on impact on emerging countries that are major suppliers of commodities, was cited as the main reason for the Fed's decision at its September meeting to pull back from a first rate increase. However, the nonfarm payrolls figure for growth in employment in October was very strong and, together with a likely perception by the Fed. that concerns on the international scene have subsided, has now firmly opened up the possibility of a first rate rise in December.

Eurozone

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 is 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 a significant 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, the recent downbeat Chinese and Japanese news has raised questions as to whether the ECB will need to boost its QE programme if it is to succeed in significantly improving growth in the EZ and getting inflation up from the current level of around zero to its target of 2%.

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.

Overview

- *Investment returns are likely to remain relatively low during 2016/17 and beyond;*
- *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. Gilt yields have continued to remain at historically phenominally low levels during 2015. The policy of avoiding new borrowing by running down spare cash balances, has served well over the last few years. However, this needs to be carefully reviewed to avoid incurring higher borrowing costs in later times, when authorities will not be able to avoid new borrowing to finance new capital expenditure and/or to refinance maturing debt;*
- *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.*

3.4 Borrowing Strategy

49. As shown in the tables above, currently the Council has a debt portfolio of £353m, mainly long term, with an average maturity of 36 years assuming no early repayment of the LOBO loans. Cash balances have remained high and at 31 December 2015 were £109m. With the investment portfolio yielding around 1% and the likely average cost of new debt 3.5%, there is a substantial short term cost to carrying excessive debt.

50. As shown in Table 7 above the Council is currently maintaining an under-borrowed position. This means that the capital borrowing need (CFR), 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 source of funding. This strategy is prudent with investment returns low and counterparty risk relatively high.

51. For the last few years the capital programme has been funded from grants and revenue resources and there has not been a need for further borrowing. However, with the reduction in cash balances and the likelihood that they will be further reduced by the end of 2015/16 much of the increased capital programme in the next few years will need to be funded from borrowing. As shown in Table 7 above, it is currently estimated that sums of £25m, £86m, £55m and £20m will need to be borrowed in the current year next three years respectively. The Council will have a range of funding sources available and will need to base its decisions on optimum borrowing times and periods taking into account current interest rates and likely future movements and the "cost of carry" (difference between rates for borrowing and rates for investments) which currently remain high. A strategy is being devised in consultation with the Treasury Management Adviser. It is also possible that new long term borrowing in the next three years might be required either if part of the LOBO portfolio had to be refinanced early.

52. It may be necessary to resort to temporary borrowing from the money markets or other local authorities to cover mismatches in timing between capital grants and payments. However with several Government grants now paid early in the financial year this is not very likely.

53. Against this background and the risks within the economic forecast, caution will be adopted with the 2016/17 treasury management operations. The Director of Finance will monitor interest rates in financial markets and adopt a pragmatic approach to changing circumstances.

54. The Council has adopted a single pooled approach for debt. Allocations to HRA are based on its CFR, with interest charged to HRA at the average rate on all external borrowing. Longer term, the HRA's ability to repay borrowing will depend on future revenues and the capital expenditure programme.

3.5 Treasury Management Limits on Activity

55. 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.

Upper limit on variable interest rate exposure

56. This identifies a maximum limit for variable interest rates based upon the debt position net of investments. As shown in Table 9 above the Council does not expect to undertake any borrowing on this basis.

Upper limit on fixed interest rate exposure

57. This identifies a maximum limit for fixed interest rates based upon the debt position net of investments. The Council's proposed limits are shown in Table 9 above

Maturity Structure of Borrowing

58. 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.

59. The Council has no variable rate borrowing and the comments below relate only to its fixed rate portfolio.

60. In the table below, the maturity structure for the LOBO debt, in accordance with CIPFA Guidance, is shown as the first date that the interest rate can be increased.

Table 11 Maturity Structure of Fixed Rate Borrowing

	As at 31.12.2015 %	Upper limit %	Lower limit %
Under 12 months	25	30	0
12 months to 23 months	3	20	0
24 months to under 5 years	7	30	0
5 years to under 10 years	1	40	0
10 years and over	64	90	30

3.6 Policy on Borrowing in Advance of Need

61. 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 CFR 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.

62. Risks associated with any borrowing in advance activity will be subject to prior appraisal and subsequent reporting through the mid-year or annual reporting mechanism.

3.7 Debt Rescheduling

63. Capita currently advise that:

As short term borrowing rates will be considerably cheaper than longer term fixed interest rates, there may be potential opportunities to generate savings by switching from long term debt to short term debt. However, these savings will need to be considered in the light of the current treasury position and the size of the cost of debt repayment (premiums incurred).

The reasons for any rescheduling to take place will include:

- *the generation of cash savings and / or discounted cash flow savings;*
- *helping to fulfil the treasury strategy;*
- *enhance the balance of the portfolio (amend the maturity profile and/or the balance of volatility).*

64. Opportunities to reduce the cost of debt by premature repayment or to improve the maturity profile are kept under review in discussion with the Council's Treasury Management Adviser. Early repayment of market loans is by negotiation. For PWLB loans, there are daily published prices for early repayment that allows analysis of the opportunities for restructuring. There is currently a spread which has generally made restructuring uneconomic.

65. Should any of the LOBO loans with interest rate reset dates in 2016-17 (£83.8m) require refinancing, the most likely source will be external borrowing.

66. All rescheduling will be reported to Cabinet at the earliest meeting following the exercise.

3.8 Annual Investment Strategy

3.8.1 Changes to credit rating methodology

67. During the last year there have been significant changes in the methodologies adopted by the the three main credit rating agencies and the Council's Treasury Management Adviser comments as follows:

The main rating agencies (Fitch, Moody's and Standard & Poor's) have, through much of the financial crisis, provided some institutions with a ratings "uplift" due to implied levels of sovereign support. Commencing in 2015, in response to the evolving regulatory regime, all three agencies have begun removing these "uplifts" with the timing of the process determined by regulatory progress at the national level. The process has been part of a wider reassessment of methodologies by each of the rating *agencies. In addition to the removal of implied support, new methodologies are now taking into account additional factors, such as regulatory capital levels. In some cases, these factors have "netted" each other off, to leave underlying ratings either unchanged or little changed. A consequence of these new methodologies is that they have also lowered the importance of the (Fitch) Support and Viability ratings and have seen the (Moody's) Financial Strength rating withdrawn by the agency.*

In keeping with the agencies' new methodologies, the rating element of our own credit assessment process now focuses solely on the Short and Long Term ratings of an institution. While this is the same process that has always been used for Standard & Poor's, this has been a change in the use of Fitch and Moody's ratings. It is important to stress that the other key elements to our process, namely the assessment of Rating Watch and Outlook information as well as the Credit Default Swap (CDS) overlay have not been changed.

The evolving regulatory environment, in tandem with the rating agencies' new methodologies also means that sovereign ratings are now of lesser importance in the assessment process. Where through the crisis, clients typically assigned the highest sovereign rating to their criteria, the new regulatory environment is attempting to break the link between sovereign support and domestic financial institutions. While this authority (Harrow) understands the changes that have taken place, it will continue to specify a minimum sovereign rating of AAA. This is in relation to the fact that the underlying domestic and where appropriate, international, economic and wider political and social background will still have an influence on the ratings of a financial institution.

It is important to stress that these rating agency changes do not reflect any changes in the underlying status or credit quality of the institution. They are merely reflective of a reassessment of rating agency methodologies in light of enacted and future expected changes to the regulatory environment in which financial institutions operate. While some banks have received lower credit ratings as a result of these changes, this does not mean that they are suddenly less credit worthy than they were formerly. Rather, in the majority of cases, this mainly reflects the fact that implied sovereign government support has effectively been withdrawn from banks. They are now expected to have sufficiently strong balance sheets to be able to withstand foreseeable adverse financial circumstances without government support. In fact, in many cases, the balance sheets of banks are now much more robust than they were before the 2008 financial crisis when they had higher ratings than now. However, this is not universally applicable, leaving some entities with modestly lower ratings than they had through much of the "support" phase of the financial crisis.

68. These changes are reflected in the Council's counterparty lists described in Tables 12 and 13 below.

3.8.2 Investment policy

69. The Council's investment policy has regard to the Department for Communities and Local Government Investment Guidance and the CIPFA Treasury Management Code. The Council's investment priorities will be security first, liquidity second, then return.

70. In accordance with the above guidance and in order to minimise the risk to investments, the Council below clearly stipulates the minimum acceptable credit quality of counterparties for inclusion on the lending list. The creditworthiness methodology used to create the counterparty list fully accounts for the ratings, watches and outlooks published by all three ratings agencies. The Treasury Management Adviser monitors counterparty ratings on a real time basis with knowledge of any changes advised electronically as the agencies notify modifications.

71. Further, the Council's officers recognise that ratings should not be the sole determinant of the quality of an institution and that it is important to assess continually 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 adviser to maintain a monitor on market pricing such as "credit default swaps" and overlay that information on top of the credit ratings.

72. The aim of the strategy is to generate a list of highly creditworthy counterparties which will provide security of investments, enable divesification and minimise risk.

73. Investment instruments identified for current use are listed in Tables 12 and 13 below under the 'specified' and 'non-specified' investments categories. Counterparty limits will be as set through the Council's Treasury Management Practices.

3.8.3 Creditworthiness policy

74. The primary principle governing the Council's investment criteria is the security of its investments, although the return on the investment is also a key consideration. After this main principle, the Council will ensure that:

- It maintains a policy covering both the categories of investment types it will invest in, criteria for choosing investment counterparties with adequate security, and monitoring their security. This is set out in the specified and non-specified investment sections below; and
- 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. These procedures also apply to the Council's prudential indicators covering the maximum principal sums invested.

75. The Director of Finance will maintain a counterparty list in compliance with the following criteria and will revise the criteria and submit them to Council for approval as necessary. These criteria are separate to those which determine which types of investment instrument are either specified or non-specified as they provide an overall pool of counterparties considered high quality which the Council may use, rather than defining what types of investment instruments are to be used.

76. The minimum rating criteria uses the lowest common denominator method of selecting counterparties and applying limits. This means that the application of the Council's minimum criteria will apply to the lowest available rating for any institution. For instance, if an institution is rated by two agencies, one meets the Council's criteria, the other does not, the institution will fall outside the lending criteria.

77. Credit rating information is supplied by the Treasury Management Adviser 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. For instance, a negative rating watch applying to a counterparty at the minimum Council criteria will be suspended from use, with all others being reviewed in light of market conditions.

78. The Council's criteria for an institution to become a counterparty are:

Specified Investments
These are sterling investments of a maturity period of not more than 364 days, or those which could be for a longer period but where the lender has the right to be repaid within 364 days if it wishes. These are low risk assets where the possibility of loss of principal or investment income is negligible. The instruments and credit criteria to be used are set out in the table below.

Table 12: Specified Investments

Instrument	Minimum Credit Criteria	Use
Debt Management Agency Deposit Facility	Government backed	In-house
Term deposits – other LAs	Local Authority issue	In-house
Term deposits – banks and building societies	AA- Long Term F1+Short-term 2 Support UK or AAA Sovereign	In-house
Money Market Funds	AAA	In-house

Non-Specified Investments

Non-specified investments are any other type of investment (i.e. not defined as Specified above). They normally offer the prospect of higher returns but carry a higher risk. The identification and rationale supporting the selection of these other investments are set out in the table below.

Table 13: Non - Specified Investments

	Minimum Credit Criteria	Use	Max total investment	Max. maturity period
Term deposits – banks and building societies (excluding Lloyds / HBOS)	A Long Term F1 Short-term UK or AAA Sovereign	In-house	50%	3 months
Lloyds / HBOS	A Long Term F1 Short-term	In-house	50%	6 months
Callable Deposits	A Long Term F1 Short term	In-house	20%	3 months
UK nationalised Banks [RBS]	F2 Short-term	In-house	60%	36 months
Enhanced Cash Funds	AAA	In-house	25% (maximum £10 million per fund)	Minimum monthly redemption
Corporate bonds pooled funds, other non-standard investments and gilts		In house	£10m in total	Dependent on specific agreement
HB Public Law Ltd		In house	£0.1m	36 months
Investment Property Strategy		In house	£20.0m	Dependent on specific agreement
Concilium Business Services Ltd t/a Smart Lettings Ltd		In house	£0.274m	36 months
Concilium Group Startup capital		In house	£0.702m	60 months
Concilium Group 5% Long Term Investment		In house	£1.5m	Dependent on specific agreement
Cultura London re Harrow Arts Centre		In house	£1m	25 years
Housing Development Vehicle (LLP) – Initially on acquisition of 100 homes		In house	£30m	Dependent on specific agreement

Unless specified above, individual bank & building society counterparty limits that are consistent with the above limits are approved by the Section 151 Officer in accordance with the Council's Treasury Management Practices.

3.8.4 Country Limits

79. The Council has determined that it will only use approved counterparties from the UK or from countries with a minimum sovereign credit rating of AAA. Currently the only countries meeting this criterion are Australia, Canada, Denmark, Germany, Singapore, Sweden and Switzerland. The current UK rating is the second level of AA+. This list will be added to, or deducted from, by officers should ratings change in accordance with this policy.

3.8.5 Investment Strategy

80**. In-house funds.** The Council's funds are mainly cash derived primarily from the General Fund and HRA. Balances are also held to support capital expenditure. From 1st April 2011, pension fund cash balances have been held separately from those of the Council. However, a separate investment strategy has not been developed for the pension fund and all its cash is held on overnight call account with RBS. Investments are 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).

81**. Investment returns expectations.** Bank Rate has remained unchanged at 0.50% since March 2009 and is not forecast to rise until at least quarter 2 of 2016. Forecasts for financial year ends are:

- 2015/16 0.50%
- 2016/17 1.00%
- 2017/18 1.75%
- 2018/19 2.00%

82. As regards returns and potential returns key points made by Capita in Section 3.4 above and of prime significance in the Council's investment strategy are:

- Counterparty risks remain elevated. This continues to suggest the use of higher quality counterparties for shorter time periods;
- Investment returns are likely to remain relatively low during 2015/16 and beyond.

83**. Investment treasury indicator and limit** - total principal funds invested for greater than 364 days. These limits are set with regard to the Council's liquidity requirements and to reduce the need for early sale of an investment. The Council's limit for investments of over 364 days is £40.5m.

84. Throughout 2015-16 to date interest rates for periods of up to 6 months have remained stable with the Council receiving about 0.75% for investments and 0.25% for the RBS Special Interest Bearing Account.

85. As a consequence of these rates and the maturity of several higher yielding investments the Council's return for the whole year is likely to be close to 0.7%. Whilst this compares well with the LIBOR benchmark and peer authorities it represents a substantial reduction from the 1% earned in 2014-15 and 1.5% earned in 2013-14.

86. As a result of the Council's strategy and the interest rates available the only counterparties actively in use during 2015-16 have been Lloyds and Royal Bank of Scotland Group, Enhanced Money Market Funds and Svenska Handelsbanken. The investment portfolio has inevitably remained concentrated with RBS and Lloyds with 80% of the total portfolio invested with them on 31st December 2015. When opportunities arise consistent with the Council's policies diversification will be sought but it is not anticipated that there will be any significant change during 2016-17.

87. Due to the low interest rates environment and uncertainties around Government funding for banks, setting expected income levels for 2016-17 and beyond is imprecise. Investment income (net of allocations and interest from West London Waste Authority) has been budgeted at £414,500 for 2016/17 (2015/16 £699,000).

4. OPTIONS CONSIDERED

88. No options were considered beyond those discussed in the report due to the statutory and risk management constraints inherent in treasury management.

5. IMPLICATIONS OF THE RECOMMENDATIONS

89. The recommendations primarily relate to the requirements for the Council to comply with statutory duties. However, the content of the report, covering borrowing and investment strategy, has implications for the Council's ability to fund its capital projects and revenue activities.

90. The recommendations do not directly affect the Council's staffing /workforce.

6. FINANCIAL IMPLICATIONS

91. Financial matters are integral to the report.

7. RISK MANAGEMENT IMPLICATIONS

92. The identification, monitoring and control of risk are central to the achievement of treasury management objectives and to this report. Potential risks are identified, mitigated and monitored in accordance with Treasury Management Practice Notes approved by the Treasury Management Group.

93. Risks are included in the Directorate Risk Register.

8. EQUALITIES IMPLICATIONS / PUBLIC SECTOR EQUALITY DUTY

94. Officers have considered possible equalities impact and consider that there is no adverse equalities impact as there is no direct impact on individuals

9. COUNCIL PRIORITIES

95. This report deals with the Treasury Management Strategy which plays a significant part in supporting the delivery of all the Council's corporate priorities.

Section 3 - Statutory Officer Clearance

Name: Dawn Calvert Date: 18 January 2015	X	Director of Finance
Name: Caroline Eccles Date: 18 January 2015	X	on behalf of the Monitoring Officer

Ward Councillors notified:	**No**

Section 4 - Contact Details and Background Papers

Contact: Ian Talbot (Treasury and Pension Fund Manager) Tel: 020-8424-1450 / Email: ian.talbot@harrow.gov.uk

Background Papers: N/A

APPENDIX 1

LEGISLATION AND REGULATIONS IMPACTING ON TREASURY MANAGEMENT

The following items numbered 1 - 4 show the sequence of legislation and regulation impacting on the treasury management function. The sequence begins with primary legislation, moves through Government guidance and Chartered Institute of Public Finance and Accountancy (CIPFA) codes of practice and finishes with implementation through the Council's own Treasury Management Practices.

1. Local Government Act 2003

Link below

Local Government Act 2003

Below is a summary of the provisions in the Act dealing with treasury management.

In addition the Secretary of State is empowered to define the provisions through further regulations and guidance which he has subsequently done through statutory instruments, Department of Communities and Local Government Guidance and CIPFA codes of practice.

Power to borrow
The Council has the power to borrow for purposes relevant to its functions and for normal treasury management purposes – for example, to refinance existing debt.

Control of borrowing
The main borrowing control is the duty not to breach the prudential and national limits as described below.
The Council is free to seek loans from any source but is prohibited from borrowing in foreign currencies without the consent of Treasury, since adverse exchange rate movements could leave it owing more than it had borrowed.
All of the Council's revenues serve as security for its borrowing. The mortgaging of property is prohibited.
It is unlawful for the Council to 'securitise', that is, to sell future revenue streams such as housing rents for immediate lump-sums.

Affordable borrowing limit
The legislation imposes a broad duty for the Council to determine and keep under review the amount it can afford to borrow. The Secretary of State has subsequently defined this duty in more detail through the Prudential Code produced by CIPFA, which lays down the practical rules for deciding whether borrowing is affordable.

It is for the Council (at a meeting of the full Council) to set its own 'prudential' limit in accordance with these rules, subject only to the scrutiny of its external auditor. The Council is then free to borrow up to that limit without Government consent. The Council is free to vary the limit during the year, if there is good reason.

Requirements in other legislation for the Council to balance its revenue budget prevents the long-term financing of revenue expenditure by borrowing. However the legislation does confer limited capacity to borrow short-term for revenue needs in the interests of cash-flow management and forseeable requirements for temporary revenue borrowing are allowed for when borrowing limits are set by the Council.

The Council is allowed extra flexibility in the event of unforeseen needs, by being allowed to increase borrowing limits by the amounts of any payments which are due in the year but have not yet been received.

Imposition of borrowing limits
The Government has retained reserve power to impose 'longstop' limits for national economic reasons on all local authorities' borrowing and these would override authorities' self-determined prudential limits. Since this power has not yet been used the potential impact on the Council is not known.

Credit arrangements
Credit arrangements (eg property leasing, PFI and hire purchase) are treated like borrowing and the affordability assessment must take account not only of borrowing but also of credit arrangements. In addition, any national limit imposed under the reserve powers would apply to both borrowing and credit.

Power to invest
The Council has the power to invest, not only for any purpose relevant to its functions but also for the purpose of the prudential management of its financial affairs.

2. Department for Communities and Local Government Investment Guidance (March 2010)

The Local Government Act 2003 requires a local authority "…..to have regard (a) to such guidance as the Secretary of State may issue…………." and the current guidance became operative on 1 April 2010.

The Guidance recommends that for each financial year the Council should prepare at least one investment Strategy to be approved before the start of the year. The Strategy must cover:

- **Investment security**

  Investments should be managed prudently with security and liquidity being considered ahead of yield

  Potential counterparties should be recognised as "specified" and "non-specified" with investment limits being defined to reflect the status of each counterparty

- **Investment risk**

  Procedures should be established for monitoring, assessing and mitigating the risk of loss of invested sums and for ensuring that such sums are readily accessible for expenditure whenever needed.

  The use of credit ratings and other risk assessment processes should be explained

  The use of external advisers should be monitored

  The training requirements for treasury management staff should be reviewed and addressed

  Specific policies should be stated as regards borrowing money in advance of need

- **Investment Liquidity**

  The Strategy should set out procedures for determining the maximum periods for which funds may prudently be committed

The Strategy should be approved by the full Council and made available to the public free of charge. Subject to full Council approval, or approved delegations, the Strategy can be revised during the year.

3. Treasury Management in the Public Services: Code of Practice and Cross-Sectoral Guidance Notes (CIPFA 2011)

The primary requirements of the Code are:

- Creation and maintenance of a Treasury Management Policy Statement which sets out the policies and objectives of the Council's treasury management activities.

- Creation and maintenance of Treasury Management Practices ("TMPs") that set out the manner in which the Council will seek to achieve those policies and objectives.

- Receipt by the full Council or Cabinet of an annual Treasury Management Strategy Statement - including the Annual Investment Strategy and Minimum Revenue Provision Policy - for the year ahead, a Half-year Review Report and an Annual Report (stewardship report) covering activities during the previous year.

- Delegation by the Council of responsibilities for implementing and monitoring treasury management policies and practices and for the execution and administration of treasury management decisions.

- Delegation by the Council of the role of scrutiny of treasury management strategy and policies to a specific named body.

4. The Prudential Code for Capital Finance in Local Authorities (CIPFA 2011)

Compliance with the objectives of the Code by the Council should ensure that:

- Capital expenditure plans are affordable in terms of their implications on Council Tax and housing rents
- External borrowing and other long term liabilities are within prudent and sustainable levels
- Treasury management decisions are taken in accordance with good professional practice

As part of the two codes of practice above the Council is required to:

- agree a series of prudential indicators against which performance is measured
- produce Treasury Management Practice Notes for officers which set out how treasury management policies and objectives are to be achieved and activities controlled.

APPENDIX 2

TREASURY MANAGEMENT DELEGATIONS AND RESPONSIBILITIES

The respective roles of the Cabinet, GARMCS, the Section 151 officer, the Treasury Management Group and the Treasury Team are summarised below. Further details are set out in the Treasury Management Practices.

The main responsibilities and delegations in respect of treasury activities are:

Council

Council will approve the annual treasury strategy, including borrowing and investment strategies. In doing so Council will establish and communicate their appetite for risk within treasury management having regard to the Prudential Code

Cabinet

Cabinet will recommend to Council the annual treasury strategy, including borrowing and investment strategies and receive a half-year report and annual out-turn report on treasury activities.

Cabinet also approves revenue budgets, including those for treasury activities.

Governance, Audit, Risk Management and Standards Committee

GARMSC is responsible for ensuring effective scrutiny of the Treasury strategy and policies.

Section 151 Officer

Council has delegated responsibility for the implementation and monitoring of treasury management decisions to the Section 151 Officer to act in accordance with approved policy and practices. In particular, the Sector 151 Officer:

- Approves all new borrowing, investment counterparties and limits and changes to the bank mandate,
- Chairs the Treasury Management Group ("TMG"), and
- Approves the selection of treasury advisor and agrees terms of appointment.

Treasury Management Group

Monitors the treasury activity against approved strategy, policy, practices and market conditions.

Approves changes to treasury management practices and procedures.

Reviews the performance of the treasury management function using benchmarking data on borrowing and investment provided by Sector.

Monitors the performance of the appointed treasury advisor and recommends any necessary actions.

Ensures the adequacy of treasury management resources and skills, and the effective division of responsibilities within the treasury management function.

Monitors the adequacy of internal audit reviews and the implementation of audit recommendations.

Treasury and Pension Fund Manager

Has responsibility for the execution and administration of treasury management decisions, acting in accordance with the Council's Treasury Policy Statement and CIPFA's 'Standard of Professional Practice on Treasury Management'.

Treasury Team

Undertakes day to day treasury investment and borrowing activity in accordance with strategy, policy, practices and procedures and recommends changes to these to the TMG.

APPENDIX 3

Provided by Capita Asset Services at November 2015

Economic Background

UNITED KINGDOM

UK GDP growth rates in of 2.2% in 2013 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 the 2015 growth rate is likely to be a leading rate in the G7 again. However, quarter 1 of 2015 was weak at +0.4%, although there was a short lived rebound in quarter 2 to +0.7% before it subsided again to +0.5% (+2.3% y/y) in quarter 3. The Bank of England's November Inflation Report included a forecast for growth to remain around 2.5% – 2.7% over the next three years. For this recovery, however, to become more balanced and sustainable in the longer term, it still needs to move away from dependence on consumer expenditure and the housing market to manufacturing and investment expenditure. The strong growth since 2012 has resulted in unemployment falling quickly to a current level of 5.3%.

The MPC has been particularly concerned that the squeeze on the disposable incomes of consumers should be reversed by wage inflation rising back above the level of CPI inflation in order to underpin a sustainable recovery. It has, therefore, been encouraging in 2015 to see wage inflation rising significantly above CPI inflation which has been around zero since February. The Inflation Report was notably subdued in respect of the forecasts for CPI inflation; this was expected to barely get back up to the 2% target within the 2-3 year time horizon. However, once the falls in oil, gas and food prices over recent months fall out of the 12 month calculation of CPI, there will be a sharp tick up from the current zero rate to around 1% in the second half of 2016. Indeed, the increase in the forecast for inflation at the three year horizon was the biggest in a decade and at the two year horizon it was the biggest since February 2013. Nevertheless, despite average weekly earnings ticking up to 3.0% y/y in the three months ending in September, this is unlikely to provide ammunition for the MPC to take action to raise Bank Rate in the near future as labour productivity growth has meant that net labour unit costs appear to be rising by about only 1% y/y. Having said that, at the start of October, data came out that indicated annual labour cost growth had jumped sharply in quarter 2 from +0.3% to +2.2%: time will tell if this is just a blip or the start of a trend.

There is, therefore, considerable uncertainty around how quickly 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. There are also concerns around the fact that the central banks of the UK and US currently have few monetary policy options left to them given that central rates are near to zero and huge QE is already in place. There are, therefore, arguments that they need to raise rates sooner, rather than later, so as to have some options available for use if there was another major financial crisis in the near future. But it is unlikely that either would raise rates until they are sure that growth was securely embedded and ‘noflation’ was not a significant threat.

The forecast for the first increase in Bank Rate has, therefore, been pushed back progressively during 2015 from Q4 2015 to Q2 2016 and increases after that will be at a much slower pace, and to much lower levels than prevailed before 2008, as increases in Bank Rate will have a much bigger effect on heavily indebted consumers than they did before 2008.

The Government’s revised Budget in July eased the pace of cut backs from achieving a budget surplus in 2018/19 to achieving that in 2019/20 and this timetable was maintained in the November Budget.

USA

GDP growth in 2014 of 2.4% was followed by Q1 2015 growth, which was depressed by exceptionally bad winter weather, at only +0.6% (annualised). However, growth rebounded very strongly in Q2 to 3.9% (annualised) before dipping again in Q3 to 2.1%.

Until the turmoil in financial markets in August, caused by fears about the slowdown in Chinese growth, it had been strongly expected that the Fed. may start to increase rates in September. However, the Fed pulled back from that first increase due to global risks which might depress US growth and put downward pressure on inflation, as well as a 20% appreciation of the dollar which has caused the Fed. to lower its growth forecasts. Although the non-farm payrolls figures for growth in employment in August and September were disappointingly weak, the October figure was stunningly strong and, together with a likely perception by the Fed. that concerns on the international scene have subsided since August, has now firmly opened up the possibility of a first rate rise in December.

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 is 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 a significant improvement in economic growth. GDP growth rose to 0.5% in Q1 2015 (1.0% y/y) but came in at +0.4% (+1.5% y/y) in Q2 and +0.3% in Q3. However, the recent downbeat Chinese and Japanese news has raised questions as to whether the ECB will need to boost its QE programme if it is to succeed in significantly improving growth in the EZ and getting inflation up from the current level of around zero to its target of 2%.

GREECE

During July, Greece finally capitulated to EU demands to implement a major programme of austerity. An €86bn third bailout package has since been agreed although 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 initial 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 a Greek exit from the euro may only have been delayed by this latest bailout.

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 -0.7% after a short burst of strong growth of 1.0% during Q1. Growth in Q3 was -0.8% so Japan is now back into recession for the fourth time in five years. It has been hit hard by the downturn in China during 2015. This does not bode well for Japan as the Abe government has already fired its first two arrows to try to stimulate recovery and a rise in inflation from near zero, 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 in implementing several stimulus measures to try to ensure the economy hits the growth target of 7% for the current year and to bring some stability after the major fall in the onshore Chinese stock market during the summer. 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 the 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, concerns about whether the Chinese economy could be heading for a hard landing, and the volatility of the Chinese stock market, which was the precursor to falls in world financial markets in August and September, remain a concern.

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.

FORWARD VIEW

Economic forecasting remains difficult with so many external influences weighing on the UK. Our Bank Rate forecasts, (and also MPC decisions), will be liable to further amendment depending on how economic data evolves over time. Capita Asset Services undertook its last review of interest rate forecasts on 9 November 2015 shortly after the publication of the quarterly Bank of England Inflation Report. 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 2 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. Increasing 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 evenly balanced. 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 November, (based on short sterling), for the first Bank Rate increase are currently around mid-year 2016.

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

- Geopolitical risks in Eastern Europe, the Middle East and Asia, increasing safe haven flows.
- UK economic growth turns significantly weaker than we currently anticipate.
- Weak growth or recession in the UK's main trading partners - the EU, US and China.
- A resurgence of the Eurozone sovereign debt crisis.
- Recapitalisation of European banks requiring more government financial support.

- Emerging country economies, currencies and corporates destabilised by falling commodity prices and / or the start of Fed. rate increases, causing a flight to safe havens

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 commencement by the US Federal Reserve of increases in the Fed. 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.

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

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