



AUDIT COMMITTEE

Thursday, 29th September, 2011

7.30 pm

Town Hall, Watford

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CONTACT

If you require further information or you would like a copy of this agenda in another format, e.g. large print, please contact Sandra Hancock in Legal and Property Services on 01923 278377 or by email to legalanddemocratic@watford.gov.uk (Minicom available on 01923 278499).

Welcome to this meeting. We hope you find these notes useful.

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COMMITTEE MEMBERSHIP

Councillor I Brown (Chair)

Councillors A Burtenshaw, A Khan, R Martins and S Rackett

AGENDA

PART A - OPEN TO THE PUBLIC

1. APOLOGIES FOR ABSENCE/COMMITTEE MEMBERSHIP

2. DISCLOSURE OF INTERESTS (IF ANY)

3. MINUTES (Pages 1 - 8)

The minutes of the meeting held on 30 June 2011 to be submitted and signed.

4. OMBUDSMAN'S ANNUAL REVIEW (Pages 9 - 18)

This report includes the Ombudsman's Annual Review of its dealings with the Council for 2010/11.

5. EXTERNAL AUDITOR'S REPORT TO THOSE CHARGED WITH GOVERNANCE, ISA 260

Report to follow

6. STATEMENT OF ACCOUNTS 2010/11

Report to follow

7. TREASURY MANAGEMENT QUARTERLY REPORT (Pages 19 - 32)

This report provides the second quarter's review of the Council's Treasury Management Strategy and investment performance.

8. INTERNAL AUDIT ANNUAL REPORT 2010/11 (Pages 33 - 46)

This report introduces the Acting Audit Manager's Final Annual Report on the work of the Internal Audit Service for 2010/2011 and his opinion of the adequacy and effectiveness of the Council's control environment.

9. INTERNAL AUDIT PROGRESS REPORT (Pages 47 - 54)

This report provides updated information on the work undertaken by Internal Audit on the audit plan for 2010/2011 since the last report to Audit Committee in March and also for the work on the 2011/2012 Audit Plan in the period 1 April 2011 to 2 September 2011.

10. IMPLEMENTATION OF INTERNAL AUDIT RECOMMENDATIONS (Pages 55 - 58)

This report highlights any lack of progress in implementing Internal Audit recommendations.

Agenda Item 3

AUDIT COMMITTEE

30 JUNE 2011

Present: Councillor I Brown (Chair)
Councillors A Burtenshaw, A Khan and R Martins

Also present: Councillor Malcolm Meerabux and Paul Dossett (Grant Thornton)

Officers: Head of Strategic Finance
Head of Revenues and Benefits
Acting Audit manager
Fraud Manager
Committee and Scrutiny Officer

1 APOLOGIES FOR ABSENCE/COMMITTEE MEMBERSHIP

Apologies for absence were received from Councillor Rackett.

2 DISCLOSURE OF INTERESTS (IF ANY)

There were no disclosures of interest.

3 MINUTES

The minutes of the meeting held on 16 March 2011 were submitted and signed.

4 REQUESTS MADE UNDER THE FREEDOM OF INFORMATION ACT 2000

The Committee received a report of the Head of Legal and Property Services setting out details of requests made under the Freedom of Information Act 2000 for the period from 1 October 2010 to 31 March 2011.

The Chair advised that any questions would be forwarded to the Head of Legal and Property Services and a response would be circulated at a later date.

A Member asked if it was possible to find out how many hours and what costs were involved in responding to Freedom of Information requests.

Another Member noted the request for information about the purchase of Nintendo DS and DS Lite consoles. He asked why the authority would be purchasing these machines.

A Member noted that a resident had submitted 11 questions about planning. He questioned whether the authority should be exploring the request in more detail and what might lie behind it.

The Portfolio Holder advised that the Constitution Working Party had considered whether redacted responses could be added to the Council's website. The Head of Legal and Property Services was going to investigate whether this was possible.

The Chair asked that the Head of Legal and Property Services was invited to the next meeting.

RESOLVED –

1. that the Head of Legal and Property Services be invited to attend the next meeting.
2. that Members' questions be forwarded to the Head of Legal and Property Services and that the responses be circulated to the Committee.

5 **EXTERNAL AUDITOR'S REPORTS**

The Committee received reports from the Council's External Auditor, Grant Thornton, which covered –

- Certification Work – Planning Memorandum
- Accounts Audit Approach Memorandum
- Annual Governance Statement: Adding Real Value?

Paul Dossett explained each report. He stated that the most important grant claim referred to in the certification work was the Housing and Council Tax Benefit Claim. The Audit Approach set out the plans for the final accounts audit. The Annual Governance Statement explained the External Auditor's findings, having reviewed a number of 2009/10 Annual Governance Statements.

RESOLVED –

that the Committee has considered the reports carefully and notes that they will be extremely valuable documents in planning an orderly audited closure of the 2010/11 Final Accounts.

6 **TREASURY MANAGEMENT QUARTERLY REPORT**

The Committee received a report of the Head of Strategic Finance which provided the first quarter's review of the Council's Treasury Management Strategy.

The Head of Strategic Finance updated the Committee on recent events including the situation in Greece. He also referred Members to the Council's current portfolio, attached as Appendix 1 to the report.

A Member commented that he was aware the Council focussed on investing in UK banks; however, the strongest banks were now found in China and India.

The Head of Strategic Finance acknowledged that two of the five largest banks in the world were based in China. He advised Members that some banks would only want a large investment, for example over the £5 million limit the Council set and it was possible that the Chinese banks might require a higher investment. If the Council did invest in Chinese banks the investment would need to be in sterling and not the local currency.

Paul Dossett suggested that Members might want to wait and monitor how other local authorities manage investing in these markets.

The Head of Strategic Finance informed the Committee that the reference to Santander in the portfolio was Santander UK and not Santander Spain.

A Member questioned the security of the investment in Lloyds TSB. The Head of Strategic Finance responded that the bank was covered by the Government's Guarantee scheme. Officers had invested with the bank due to the good rate of interest and it was not considered to be a risk as it was part owned by the UK Government.

RESOLVED –

that the report be noted.

7

ANNUAL GOVERNANCE STATEMENT

The Committee received a report of the Head of Strategic Finance setting out the Annual Governance Statement which the Council was required to produce annually.

The Head of Strategic Finance explained the basic principles of the Statement which would have to be signed by the Mayor and the Managing Director. He referred to the significant governance issues. For example, the Revenues and Benefits service had ongoing issues regarding reconciliations. Officers wanted to ensure that the appropriate systems were in place to avoid any errors, as this could be costly. With reference to the downtime caused by the ICT problems, the cost to the Council was probably significant. He added that if the External Auditor raised any other issues during the audit process, these would be included in the Statement of Accounts produced for consideration in September.

Paul Dossett said that he wished to draw Members' attention to ICT, which was considered to be the most significant issue. ICT systems had to be robust.

The Portfolio Holder informed the Committee that the Shared Services Joint Committee had discussed ICT in great detail. Officers had been tasked with providing robust proposals. The infrastructure needed to be future-proofed. ICT's performance needed to be substantially improved.

A Member said that he had also been present at the Shared Services Joint Committee and had been shocked at the state of ICT within the Councils. He said that there had been cross party agreement on this matter.

A Member said that he was concerned how reliant the Council was on ICT. If the systems failed it was not possible to do anything.

The Portfolio Holder said that this was an issue faced by both local authorities. Changes to the ICT systems should not limit future development. Resilience still needed to be retained.

A Member commented that the Annual Governance statement looked back in time. He asked whether there should be a section setting out the way forward.

The Head of Strategic Finance responded that if the document were to include future plans it would probably be twice as thick as the current document.

The Portfolio Holder advised that the Council's Corporate Plan was the 'forward looking' document. The Corporate Plan and Annual Governance Statement should 'mesh'.

RESOLVED –

that the Annual Governance Statement set out as Appendix A to the report be approved.

8 **STATEMENT OF ACCOUNTS 2010/2011**

The Committee received a report of the Head of Strategic Finance which explained the changes to the statutory reporting arrangements for the 2010/2011 Statement of Accounts.

The Head of Strategic Finance informed the Committee that he was required to sign the Statement by the end of the day. Paul Dossett confirmed that it needed to be signed off that day.

It was noted that the calculation for the second potential risk was incorrect and the overall score should have been '4'.

RESOLVED –

that the report be noted.

9 **REVENUES AND BENEFITS HEALTH CHECK**

The Committee received a report of the Head of Revenues and Benefits which provided an update of the recommendations made by ISCAS Ltd following their review of the Revenues and Benefits Service in August 2010.

The Head of Revenues and Benefits stated that the recommendations had helped him in the first few months in his role as the Head of Service. 41 of the recommendations had been implemented and 29 were still to be completed. Some of the recommendations were more significant than others. Reconciliation procedures had been put in place and assessments were reviewed on a regular

basis. Once the systems had been migrated by the end of December the service would focus on the outstanding recommendations.

Following a Member's question about the deadlines revised to June 2011, the Head of Revenues and Benefits advised that these would not be revised again as the reconciliation procedures had been put in place.

RESOLVED –

that the report be noted.

10

INTERNAL AUDIT PROGRESS REPORT

The Committee received a report of the Acting Audit Manager which provided updated information on the work undertaken by the Internal Audit Service.

The Acting Audit Manager reported that 93% of the 2010/11 Audit Plan had been achieved. The 2011/12 Audit Plan had been started.

Paul Dossett referred to the ICT related issues and said that he expected discussions would be held with both authorities. He added that it was important the audits took place and that the recommendations made should be implemented.

The Acting Audit Manager advised that IT related audits were outsourced to Deloitte. The IT audits had recently been deferred until November and the last one would commence in January. Discussions had taken place with the Head of ICT.

The Portfolio Holder advised that the Shared Services Joint Committee had looked at the projects the ICT service was involved in over the year. It would be necessary to consider whether some projects were deferred. It was important to ensure that the service was not overloaded and that staff had time to implement recommendations.

A Member stated that the role of Audit Manager was important and the service was invaluable. He asked for assurance that the service had support and would continue.

The Head of Strategic Finance said that the Council needed an effective internal Audit. The function was being reviewed and in September a report would explain the arrangements being put in place.

A Member commented that ICT had been flagged as an issue for concern. He asked what the financial cost would be to boost the system.

The Portfolio Holder replied that the cost for small district councils was becoming too huge. It was necessary to look at how services were procured; how it was run and administered. All options for the service would be considered.

RESOLVED –

that the report be noted.

11

IMPLEMENTATION OF INTERNAL AUDIT RECOMMENDATIONS

The Committee received a report of the Acting Audit Manager which highlighted any lack of progress in implementing Internal Audit recommendations.

The Chair asked the Head of Strategic Finance for an update on the role of Procurement Officer and recruitment to the post.

The Head of Strategic Finance informed the Committee that the post was still vacant. The Council was able to purchase strategic procurement advice from Dacorum Borough Council. A study was taking place, which was looking at the procurement strategies for Watford Borough Council and Three Rivers District Council. The post would remain vacant for the present time. He advised that a report would be presented to Cabinet in July regarding the latest procurement of gas and electricity services. There was an increased use of other procurement frameworks or consortia. With regard to major projects including the Health Campus and Charter Place external advice was sought. Consideration would need to be given to whether the role was a full-time post.

RESOLVED –

that the report be noted.

12

FRAUD ANNUAL REPORT

The Committee received a report of the Fraud Manager which provided information about the work of the Fraud Section during 2010/11. It included news articles which had highlighted some of the cases completed during the year.

Following a Member's questions about whether the sanctions were higher or lower than the previous year, the Fraud Manager responded that there was a higher risk than in previous years. The data matching had helped to identify the easier cases. The more complex cases were resource intensive. Methods of surveillance were currently under scrutiny due to some high profile cases in the national media. Many of the cases related to people not reporting changes in circumstances, for example when they took on a second job. The more sophisticated cases might involve false wills or death certificates being presented to benefits.

The Head of Strategic Finance informed the Committee that one area the Fraud Team and Revenues and Benefits would be concentrating on would be the single person discount claims for Council Tax. It was possible that some people did not consider the wrongful application for the discount to be fraud.

The Head of Revenues and Benefits added that this initiative was jointly being carried out with the County Council, as 80% of the Council Tax was for the

County. There was an £80.00 penalty for failing to report a change in circumstance. Any penalties were paid to Watford Borough Council, which would retain the full penalty charge.

Following a further question about the fraud cases, the Fraud Manager advised that the Council had a reciprocal arrangement with other countries, mainly in Europe.

RESOLVED –

that the contents of the report be noted.

13 EXCLUSION OF PRESS AND PUBLIC

that, under Section 100A (4) of the Local Government Act 1972, the public and press be excluded from the meeting for the following item of business as it was likely, in view of the nature of the business to be transacted or the nature of the proceedings, that if members of the public were present during consideration of the item there would have been disclosure to them of exempt information as defined in Section 100(1) of the Act for the reasons stated below in terms of Schedule 12A.

14 CREDITOR PAYMENT PROCEDURES

The Committee received a report of the Head of Strategic Finance setting out a revised creditor payment procedure following a recent incident.

RESOLVED –

that the Committee notes that a full internal audit report has been produced and is being considered by Senior Managers both within Watford and Three Rivers Councils. The Committee also notes that interim additional security procedures have been put in place to seek to ensure that future fraudulent incidents can be avoided.

Chair

The Meeting started at 7.30 pm
and finished at 9.35 pm

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PART A

Report to: Audit Committee
Date of meeting: 29th September 2011
Report of: Head of Legal and Property Services
Title: Ombudsman's Annual Review

1.0 SUMMARY

- 1.1 Attached as Appendix A is a copy of the Ombudsman's Annual Review of its dealings with the Council for the financial year 2010/2011

2.0 RECOMMENDATIONS

- 2.1 That the Annual Review be noted.

Contact Officer:

For further information on this report please contact: Carol Chen
telephone extension: 8350 email: Carol.chen@watford.gov.uk

Report approved by: Managing Director

3.0 DETAILED PROPOSAL

- 3.1 Attached at Appendix A is the Ombudsman's Annual Letter now called Annual Review detailing the complaints it received against the Council from members of the public in the financial year 2010/11.
- 3.2 In 2010/11 the Ombudsman received 22 enquiries and complaints about the Council up from 17 enquiries and complaints in 2009/10, of which 10 were forwarded for further investigation.
The subject area generating the largest number of complaints and enquiries was housing (8) followed by planning and building control (5), benefits and tax (4) and environmental services (3).

- 3.3 In addition the Ombudsman decided 11 complaints against the Council in the same period. The figures do not match with those in 3.2 above as some decisions may have related to complaints actually received in the previous accounting year but not finalised, and some cases still being outstanding at the end of this accounting period.
- 3.4 Of those 6 were classified as no maladministration and 5 as where the Ombudsman used his discretion to not uphold the complaint and discontinue the investigation.
- 3.5 The Council's average response time for responding to enquiries was 15.3 days an improvement on the 20 days in 2009/10 and well within the Ombudsman's target of 28 days

4.0 **IMPLICATIONS**

4.1 **Financial**

- 4.1.1 The Head of Strategic Finance comments that There are no financial implications in this report. Any payments of compensation agreed with the Ombudsman come out of the budgets of the requisite service area.

4.2 **Legal Issues** (Monitoring Officer)

- 4.2.1 The Head of Legal and Property Services comments that there are no legal issues in this report.

4.3 **Equalities**

- 4.3.1 None

4.4 **Potential Risks**

- 4.4.1 None

4.5 **Staffing**

- 4.5.1 None

4.6 **Accommodation**

- 4.6.1 None

4.7 **Community Safety**

- 4.7.1 None

4.8 **Sustainability**

- 4.8.1 None

Appendices

Ombudsman's Annual Review

Background Papers

"No papers were used in the preparation of this report".

File Reference

None

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24 June 2011

Mr M Lewis
Chief Executive
Watford Council
Town Hall
WATFORD
WD17 3EX

Dear Mr Lewis

Annual Review Letter

I am writing with our annual summary of statistics on the complaints made to me about your authority for the year ending 31 March 2011. I hope the information set out in the enclosed tables will be useful to you.

The statistics include the number of enquiries and complaints received by our Advice Team, the number that the Advice Team forwarded to my office and decisions made on complaints about your council. Not all complaints are decided in the same year that they are received. This means that the number of complaints received and the number decided will be different.

The statistics also show the time taken by your authority to respond to written enquiries and the average response times by type of authority.

Communicating decisions

We want our work to be transparent and our decisions to be clear and comprehensible. During the past year we changed the way we communicate our decisions and reasons. We now provide a stand-alone statement of reasons for every decision we make to both the citizen who has complained and to the council. These statements replace our former practice of communicating decisions by letter to citizens that are copied to councils. We hope this change has been beneficial and welcome comments on this or any other aspect of our work.

In April 2011 we introduced a new IT system for case management and revised the brief descriptions of our decisions. My next annual letter will use the different decision descriptions that are intended to give a more precise representation of complaint outcomes and also add further transparency to our work.

Extended powers

During 2010/11 our powers were extended to deal with complaints in two significant areas.

In October 2010 all complaints about injustice connected to adult social care services came under our jurisdiction. The greater use of direct payments and personalised budgets mean that it is particularly important for us to be able to deal with such complaints irrespective of whether a council has arranged the care. The increasing number of people who arrange and pay for their own social care now have the right to an independent and impartial examination of any complaints and concerns they may have about their care provider.

In the six months to April 2011 we received 89 complaints under our new adult social care powers. Between 2009/10 and 2010/11 complaints about care arranged or funded by councils doubled from 657 to 1,351.

The Apprenticeships, Skills, Children & Learning Act 2009 introduced powers for us to deal with complaints about schools by pupils or their parents. This was to be introduced in phases and currently applies in 14 council areas. By the end of 2010/11 we had received 169 complaints about schools in those areas and 183 about schools in other areas where we had no power to investigate. The Education Bill currently before Parliament proposes to rescind our new jurisdiction from July 2012.

Our new powers coincided with the introduction of Treasury controls on expenditure by government departments and sponsored bodies designed to reduce the public spending deficit. This has constrained our ability to inform care service users, pupils and their parents of their new rights.

Assisting councils to improve

For many years we have made our experience and expertise available to councils by offering training in complaint handling. We regard supporting good complaint handling in councils as an important part of our work. During 2010/11 we surveyed a number of councils that had taken up the training and some that had not. Responses from councils where we had provided training were encouraging:

- 90% said it had helped them to improve their complaint handling
- 68% gave examples of how the knowledge and skills gained from the training had been applied in practice
- 55% said that complaints were resolved at an earlier stage than previously
- almost 50% said that citizens who complained were more satisfied.

These findings will inform how we develop and provide training in the future. For example, the survey identified that councils are interested in short complaint handling modules and e-learning.

Details of training opportunities are on our web site at www.lgo.org.uk/training-councils/

More details of our work over the year will be included in the 2010/11 Annual Report. This will be published on our website at the same time as the annual review letters for all councils (14 July).

If it would be helpful to your Council I should be pleased to arrange for me or a senior manager to meet and explain our work in greater detail.

Yours sincerely

A handwritten signature in black ink that reads "Anne Seex". The signature is written in a cursive style with a large initial 'A'.

Anne Seex
Local Government Ombudsman

For information on interpretation of statistics click on this link to go to www.lgo.org.uk/CouncilsPerformance

LGO Advice Team

Enquiries and complaints received	Benefits & Tax	Corporate & Other Services	Education & Childrens Services	Environmental Services & Public Protection & Regulation	Highways & Transport	Housing	Other	Planning & Development	Total
Formal/informal premature complaints	2	0	0	1	0	3	0	2	8
Advice given	0	0	0	1	0	1	0	1	3
Forwarded in investigative team resubmitted	0	0	0	0	0	0	1	0	1
Forwarded to investigative team (new)	2	1	0	1	0	4	0	2	10
Total	4	1	0	3	0	8	1	5	22

Investigative Team

Decisions	Reports: maladministration and injustice	Local settlements (no report)	Reports: Maladministration no injustice	Reports: no Maladministration	No Maladministration (no report)	Ombudsman's discretion (no report)	Outside jurisdiction	Total
2010 / 2011	0	0	0	0	6	5	0	11

No adult social care decisions were made in the period

Provisional comparative response times 01/04/2010 to 31/03/20 11

Response times	First enquiries	
	No of first Enquiries	Avg no of days to respond
01/04/2010 / 31/03/2011	3	15.3
2009 / 2010	2	20.0
2008 / 2009	2	15.5

Types of authority	<= 28 days %	29 - 35 days %	> = 36 days %
District councils	65	23	12
Unitary authorities	59	28	13
Metropolitan authorities	64	19	17
County councils	66	17	17
London boroughs	64	30	6
National parks authorities	75	25	0

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PART A

Report to: Audit Committee
Date of meeting: 29 September 2011
Report of: Head of Strategic Finance
Title: Treasury Management Quarterly Report

1.0 **SUMMARY**

1.1 This report provides the second quarter's review of the Council's Treasury Management Strategy and investment performance.

2.0 **RECOMMENDATIONS**

2.1 That the Committee notes the report.

Contact Officer:

For further information on this report please contact: Bernard Clarke, Head of Strategic Finance

telephone extension: 8189 email: bernard.clarke@watford.gov.uk

3.0 Background

- 3.1 The UK and global economies have experienced a slowing of overall growth projections. Combined with that there has effectively been turmoil within 'euroland'. Mixed messages from Continental politicians and a lack of firm action has increased speculation that there will be a sovereign default in Greece. Should this occur then the more pessimistic forecast is that this will create a domino effect in Portugal, Ireland, Belgium, Spain and Italy with each being picked off in turn.
- 3.2 French and German Banks have been drawn into this turmoil due to their large loan exposure initially to Greece, with French banks having the largest exposure (50 billion euros). Consequently share values in French Banks have dropped significantly with the credit rating for Societe Generale and Credit Agricole being downgraded and BNP Paribas put on 'credit watch'.
- 3.3 The UK Bank scene has not been immune, and falls in the value of bank shares have also been experienced. Within the UK this has been exacerbated by the announcement of US Federal action against HSBC, RBS and Barclays for the mis-selling of sub prime mortgages. The impending report of the Independent Commission on Banking also 'spooked' the markets although its subsequent recommendation to allow a considerable implementation timescale has calmed initial concerns.
- 3.4 Within the United States fears of the implosion of euroland has resulted in no dollar lending to European financial institutions and which had the potential consequence of stopping all trade (as it is largely conducted in dollars). This forced (on 15th September) the Bank of England and its counterparts in America, Europe, Japan, and Switzerland to promise to lend 'truckloads' of money to any bank finding itself short of dollars. This promise will remain in place until December.
- 3.5 Meanwhile the Chinese Government has signalled a move away from purchasing sovereign treasury bonds and which is a particular blow to Italy where Chinese investment was seen to be a last hope. China's sovereign wealth fund is now focussing on purchasing key industrial and strategic assets particularly in America and Italy and, in the case of the United States, will bring it into conflict with the President and Congress.
- 3.6 The consequence of this accumulation of 'fear' has resulted in a situation where lending between banks has virtually dried up, and the rest of the economy not really knowing where to place its surplus cash. Watford has not been immune from this dilemma and I have never experienced such uncertainty regarding where are the best safe havens whilst seeking to obtain some return on our investments.
- 3.7 The global slowdown in the economy has resulted in an increase in UK base rate being delayed until probably late 2012. This is additional bad

news for the Council's investment portfolio as the base rate (currently 0.5%) determines the rates of interest that can be achieved on the money markets.

3.8 For Watford, the estimate of interest to be earned in 2011/2012 was geared to achieving an average rate of return of 1.3% for the year (for the first half year an average 1.25% has occurred). This has been achieved by the placing of a large part of the portfolio for between 6 to 12 months where the best rate of return could be obtained. The volatility in the financial markets referred to earlier has meant that this strategy has had to be reviewed and this is discussed within the next section of the report.

4.0 Revised Investment Strategy

4.1 The over-riding criteria for the Council's investments is governed by:

S ecurity of the investment (how safe is the counterparty)

L iquidity (how quickly can you move your investment somewhere else)

Y ield (what rate of interest can you achieve)

In that priority order.

4.2 Another tenet of investment strategy is to spread your investments (so any losses will not be disastrous—in this respect any loss would be a disaster from my perspective). The revised strategy in place at the present time therefore is to restrict all investments in banks to £3m or less per institution and to £2m for the top 5 building societies (previous limits were £5m and £3m respectively). Special Council approval has been obtained to the placing of overnight money with Nat West (maximum ceiling £10m) and the Co-op (maximum ceiling £5m).

4.3 Further, whilst current volatility in the markets prevails, the Watford portfolio is being managed with a shorter maturity profile than has been the case throughout 2010/2011 and the first quarter of 2011/2012. This will have an adverse affect upon the investment return. To some extent this is being ameliorated by placing investments with building societies with a six to twelve month profile. The logic for this being that the larger building societies have mainly cleaned up their loan portfolios and are not so reliant upon funding from the financial markets. With mortgage rates likely to remain low until there is a base rate increase, it is hoped that the largest building societies will prove less of a risk.

4.4 With regard to banking institutions, Watford's investments are being placed with a shorter profile. The current portfolio is attached at **Appendix 1** and indicates £20m of bank investments capable of maturity by 6th December. A further £3m will mature in February 2012, and a final £2m in May 2012. These two latter investments were placed before the current volatility struck the markets.

4.5 It must be emphasised that it is inconceivable that a financial meltdown would be allowed to occur but our investment strategy needs to try and anticipate any isolated problems before they materialise. Watford had registered with the Government Debt Management Office (DMO) in 2009 in case it needed to access the safest of havens. Investments have not been placed there to date (for the simple reason that the DMO pays a 0.25% rate of interest). Had we placed all our portfolio with the DMO for the past two years then a £750k loss of investment interest would have resulted). Use of the DMO is an available option in the worst scenario.

4.6 The Council pay an annual fee (£5k) to treasury management advisers, Sector Treasury Services, who also review the Council's performance. On 8th September 2011 Sector circulated a 'Credit Issues Newsflash' which included the following:

"We recommend all duration limits to banks be restricted to a maximum of three months. This limit would apply to all entities with the following exceptions:

- UK Govt and related entities such as Local Authorities.
- UK semi-nationalised institutions (Lloyds/ RBS) where we continue to view the current significant UK ownership of these entities as providing significant comfort to investors.
- Money Markey Funds

4.7 This advice supports the revised investment strategy currently in place. Sector does not provide advice regarding the building society market.

5.0 UK Financial Institutions

Watford's portfolio currently includes the following banks

- Clydesdale (parent bank, National Australia Bank). The £3m investment enjoys the protection of Clydesdale nationally, but is actually managed from the branch at Clarendon Road and provides supporting equity to enable the bank to lend to local businesses (no risk attaching to the Council's loan). The £3m is invested on a rolling 1 month notice period.
- Nat West (£8m) is a subsidiary of RBS and is covered by an implicit Government Guarantee (through its 93% ownership). This balance is effectively 'on call' and can be redeemed at one day's notice. It fluctuates daily and is dependent upon the Council's cash flows at any particular time.
- The Co-operative Bank (£3m) is the Council's banker and, like the

Nat West account, is an overnight facility and again will be subject to daily fluctuation. The Co-operative bank has traditionally been a conservative institution chiefly focussed upon its domestic market. It has had no exposure to reckless lending in the American market or those countries in Europe currently under threat.

- Barclays. The £3m investment has just over 4 months to run. It is likely the future use of Barclays will depend upon the changing financial scene.
- Nat West. This £2m investment was placed for 12 months in May 2011 at a rate of 1.51%. Nat West is deemed to be protected by the Government.
- Santander UK Ltd (£3m). Its parent bank is Santander Spain although it is ring fenced from the parent. Attached at **Appendix 2** is a summarised analysis which I requested from Sector Treasury Services and relating to Santander UK and its parent. It was produced on 8th August 2011.
- Lloyds. The Council initially had £5m with Lloyds for the period 5th September 2010 to 5th September 2011 and which earned a 2% rate of interest. The Council's most profitable recent investment. Due to market turmoil, this has now been reduced to £3m and for a three month period. It is over 40% owned by the Government and this has been deemed to provide a comfort factor.

6.0 Exposure to Sovereign Debt Default

6.1 The introduction to this report referred at paragraph 3.2 to the exposure of French and German banks to the risk of sovereign default in Greece. Detailed below are relevant figures for those institutions on the Council's portfolio and potentially affected by the immediate risk of sovereign default:

The figures have been provided by Sector and are quoted in Euro billions

	RBS	Lloyds	Barclays
Greece	1.160	0.773	0.093
Ireland	0.402	16.286	0.407
Portugal	0.208	0.156	1.170
Spain	0.379	3.731	5.496
Italy	4.650	0.172	2.920

6.2 As can be deduced from the figures, default in any one country would have differing effects upon these three high street banks.

7.0 Conclusion

7.1 The financial and sovereign debt markets are more volatile than at any time for potentially the past 80 years. The situation on the Continent of Europe is the main area of concern with the lack (and cost of funding) for Italy and Spain adding to the risk of sovereign default in Greece. Watford's investment portfolio has been structured to (hopefully) be able to respond to further developments.

7.2 This report was produced on 16th September and may well be out of date by the time of the Audit Committee.

8.0 IMPLICATIONS

8.1 Financial Issues

The Head of Strategic Finance comments that the revenue estimates for 2011/2012 has assumed £346k of investment interest will be achieved (based upon a 1.3% rate of return). The current rate of return is 1.25% so it is hoped that anticipated income will be achieved. This would of course be totally meaningless should any investment not be honoured by the counterparty.

8.2 Legal Issues (Monitoring Officer)

The Head of Legal and Property Services comments that there are statutory limitations governing cash fund investments and all proposals within this report ensure continued compliance.

8.3 Potential Risks

Potential Risk	Likelihood	Impact	Overall score
Investment with non approved body	1	3	3
Investment with an approved counterparty that subsequently defaults	1	4	4
Failure to achieve investment interest budget targets	2	2	4
Those risks scoring 9 or above are considered significant and will need specific attention in project management. They will also be added to the service's Risk Register.			

8.4 **Staffing**
None Directly

8.5 **Accommodation**
None Directly

APPX 1

Loan Ref	Lender	Loan Type	Broker	Profile	Fix/Var	Notice	Start Date	Maturity	Principal	Rate
1005	CLYDESDALE	D	V	V	V		06-Apr-10	-	-3,000,000.00	0.85
1010	NAT WEST	D	V	V	V		27-Apr-10	-	-8,000,000.00	0.90
1025	CO-OP	D	V	V	V	C	01-Jul-10	-	-3,000,000.00	0.56
1034	NATIONWIBS	D	STER	M	F		24-Nov-10	23-Nov-11	-2,000,000.00	1.33
1035	BARCLAYS	D	TRAD	M	F		09-Feb-11	08-Feb-12	-3,000,000.00	1.50
1038	NAT WEST	D	M	M	F		19-May-11	18-May-12	-2,000,000.00	1.51
1039	SKIPTON BS	D	STER	M	F		27-Jul-11	25-Jul-12	-2,000,000.00	2.00
1041	SANTANDER	D	M	M	F		05-Sep-11	05-Oct-11	-3,000,000.00	0.92
1042	YORKSHIRE BS	D	PREB	M	F		05-Sep-11	03-Sep-12	-2,000,000.00	1.50
1043	LLOYDS	D	M	M	F		06-Sep-11	06-Dec-11	-3,000,000.00	1.25
1044	COVENTRY BS	D	TRAD	M	F		09-Sep-11	09-Dec-11	-2,000,000.00	0.86
									-33,000,000.00	

AS AT 16/09/11

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Santander UK

Santander UK is regulated on a standalone basis by the United Kingdom Financial Services Authority. The bank is UK focused with more than 95% of assets UK based. In the UK, the bank has a market share of over 10% across mortgages, savings, banking and branches. It is one of the largest banking groups and the second-largest UK mortgage lender. It holds 14% of UK mortgages and 10% of customer deposits.

The ratings of Santander UK are based on its position in the Banco Santander Group, and its position as one of the leading providers of domestic financial services.

Please see below for the current credit ratings of Santander UK:

Fitch's Ratings applicable are:

Long Term: AA-, Stable Outlook

Short Term: F1+

Individual: B

Support: 1

- 20th January 2011 Fitch Ratings has affirmed Santander UK's Long Term and Short Term Rating, which together with the bank's Individual Rating reflects Santander UK's strong profitability, low risk mortgage portfolio, solid funding and sound capital base. They also reflect the bank's growing franchise in the UK mortgage and savings market.
- 20th July 2011, Fitch Ratings introduced Viability Ratings, representing Fitch's primary assessment of the intrinsic creditworthiness of financial institutions around the globe. These ratings will eventually replace Individual ratings. Santander UK received a rating of "aa-". As defined by Fitch, "aa" ratings denote very strong prospects of ongoing viability.

Moody's Ratings applicable are:

Long Term: Aa3, Under Review for Possible Downgrade

Short Term: P-1,

BFS: C-, Stable Outlook

- 7th April 2011 Moody's announced a review of their treatment of systemic support in UK bank ratings. Systematic support is defined as the uplift given to banks' ratings in respect of the likely support they would receive from the UK government.
- 24th April 2011 Moody's announced that after an initial review of systemic support the ratings of 14 UK banks have been put under review for a possible downgrade.
- 19th May 2011 Moody's upgrades the Financial Strength rating and junior debt ratings for Santander UK. The standalone rating upgrade reflects Moody's view that Santander UK's underlying financial strength has improved.

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S&P's Ratings applicable are:

Long Term: AA, Negative Outlook

Short Term: A-1+

- Standard & Poor's give Santander UK one of the highest ratings amongst its UK peers. It considers the bank to be of high systemic importance in the UK, although its business diversity and market position will remain more limited than the top tier of UK banking peers. While Santander UK has not been immune from the adverse economic and market environment in the U.K., Standard & Poor's consider that the bank will continue to demonstrate resilient earnings performance. In Standard & Poor's view, the weakest element of the bank's financial profile is capitalization, although we expect sustained improvement through 2011.
- The negative outlook on Santander UK mirrors that on Banco Santander, reflecting Standard & Poor's expectation that Santander UK will remain a core subsidiary. While Standard & Poor's expect the loan impairment charge to remain elevated, we consider that Santander UK remains relatively well positioned to withstand the adverse economic environment, and therefore expect its resilient performance to continue.
- Due to its core status, Standard & Poor's expect the ratings on Santander UK to move in line with those on Banco Santander. However, a negative rating action on Santander UK could result if, in Standard & Poor's opinion, it becomes less strategically or operationally integrated with the parent.

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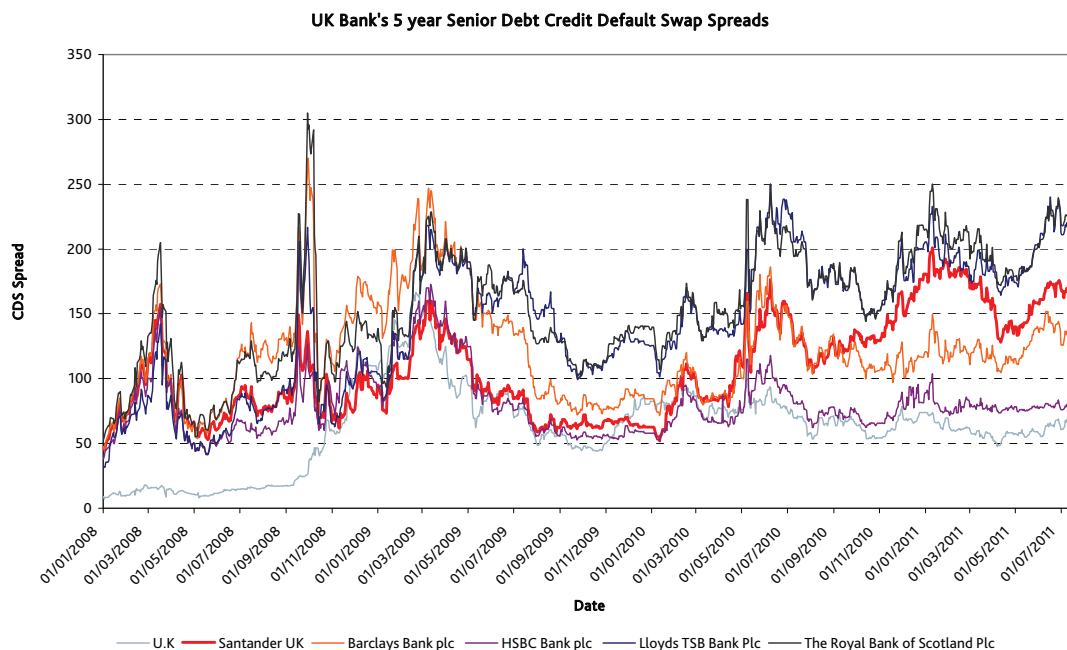
How does Santander UK's credit quality compares to its UK peers?

Overall, there is still a lot of uncertainty in the UK banking sector. Banks are facing long roads to normalised returns with tail risk in UK banks' credit portfolios remaining a particular concern.

Santander UK is considered to be in a relatively strong position when compared to its UK peers. Moody's latest ratings for Santander UK and its main peers are outlined below:

Bank	Long Term Rating	Short Term Rating	BFSR	Current LT Outlook
Barclays Bank Plc	Aa3	P-1	C	Negative
HSBC Bank Plc	Aa2	P-1	C+	Negative
Lloyds TSB Bank Plc	Aa3	P-1	C-	RUR-down
Royal Bank of Scotland Plc	Aa3	P-1	C-	RUR-down
Santander UK	Aa3	P-1	C-	RUR-down

In addition, although stigmatized for their role in the financial crisis, credit default swaps (CDS) have played a pivotal role in the global financial system over the last couple of years. Credit default products provide the market's view on a company's default prospects. CDS spreads react instantly to new information and market news. Institutions that are rated AA, for example, should have the same credit risk, thus, their CDS spreads should trade broadly in line with each other. However, this is not always the case. Sometimes, the market perceives a particular institution to be more risky than its peer AA rated institutions and Sector is able to inform clients of this disparity. Our research has shown that credit rating agencies downgrade institutions far after the CDS market has reacted to the new data. By using the CDS spreads, Sector is able to inform clients earlier of any expected credit rating downgrades. The graph below compares the CDS spread of Santander UK against its UK peers.



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Relationship between Santander UK and its parent Banco Santander

Banco Santander does not guarantee the deposits of its 100% owned UK subsidiary Santander UK Plc. Instead of an explicit parental guarantee, Banco Santander chose to inject capital directly into Santander UK Plc, meaning Santander UK has its own capital to protect deposits and, therefore, does not need to rely on the parent for support. This "subsidiary model" applies across all Santander subsidiaries whereby the local entities are provided with local capital to support local deposits.

Fitch has noted that:-

'Banco Santander would, if required, support Abbey (Santander UK), given the UK bank's significance in the group. If the parent were unable to provide support, Fitch considers that Abbey's inclusion in 2008 among systemically significant UK banks means there is an extremely high probability that ultimate support would be forthcoming from the UK authorities.'

Banco Santander runs a subsidiary model which mitigates the systematic risk within Group. This is achieved by the creation of autonomous local divisions where each unit is accountable for their own liquidity and capital management, which gives Santander's businesses local autonomy. In essence, each unit essentially operated as a separate business with one controlling shareholder. At least in theory, the parent cannot raid the Santander UK for capital, liquidity or cash because it has no direct access. This is particularly important when the parent company is abroad. In September 2008, UK operations of Lehman Brothers were raided by its American parent before it went bust.

In addition, Banco Santander group, as a result of its clear and transparent structure, has become the first global bank to submit to regulators a 'living will', detailing how it can be wound down in the event of failure without jeopardising financial stability.

In principle, should the Spanish arm fail, the UK bank would be unaffected. It even has its own credit ratings (Fitch: F1+, AA-, B, 1; Moody's: P-1, Aa3, C-; S&P: A-1+, AA).

From a business perspective this subsidiary model neutralises the risk of contagion among different entities of the Group, it reinforces supervision, it brings market discipline in local issuances and demands accountability for local risk management. This model also offers a few additional advantages as corporate policies are implemented globally.

Overall, Santander UK is considered to have a strong capital and liquidity position, which is reflected in evolution of Core Tier 1 Capital. In 2010, Core Tier 1 Capital stood at 12%, which is a significant increase from the 2007 position of 5%. In 2007, the loan to deposit ratio of Santander UK was 173%, but this has been reduced to 123% in the first quarter of 2011. On 3 August 2010, Banco Santander S.A., through a wholly-owned Spanish-based subsidiary Santusa Holding, S.L., injected £4.4bn of equity capital into Santander UK plc, to support organic and inorganic growth, as well as a planned reorganisation of Banco Santander, S.A. group companies in the UK.

Despite Banco Santander being a Spanish bank, only a small proportion of Santander's profits (around 25%) actually come from Spain, the remainder come from the UK, the rest of Continental Europe, and Central and South America. This is a global bank and extremely

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well diversified with the major part of the business focused on the retail and commercial banking sectors - over 70% of total deposits and 87% of income comes from these sectors. The fact that Santander has 14,000 branches worldwide is further testament to the main focus of the bank being on the retail side. This approach is very different to a lot of other banks who have a greater reliance on the wholesale markets for their funding.

Santander UK's parent, Banco Santander, was one of the 91 banks that was put under "stress test" by the Committee of European Banking Supervision, the result of which were published on 23 July 2010. Under the assumed "adverse scenario" banks capital levels were tested against a 35% drop in commercial properties prices and an 8.8% drop in residential properties prices in 2010, followed by a further fall of 30% for commercial properties and 15.2% for residential properties in 2011. In this scenario, Banco Santander's tier 1 capital ratio would have dropped to 10.2%. If sovereign risk shock were included, that would affect the value of sovereign bond holdings on the bank's trading books, then the tier 1 capital ratio would drop to 10%. Under both adverse scenarios put forward by the regulator and Committee of European Banking Supervision, the bank's tier 1 capital is well above the Committee of European Banking Supervision's threshold at the time of 6%.

Banco Santander also passed the second stress test in July 2011. This showed that under the "stress scenario" that Banco Santander would end 2012 with a Core Tier 1 ratio of 8.4%, well above the 5% minimum set out by the European Banking Authority for the purpose of the tests. The Core Tier 1 ratio would stand at 8.9% including generic provisions. The stress test has been carried out using a static balance sheet assumption as at 31 December, 2010 and a constant business model in terms of geographies and products.

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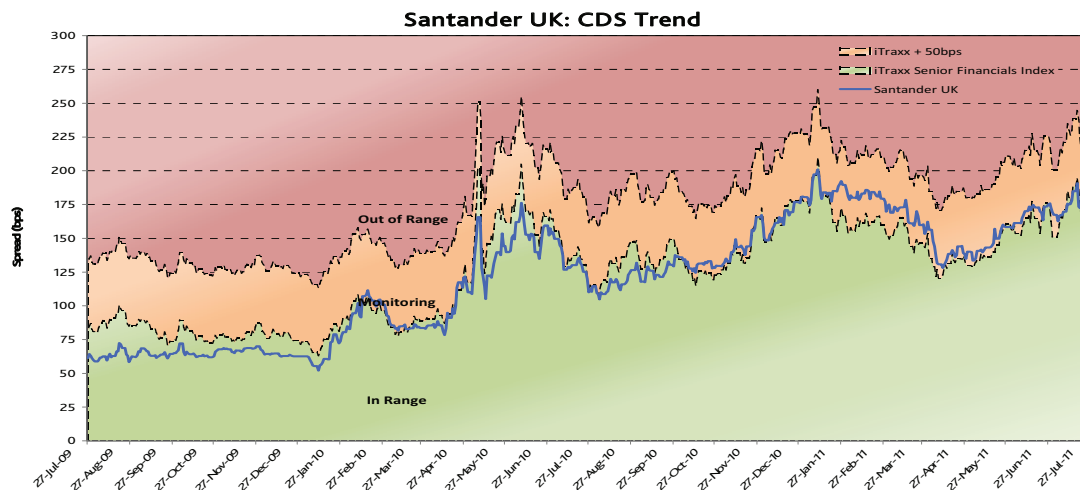
Investing with Santander UK

Sector's suggested duration for Santander UK, as at end of July 2011, is up to three months. As part of our creditworthiness methodology, we have implemented an overlaying system incorporating CDS spreads that are actively traded in the market. This means that we can base our duration suggestions on the opinions of the credit rating agencies AND the market.

	Fitch				Moody's				S&P			Suggested Duration	Suggested Duration (Watch/Outlook Adjusted)	Suggested Duration (CDS Adjusted)
	Long Term Status	Short Term Status	Individual Status	Support Status	Long Term Status	Short Term Status	Individual Status	Long Term Status	Short Term Status					
Santander UK plc	AA- SB	F1+ -	B -	1 -	Aa3 RD	P-1 -	C- SB	AA NO	A-1+ -	0 - 12mths	R - 6 mths	G - 3 mths		

Sector uses a credit rating system that incorporates all of the credit ratings from all three major rating agencies to produce a mathematically calculated, risk-weighted score that is then compared to pre-determined credit scoring bands. In addition, our approach is based on comparing the CDS spread of a subject institution with the benchmark level based on a CDS market index. This cut-off point is capped at 50 basis points above the benchmark level. If an institution's CDS spread is below the benchmark level, the suggested duration is equal to the credit rating suggested duration. If the CDS spread is above the benchmark, but below the cut-off point, then the suggested duration drops one colour band from the credit rating suggested colour. This is the case with Santander UK (as of July 2011 data), where the bank's CDS spread is above the benchmark but below the cut-off point. Suggested duration of up to 6 months (colour code 'red') is therefore reduced to 3 months (colour code 'green').

As the graph below illustrates, over the last 18 months the CDS spread for Santander UK was hovering over the benchmark level. This had an impact on Sector's suggested duration for the bank because on many occasions during the same period, the suggested duration for Santander UK was changing from three months to six months and vice versa.



In accordance with investment guidance, the final decision on investment remains with the Local Authority.

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PART A

Report to: Audit Committee
Date of meeting: 29 September 2011
Report of: Acting Audit Manager
Title: Internal Audit Annual Report 2010/2011

1.0 **SUMMARY**

This report introduces the Acting Audit Manager's Final Annual Report on the work of the Internal Audit Service for 2010/2011 and his opinion of the adequacy and effectiveness of the Council's control environment (attached).

2.0 **RECOMMENDATIONS**

- 2.1 That the contents of the final annual internal audit report for 2010/2011 be noted.

Contact Officer:

For further information on this report please contact: Mark Allen, Acting Audit Manager, Telephone 01923 727463, email: mark.allen@watford.gov.uk

Report approved by: Bernard Clarke, Head of Strategic Finance

3.0 **DETAILED PROPOSAL**

3.1 Members are invited to discuss the contents of the Acting Audit Manager's annual report for 2010/2011. This provides an updated audit opinion on the control environment for that year.

3.2 CIPFA's *Code of Practice for Internal Audit* requires that the Head of Internal Audit must provide an annual report to those charged with governance which must:

- Include an opinion on the overall adequacy and effectiveness of the control environment
- Disclose any qualifications to that opinion together with the reasons for the qualification
- Present a summary of the audit work from which the opinion is derived, including reliance placed on work by other assurance bodies
- Draw attention to any issues the Head of Internal Audit judges particularly relevant to the preparation of the Annual Governance Statement
- Compare the work actually undertaken with the work that was planned and summarise the performance of the internal audit function against its performance measures and targets
- Comment on compliance with the CIPFA standards and communicate the results of the Internal Audit quality assurance programme.

3.3 An interim report was presented to the Committee in March as the Audit Manager was retiring at the end of that month. This gave an interim opinion on the control environment, based on the work to date, as required for the production of the Annual Governance Statement. Now that work has been completed, and the Acting Audit Manager has had the opportunity to consider the whole year's work, a revised opinion is being submitted to the Audit Committee.

4.0 **IMPLICATIONS**

4.1 **Financial**

4.1.1 The Head of Strategic Finance comments that there are no immediate implications arising from this report.

4.2 **Legal Issues** (Monitoring Officer)

4.2.1 The Head of Legal and Property Services comments that the legal implications are dealt with in the body of the report. The Council is under a duty to maintain an adequate and effective system of internal audit of its system of its accounting records and of its systems of internal control and the Audit Manager is required to present an annual report, including an opinion on the adequacy and effectiveness of the control environment, to those charged with governance.

4.3 Potential Risks

4.3.1

Potential Risk	Likelihood	Impact	Overall score
The most significant potential risk relates to the possibility that Internal Audit is of poor quality and ineffective. This could lead to an increase in control weaknesses, in greater risks to the Council and to a loss of confidence by the external auditors in Internal Audit and the Council's control environment.	1	3	3

Background Papers

The following background papers were used in the preparation of this report. If you wish to inspect or take copies of the background papers, please contact the officer named on the front page of the report:

Internal Audit Files

File Reference

None

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WATFORD BOROUGH COUNCIL
ANNUAL INTERNAL AUDIT REPORT 2010/2011

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1 Introduction

An earlier version of this report was submitted to the Audit Committee before the end of the 2010/2011 financial year and the completion of Internal Audit's programme of work. At that time, the audit opinion outlined within the report was an interim opinion only. This version of the report is based on completion of Internal Audit work for 2010/2011. Following completion of this work I have determined that it is possible to amend the opinion on the overall control environment from that reported to the Audit Committee in March 2011.

This report summarises the work undertaken by Internal Audit in 2010/2011. It covers functions performed directly by Watford BC and by Shared Services on its behalf. The report meets the requirements of the CIPFA Code of Practice for Internal Audit in Local Government in the United Kingdom 2006 by:

- (i) including an opinion on the overall adequacy and effectiveness of the Council's control environment
- (ii) disclosing any qualifications to that opinion, together with the reasons for the qualification
- (iii) presenting a summary of audit work undertaken to formulate the opinion, including reliance placed on the work of other assurance bodies
- (iv) drawing attention to any issue the Head of Internal Audit judges particularly relevant to the production of the Annual Governance Statement
- (v) comparing the work actually undertaken with the work that was planned and summarising the performance of the Internal Audit team against its performance measures and
- (vi) commenting on compliance with the CIPFA standards and communicating the results of the Internal Audit quality assurance programme.

The Accounts and Audit (Amendment) (England) Regulations 2006 require the Council to maintain an adequate and effective system of internal audit of its accounting records and of its systems of internal control in accordance with proper practices in relation to internal control.

The Council is responsible for ensuring its business is conducted in accordance with the law and proper standards and that public money is safeguarded, properly accounted for and used economically, efficiently and effectively. The work undertaken by Internal Audit is not a substitute for management's responsibility for maintaining sound management practices, including robust controls.

The report is one of the key sources of assurance used in the production of the Annual Governance Statement.

2 Audit Opinion

Having reviewed the work undertaken by Internal Audit I am able to give a satisfactory assurance on the adequacy and effectiveness of the internal control environment.

Whilst there have been few significant concerns arising from the majority of the audits undertaken there are some exceptions (see 3 below) which are predominantly associated with the major changes brought about by the introduction of Shared Services and, in particular, the introduction of new systems. Reference to these is included in the Annual Governance Statement.

The degree of change has been considerable over the last 18 months or so and any organisation going through the same level of changes might well experience operational problems.

Members and Officers are aware of the various problems and are working towards solutions.

The factors taken into account in forming the opinion are set out in more detail in sections 3, 4 and 5 below.

Every internal audit report contains an audit opinion on the effectiveness of controls within the system/function/activity reviewed, highlighting any significant weaknesses which could affect the Council's control environment. The opinion provided in each report falls into one of the following categories:-

Full Assurance – sound controls that are consistently applied.

Qualified Assurance – a satisfactory report - basically sound controls but some inconsistent application puts some control objectives at risk.

Limited Assurance – unsatisfactory controls or their application puts some control objectives at risk.

No Assurance – fundamental failure of control.

These individual opinions feed into the overall opinion provided in this report.

3 Key Issues Arising in 2010/2011

It is the practice to carry out audits of the key financial systems towards the end of the financial year in order to be able to give an opinion on the effectiveness of controls within each system throughout the whole year. This allows assurance to be given not only to Heads of Services but also to the external auditors when they carry out their final accounts work. Consequently, the following shortcomings associated with those specific systems have been identified/verified by Internal Audit.

These matters, where appropriate, have been reflected in the Annual Governance Statement.

- **Revenues and Benefits**

An independent consultant was appointed to review procedures across the Revenues and Benefits Service. The review identified a number of significant concerns e.g. over reconciliations and internal controls and an action plan was drawn up to address them. Internal Audit carried out follow up audits (February 2011) to check on the implementation of the recommendations made by the consultant but was only able to verify that some had been actioned.

- **Bank Reconciliations**

The General Account (the Council's main bank account) had not been reconciled until January 2011. The lengthy delay in completing what should be a monthly process represents a significant control weakness.

- **Reconciliations to the Financial Management System (COA)**

An audit of reconciliations between the various feeder systems (Academy, payroll etc) and COA carried out in January/February 2011 identified that there had been no reconciliations carried out between the Revenues and Benefits system (Academy) for Council Tax, NNDR and Housing and Council Tax Benefits.

- **Payroll**

The outsourcing of the payroll function led to a loss of payroll expertise and internal controls associated with an in-house provider. An audit of payroll concentrated on procedures within HR who reported that, during the year, improvements had been made in their own procedures but that some basic checks previously carried out by the payroll team were now the responsibility of NorthgateArinso. Input and output controls within NorthgateArinso will form the main focus of the 2011/12 payroll audit.

- **ICT**

The experience of users during the year and the outcome of audits undertaken illustrate the need to ensure that the capacity, security and resilience of hardware and software must be adequate for current and future requirements. An audit of change management identified the need for a formal change management policy to ensure that consistent, secure procedures are in place.

4 Basis of Opinion

4.1 Work Undertaken

The work undertaken by Internal Audit during the 2010/2011 financial year was in accordance with the Audit Plan as approved by the Audit Committee. The work completed has been sufficient to enable me to provide a reasoned opinion on the overall adequacy and effectiveness of the control environment.

Details of the audits undertaken and a note of the progress on each one are shown in Appendix 1.

4.2 The Scope of the Audit Plan

The 2010/2011 Audit Plan was based on discussions with senior managers to identify their key concerns, on my knowledge of developments within the Council, on Internal Audit's own long-term risk assessment and fraud risk assessment, on the requirements and results of external assessments and on a review of risk registers.

The draft plan was discussed with the Head of Strategic Finance and approved by the Audit Committee in March 2010.

The planning process should therefore help ensure that all key systems and significant risks have been taken into account.

4.3 Implementation of Recommendations

When an audit is completed weaknesses/areas requiring improvement are discussed with senior management. This leads to an action plan being drawn up which shows agreed measures to be taken and the timescales within which they will be implemented.

All recommendations are followed up to ensure that action has been taken, or where not, that there is an acceptable reason. All reports containing High or Medium priority recommendations are followed up on a monthly basis with written confirmation that recommendations have been implemented sought from Heads of Services. Occasional follow up visits are carried out and all recommendations relating to key systems are routinely followed up during the next planned audit. Failure to implement recommendations is now reported to the Leadership Team and to the Audit Committee.

These arrangements should ensure that action is taken to remedy any issues identified during the year.

4.4 Other Factors

- My observations arising from requests to Internal Audit for assistance, attendance at meetings, committee agendas and minutes etc

- Progress made in tackling those significant control issues raised in my last annual report and the governance issues raised in the 2009/2010 Annual Governance Statement which I am able to comment on.
- Internal Audit has had sufficient resource to enable it to complete its work programme.
- The absence of material changes in the Council's objectives or activities in the year under review.
- There have been no limitations placed on the scope of work undertaken by Internal Audit, on its access to records and information or on the provision of explanations as necessary.

4.5 External Assurance

I have also taken into account the outcome of work undertaken by the external auditors and by the consultants (ISCAS) who carried out a review of operations within the Revenues and Benefits Service.

5 Fraud Investigations/Awareness

With the exception of benefit fraud, which is investigated by the Benefit Fraud Team, Internal Audit is responsible for investigating suspected cases of fraud and corruption. There have been no cases that needed to be reported to the Audit Committee.

6 Internal Audit - Quality Assurance

The Internal Audit team seeks to operate in accordance with the standards laid down by CIPFA in the Code of Practice for Internal Audit in Local Government in the UK (2006) which sets out auditing standards under the following eleven headings:

Scope of Internal Audit
 Independence
 Ethics for Internal Auditors
 Audit Committees
 Relationships
 Staffing, Training and Continuing Professional Development
 Audit Strategy and Planning
 Undertaking Audit Work
 Due Professional Care
 Reporting
 Performance, Quality and Effectiveness.

Based on reviews undertaken to date, I am satisfied that there are no material areas of non-compliance with the Code.

Internal Audit's work is subject to review by the external auditors on an annual basis. There has been no criticism of our work over the past year.

Internal Audit has its own quality assurance controls. Standard procedures and working papers are used. For every audit I review the working papers and all versions of the audit report. Any concerns/queries are discussed with individual auditors.

Work on individual audits is carried out by auditors with the appropriate level of skill and experience.

Use is made of customer satisfaction questionnaires as a means of gaining independent comment on our service. Any issues raised are discussed with the customer and the auditor. We try to learn from any mistakes we may make or from suggestions for improvement.

We work with colleagues from other audit teams in Hertfordshire in the exchange of ideas and best practice and also help facilitate joint training sessions covering the latest developments in internal auditing. All auditors from participating authorities attend these sessions.

Mark Allen
Acting Audit Manager
15th August 2011

Appendix 1

**Work Progress on Individual Audits
2010/2011**

Project	Progress as at 15th August 2011	Days Allocated 2010/11	Days Taken 2010/11
Audits Brought forward – 2009/2010			
Use of Natural Resources	Final report	-	0.5
Budget Monitoring	Final report	-	0.5
Radius	Final report	-	1.5
Data Quality	Final report	-	0.5
Commercial Rents	Final report	-	1
Secure Data Transmission	Report not issued. Dealt with on a Service by Service basis	-	5
Financial Management System	Final report	-	0.5
Partnerships	Final report	-	1.75
2009/10 Audits - Total		-	11.25
2010/2011 Audits			
Shared Audits			
Parking Control	Final report 12 10 10	20	23
Post/Cheque Handling	Final report 01 11 10	10	15
IT – BACS Payments	Final report 17 03 11	10	11.5
Payroll	Final report 21 03 11	20	29
IT – IT Service Desk and Change Management	Final report 24 03 11	10	10
Creditors	Final report 21 03 11	20	21
Debtors	Final report 30 03 11	20	23
Benefits Administration	Final report 15 07 11	25	22
Council Tax	Final report 15 07 11	20	17
NNDR	Final report 15 07 11	20	17
Financial Management System	Final report 08 04 11	25	31

VAT	Final report 30 06 11	10	10
Procurement	Final report 15 12 10	15	12
IT – Information Governance	Draft report 15 03 11	12	12
IT – Disaster Recovery and Back up, replaced by Remote Working	Draft report 25 05 11	10	9
Watford BC			
Trade waste	Final report 04 08 10	10	11
Performance Management	Final report 15 11 10	15	16.5
Treasury Management	Final report 18 10 10	10	11
Risk Management	Final report 13 12 10	10	10.5
Homelessness and Housing Needs	Final report 01 11 10	5	4
Authorised signatories	Final reports (3) 18 10 10	3	4
Community Centres transfer	Final report 13 10 10	8	7
H&S follow up	Final report 01 11 10	10	13
Leisure Management Contract monitoring	Final memo 24 03 11	5	0.25
Asset Management	Final report 04 03 11	12	18.9
Grants to Voluntary Sector	Final report 23 12 10	10	16
Ben Subsidy Claim – inc. in Benefit Administration	Final report 15 07 11	15	
Budgetary Control	Final report 04 04 11	10	12.8
Data Quality (inc. security)	Final report 12 08 11	10	3.2
Project Management	Final report 15 11 10	10	10
Cash and Banking	Final report 29 03 11	18	8.1

APPENDIX 2

LOCAL PERFORMANCE MEASURES 2010/2011

Criteria	Target p.a. (as per Audit Plan)	To 31 March 2011	Comment
% of annual audit plan achieved. Based on number of audits.	92%	93%	Actual 2009/10 – 94.5%. Progress throughout the year is continually monitored by the Audit Manager.
Sickness – average	4	2.4	(Actual days for 2009/10 – 2)
Training – average	4	3	Time includes for internal and external seminars/training. All auditors hold a relevant qualification and two are now studying for a higher qualification. (Actual 2009/10 – 5.1).

Criteria	Target p.a.	Actual To 31 March 2011	Comment
Final audit reports issued within 10 available working days of agreement to draft report.	100%	100%	(Actual 2009/10 – 100 %)
Level of customer satisfaction	94%	93%	Based on 3 questionnaires returned since 1 st April. (Actual 2009/10 –98.2%).

PART A

Report to: Audit Committee
Date of meeting: 29th September 2011
Report of: Acting Audit Manager
Title: Internal Audit Progress Report

1.0 **SUMMARY**

This report and appendices provide updated information on the work undertaken by Internal Audit on the audit plan for 2010/2011 since the last report to Audit Committee in March and also for the work on the 2011/2012 Audit Plan in the period 1st April 2011 to 2nd September 2011.

2.0 **RECOMMENDATIONS**

2.1 The contents of the report be noted.

Contact Officer:

For further information on this report please contact: Mark Allen – Acting Audit Manager telephone extension 8104 (Watford) or (01923) 727463 (Three Rivers) email: mark.allen@watford.gov.uk

Report approved by: Bernard Clarke – Head of Strategic Finance.

3.0 **DETAILS**

- 3.1 This report covers the work undertaken by Internal Audit since the last report to Audit Committee in June 2011 to complete the Audit Plan for 2010/2011 and progress the Audit Plan for 2011/2012. Appendix (1) shows the position on outstanding audits from the 2010/2011 Audit Plan and individual audits from the 2011/2012 Audit Plan as at 2 September including cumulative time taken for the year compared to the time allocated in the annual audit plan. Appendix (2) shows the local performance measures to the same date.
- 3.2 The work undertaken to 2 September 2011 on the planned audits for 2011/2012 – namely Section 106 funds, the Museum, Decent Homes Grants, Insurance, Benefit Subsidy Claims, Current Contracts, COA Post implementation review – has not generated any issues that need to be brought to the attention of the Audit Committee, other than as detailed below.
- 3.3 The recommendations from the report into creditor payment arrangements have been discussed and agreed with Senior Management and improvements to the process for verifying changes to standing data, building on the changes put in place immediately after the incident, have been and continue to be implemented.
- 3.4 Following on from the work on creditor payments, a report has been issued to the Head of Revenues & Benefits regarding the need for improvements to the processes for verifying changes to payment details for benefit payments and refunds of council tax and NNDR. In response, the Head of Revenues & Benefits, together with the Benefits Manager and the Revenues Manager, has agreed a practical way forward that balances the need for security with the pressures of service delivery. Procedure notes have been produced and the new processes are being implemented currently.
- 3.5 The COA post implementation review that is currently work in progress is focused on the IT security arrangements surrounding the eFinancials financial management system (FMS). This work will allow an opinion to be formed on the robustness of measures to deter and detect attempted cyber crime against that system.
- 3.6 The work on the Benefit Subsidy Claim for 2010/2011 highlighted that processes and responsibilities for transferring benefit expenditure data from the Academy Benefits system onto the eFinancials FMS and reconciling the two systems still needed to be formalised and implemented so that reconciliations between the two systems can be completed during the year rather than just at the year end. A meeting was held earlier this month between senior Revenues & Benefits and Finance staff and responsibilities have now been agreed. Work is progressing on implementation of the necessary processes. A further update on this will be provided to the next Audit Committee.

4.0 IMPLICATIONS

4.1 Financial

4.1.1 The Head of Strategic Finance comments that there are no financial implications in this report.

4.2 Legal Issues (Monitoring Officer)

4.2.1 The Head of Legal and Property Services comments that there are no legal issues in the report. The Council has a responsibility to ensure that it maintains an adequate and effective system of internal audit of its accounting records and of its system of internal control in accordance with proper practices in relation to internal control.

4.3 Potential Risks

Potential Risk	Likelihood	Impact	Overall score
The most significant potential risk is the possibility that Internal Audit work is of poor quality and the service ineffective. This could lead to an increase in control weaknesses, in greater risks to the Council and to a loss of confidence by the external auditors in Internal Audit and the Council's control environment.	1	3	3

In June 2010 this Committee endorsed the conclusion that the system of internal audit had been effective in the past year.

Background Papers

The following background papers were used in the preparation of this report. If you wish to inspect or take copies of the background papers, please contact the officer named on the front page of the report.

Audit Files

File Reference

None

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**Work Progress on Individual Audits
2011/2012**

Project	Progress as at 2nd September 2011	Days Allocated 2011/12	Days Taken 2011/12
Audits Brought forward – 2010/2011			
Benefits Administration	Final report – 15 07 11	-	5.2
Data Quality - WATFORD	Final report – 12 08 11	-	7.4
Council Tax	Final report – 15 07 11	-	7.7
NNDR	Final report – 15 07 11	-	6.0
FMS – Reconciliations	Final report – 08 04 11	-	0.1
Budget Monitoring – WATFORD	Final report – 04 04 11	-	0.1
VAT (Deloitte & Touche)	Final report – 30 06 11	-	
IT - Information Governance (Deloitte & Touche)	Draft report – 15 03 11	-	
IT - Remote Working (Deloitte & Touche)	Draft report – 25 05 11	-	
2010/11 Audits – Total (WBC staff days)		-	26.5
2011/2012 Audits			
Shared Audits			
Payroll		15	
Recruitment		8	
NNDR		15	
Council Tax		15	
Benefits		25	
Creditors		15	
Debtors		15	
FMS Reconciliations		25	
Insurance	Draft report stage	10	
IT - Network Controls – follow up		5	
IT - Disaster Recovery and Back-up		10	
IT - Strategy		5	
IT – Project Management (Deloitte)	Draft report – 02 09 11	10	9
IT - Asset Management		5	
IT - Virus Protection		5	
COA – Post Implementation Review	Work in progress	20	4.8

Project	Progress as at 2nd September 2011	Days Allocated 2011/12	Days Taken 2011/12
Watford BC			
Income Collection		15	
Benefits Subsidy Claim	Work in Progress	8	5.9
Benefits Overpayments		8	
Treasury Management		6	
Budget Monitoring		8	
CIS		5	
S. 106	Draft report – 23 08 11	8	9.9
Financial Procedure Rules	Work in progress	4	0.2
Hospitality		3	
Money laundering	Work in progress	5	3.0
Current Contracts	Work in progress	10	6.0
Home Improvement Grants	Final report – 02 09 11	10	9.6
Museum	Final report – 12 08 11	10	10.2
CSC		5	
External Audit Recommendations – follow up		8	
Additional Audit			
West Herts Crematorium	Final report – 14 07 11	0	1.9

LOCAL PERFORMANCE MEASURES 2011/2012

<u>Criteria</u>	Target p.a. (as per Audit Plan)	Actual To 31 August 2011	Comment
% of annual audit plan achieved. Based on number of audits.	92%	N/A	Best measured at year end.
Sickness – average days per employee.	4	0.6	
Training – average days	4	2.2	Time includes for internal and external seminars/training. All auditors hold a relevant qualification and two are now studying for a higher qualification.

Criteria	<u>Target p.a.</u>	Actual To 31 August 2011	Comment
Final audit reports issued within 10 available working days of agreement to draft report.	100%	100%	
Level of customer satisfaction	94%	99%	Based on two surveys returned for 2011/2012 to date.

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PART A

Report to: Audit Committee
Date of meeting: 29th September 2011
Report of: Acting Audit Manager
Title: Implementation of Internal Audit Recommendations

1.0 **SUMMARY**

This is the Acting Audit Manager's regular report highlighting any lack of progress in implementing Internal Audit recommendations.

2.0 **RECOMMENDATIONS**

2.1 The contents of the report be noted.

Contact Officer:

For further information on this report please contact: Mark Allen – Acting Audit Manager
telephone extension 8104 (Watford) or (01923) 727463 (Three Rivers) email:
mark.allen@watford.gov.uk

Report approved by: Bernard Clarke – Head of Strategic Finance.

3.0 **DETAILS**

3.1 As previously reported, recommendations relating to **Council Tax** and **NDR** remain subject to progress made in addressing the findings of the consultant's report on Revenues and Benefits. Progress continues to be reported to the Shared Services Joint Committee and Watford's Audit Committee. Subsequent Internal Audit work has identified further recommendations that will be subject to future follow up and reporting to the Audit Committee as necessary.

3.2 **Procurement.** An advert has been placed for appointment of a Corporate Procurement Officer and interviews have been provisionally scheduled for October 2011. The post holder will provide the resource for addressing the recommendations from the Internal Audit report relating to the promotion of good procurement practice and monitoring the associated savings.

3.3 **Health & Safety Follow Up**

28 of the original 36 recommendations are now reported to have been implemented or are no longer required. Progress continues to be made in implementing the 8 outstanding recommendations.

3.4 **IT Service Desk / Change Management**

There were 8 outstanding recommendations to be followed up for this report. Of these, four recommendations have now been implemented. The remainder, relating to production of a service catalogue and updating service response times, have been put on hold or postponed until December 2011/January 2012 pending the review of service delivery options.

3.5 **Payroll**

There is one outstanding recommendation that relates to the harmonisation of processes between Watford and Three Rivers for making third party payments. This is not currently a priority within Finance as the existing arrangements are working satisfactorily for operational purposes and it requires the interfaces between eFinancials and the Northgate system to be re-written. Implementation has been postponed to April 2012.

3.6 **Reconciliations**

There are three outstanding recommendations for this audit.

Of these, one relates to formalising the processes and responsibilities for producing the in-year reconciliations between the Academy Benefits system and the eFinancials system and for addressing differences arising from those reconciliations. A meeting between senior officers in Revenues & Benefits and Finance took place earlier this month to agree the way forward in addressing this issue. Progress will be monitored through further internal audit work this year as reconciliations have been a cause for concern in the past.

The other two recommendations relate to harmonisation of reconciliation formats and the allocation of responsibility for reconciling the new income management system to other financial systems. Implementation of these recommendations has been postponed pending implementation of the new income management system in October.

3.7 **IT BACS Payments**

Implementation of the three recommendations for this report has been delayed due to technical issues. The roll out of transmission of BACS payments and DD requests to Finance is now scheduled to occur by the end of October 2011 and Revenues & Benefits will follow on from that.

3.8 **Asset Management**

Procedure notes for updating the Finance asset register have yet to be written. The IFRS compliant asset module was installed on the eFinancials system late in the closing of accounts process for 2010/2011. Existing assets have been updated on the system, but no new assets have yet been added. New assets acquired during 2010/11 will be added to the register during the 2011/12 financial year. Procedure notes will be written as the eFinancials asset register is updated.

3.9 There are no other outstanding recommendations to report to Committee.

4.0 **IMPLICATIONS**

4.1 **Financial**

4.1.1 The Head of Strategic Finance comments that there are no financial implications in this report.

4.2 **Legal Issues** (Monitoring Officer)

4.2.1 The Head of Legal and Property Services comments that there are no legal issues in the report. The Council has a responsibility to ensure that it maintains an adequate and effective system of internal audit of its accounting records and of its system of internal control in accordance with proper practices in relation to internal control.

4.3 **Potential Risks**

4.3.1

Potential Risk	Likelihood	Impact	Overall score
Progress in implementing Internal Audit recommendations is not monitored, recommendations are not implemented and as a consequence, internal controls are weakened.	1	3	3

Background Papers

The following background papers were used in the preparation of this report. If you wish to inspect or take copies of the background papers, please contact the officer named on the front page of the report.

Internal Audit Files

File Reference

None

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