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AUDIT COMMITTEE

Wednesday, 14th March, 2012

7.00 pm

Town Hall, Watford

Publication date: 6 March 2012

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

The minutes of the meeting held on 12 January 2012 to be submitted and signed.

4. OUTSTANDING ISSUES (Pages 1 - 8)

Report of the Head of Strategic Finance

This report updates the Committee on three areas where further information was required.

5. REPORTS FROM GRANT THORNTON (Pages 9 - 34)

Attached are three reports from the Council's External Auditor, Grant Thornton. The reports cover the following issues:

- Audit Progress Report March 2012
- IT Shared Services Update
- Accounts Audit Approach Memorandum

6. TREASURY MANAGEMENT ANNUAL REPORT AND ACTUAL PRUDENTIAL INDICATORS 2010/11, MID YEAR TREASURY MANAGEMENT MONITORING REPORT FOR 2011/12 AND TREASURY MANAGEMENT STRATEGY STATEMENT 2012/13 - 2014/15 (DCRG) (Pages 35 - 70)

Report of the Head of Strategic Finance

This report informs Members of the Treasury Management Annual Report and Prudential Indicators for 2010/11; to present to Members a mid year review of the Treasury Management function in 2011/12; and to report the Treasury Management Strategy for 2012/13 – 2014/15.

7. TREASURY MANAGEMENT UPDATE REPORT (Pages 71 - 76)

Report of the Head of Strategic Finance

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

8. STRATEGIC RISK REGISTER (Pages 77 - 82)

Report of the Head of Strategic Finance

This report informs the Committee of the Strategic Risk Register which was reviewed and approved by Leadership Team on 6 March 2012.

9. INTERNAL AUDIT STRATEGY AND ANNUAL WORK PLAN FOR 2012/13 (Pages 83 - 94)

Report of the Audit Manager

This report sets out an Internal Audit Strategy and Annual Work Plan for the coming financial year for Watford Borough Council and Three Rivers District Council.

10. IMPLEMENTATION OF INTERNAL AUDIT RECOMMENDATIONS (Pages 95 - 98)

Report of the Audit Manager

This is the Audit Manager's regular report on progress with the implementation of Internal Audit recommendations.

11. INTERNAL AUDIT PROGRESS REPORT (Pages 99 - 106)

Report of the Audit Manager

This report and appendices provide updated information on the work undertaken by Internal Audit on the 2011/2012 Audit Plan in the period 1 April 2011 to 24 February 2012.

Agenda Item 4

Report to: Audit Committee

Date of meeting: 14 March 2012

Report of: Head of Strategic Finance

Title: Outstanding Issues

1.0 **SUMMARY**

1.1 This report briefly updates the Committee upon three areas where it required further information.

2.0 **RECOMMENDATIONS**

2.1 To note the contents of the report.

3.0 **DETAILED PROPOSAL**

3.1 There are three outstanding issues highlighted by the Audit Committee:

- Misstatements within Final Accounts
- Software upgrades to IE8
- Transfer of BACS payments

3.2 With regard to 'misstatements' the head of Strategic Finance reported to Council on 25th January (see **Appendix 1)** and has nothing further to add. With regard to software upgrades, the Audit manger circulated an update to all members of the Committee on 27th January 2012, (**see Appendix 2**). Finally with regard to BACS transfer an updated note is attached at **Appendix 3.**

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Appendix 1

QUESTIONS BY MEMBERS OF THE COUNCIL UNDER PROCEDURAL RULE 10.0
COUNCIL – 25 JANUARY 2012

QUESTIONS FROM COUNCILLOR BELL
Received on 20 January 2012.

1. Question

I would like an explanation for the 2-matters which could not be completed and were raised by the auditors and amounted to £320,000 for the annual accounts for 2010/11.

Answer

The background to this issue is that all local authorities were required to carry out significant additional work (including totally re-stating their previous year's balance sheets) in order to comply with International Financial Reporting Standard requirements. The consequence of this was that many authorities (and their auditors) were involved in finalising the final accounts right up to the statutory deadline of 30th September 2011.

In the case of Watford, the accounts and accompanying external audit report were completed on 27th September (with the Audit Committee meeting on 29th September to 'sign them off'). Again to put this in context, 28 authorities failed to meet the statutory deadline of 30th September.

With regard to the specific issue of £320k referred to within the external auditors report, it rather perplexed officers within the Shared Services Finance Division as they were unaware there was any such issue. Shortage of time meant that the External Audit Report was reported unchallenged as Watford had received an unqualified opinion for both its accounts and its approach to Value for Money. These two factors are the important issues.

Subsequently officers within Shared Services Finance e mailed the external auditor on three occasions for detail regarding the apparent misstated £320k.
The Head of Strategic Finance pursued this on 13th January 2012 with the external auditors. A reply was received later that day in which the external auditor flagged up four instances which comprised the £320k. On the 16th January 2012 an officer from Shared Services Finance responded back pointing out that all four issues had in fact been amended during the audit and reflected correctly within the final Statutory Accounts.

A response has been received from the external auditor at 14.08 p.m. on 24th January which includes the following:….''we believe the query related to unadjusted items and there were no unadjusted items listed in the report. All items listed in our report have been agreed and confirmed….''.

It is interpreted therefore that the reference to a £320k misstatement had in fact been overtaken by events and should have been deleted from the external auditors report. The Head of Strategic Finance is required to report back on this to the Audit Committee on 14th March where it is hoped this issue can finally be resolved.

For more information please contact
Ext:

From: Mark Allen
Sent: 27 January 2012 15:15
To: Councillor Ian Brown; Councillor Rabi Martins; Councillor Asif Khan; Councillor Steve Rackett (TH); Councillor Alan Burtenshaw
Cc: Bernard Clarke; Avni Patel; Alan Power
Subject: For Information: Response to Audit Committee regarding use of Internet Explorer in Watford Borough Council

Dear Audit Committee Member,

For your information, following the Audit Committee meeting in January at which Members expressed their concern about the ongoing use of Internet Explorer 6 (IE6) because of its security vulnerabilities, I have contacted ICT to clarify the current position regarding the upgrade to Internet Explorer 8 (IE8).

I have been informed that the more secure IE8 has been rolled out to all Thin Client users which is the majority of staff at Watford as well as the majority of PCs that are used by non-thin client users. As the council does not have any automated audit tools, it is not possible to provide exact figures for the number of PCs not upgraded. ICT are planning a manual inventory of all PCs at both councils to be completed by the end of this quarter so they will know the exact numbers that are outstanding.

The Infrastructure team is about to implement a trial version of Microsoft System Centre Configuration Manager which will automate upgrades such as these. If the trial is successful, ICT will recommend to both councils that this solution be implemented to manage all patch management, software deployment and inventory.

Currently, the critical issues identified in the IT Health check report are being given priority. ICT will add the full implementation of IE8 to their future work programme but do not currently have a timescale for this as they arefinishing work on the 12 week programme of improvements.

In the meantime, all systems at both councils are protected by firewalls and email filters that include virus scanning upon entry into the network as well as local antivirus at server and desktop level.

I hope this explanation clarifies the current position for you.

Regards,

Mark Allen
Audit Manager
Internal Audit Service
Watford Borough Council & Three Rivers District Council,
Three Rivers House,
Northway,
Rickmansworth, Hertfordshire, WD3 1RL

Telephone: (01923) 727463 or (01923) 278104
Email: mark.allen@watford.gov.uk

Transfer of BACs Payments ***Appendix 3***

An Internal Audit Report recommended consideration should be given to transferring the responsibility for transmitting payment and DD request files to the Services responsible for the corresponding expenditure and income transactions. Such a transfer would have to be supported by an in-depth handover process by ICT. This recommendation was agreed for implementation in June 2011. Resourcing and implementation issues caused delays to transfer.

The transmission of Watford payments to Account Payable customers was transferred to Finance 1 December 2011. The set up included the installation of software and a card reader on a dedicated machine within the Accountancy Section.

It was necessary to purchase 9 authorisation cards costing £85 each and to train 9 officers in the administration and control of the process. Internal controls have been maintained and no officer responsible for processing payments has the ability to transfer funds. The implementation took 11 months from the time of ordering the cards to set up to completion.

This was due to:-

- *the complexity of getting the files from the FMS in the required format, and the right directories*
- *setting up the software and equipment*
- *ensuring that staff signing in to either the Watford or Three Rivers domain could access both the files to be sent and the software*
- *training the 9 staff at times of other conflicting priorities in both ICT and Finance.*

The process is currently being repeated for Revenues and Benefits transmissions where the latest situation is that training and card registration has been completed. This allows staff to be able to download payment related reports. The additional BACs cards requested by Benefits have been delayed due to a change in the way banks process these. All forms were returned from the bank as they now require 3 signatories from Finance (previously two signatories). These have now been submitted back to the bank and implementation should be achieved for the commencement of the new financial year.

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PART A

Report to:	Audit Committee
Date of meeting:	14th March 2012
Report of:	Head of Strategic Finance
Title:	Three Reports from Grant Thornton

1.0 SUMMARY

1.1 Attached are three reports from the Council's External Auditor, Grant Thornton. The reports cover the following issues:
- Audit Progress Report March 2012
- IT Shared Services Update
- Accounts Audit Approach Memorandum

2.0 RECOMMENDATIONS

2.1 That the Committee considers carefully the reports and note the Council's brief response attached within this covering 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 **Detail**

Dealing with the three reports in turn, the Head of Strategic Finance comments as follows:

3.1 **Audit Progress Report March 2012.**

3.2 This report provides an overview of work to date. It includes an early indication of the likely audit fee to be charged in 2012/2013 and suggests a potential circa £12k reduction. It also refers to the need to review current governance arrangements (a report will be produced for the next Audit Committee and will take into account best practice). Finally it refers to the need for the 'foreword' to the Statutory Statement of Accounts to provide more detail in an understandable format. The Head of Strategic Finance has always produced a covering report to the Statutory Statement as he has recognised it is not particularly meaningful to the lay person. To include the content of that covering report within the Statutory Statement itself should cause little problem and is supported.

3.3 **IT Shared Services Update**

3.4 This report covers a review into the arrangements for the future provision of ICT services to both councils. It largely endorses the approach and conclusions of Actica (the adviser working for the councils) and notes the next stage is to look at the current HCC Framework agreement whilst also testing the wider market. This is important in order to test where the best value service can be procured. The Audit Committee should note that financial figures are quoted within the report but these were provisional and only a proper market test will reveal the true situation.

3.5 **Accounts Audit Approach Memorandum**

This report indicates the interim audit work already carried out and proposals for an orderly closedown process. It is welcomed and provides clarity regarding what is expected of Shared Services and Watford officers. The one issue to draw to the Audit Committee's attention appears on Page 7 of the report and relates to reconciliations. Whilst higher priority work had originally been scheduled, the current situation is that reconciliations are substantially up to date and the situation is being closely monitored. It is genuinely the case that the problems in 2010/2011 should not recur.

4.0 **IMPLICATIONS**

4.1 **Financial Issues**
The Head of Strategic Finance comments that there are no financial implications arising directly out of this report.

4.2 **Legal Issues** (Monitoring Officer)

The Head of Legal and Property Services comments that there are no legal implications arising directly out of this report.

4..3 **Potential Risks**

Potential Risk	Likelihood	Impact	Overall score
That the market test of the ICT service draws a limited response with little quality or saving.	2	3	6
That the final accounts process does not meet statutory timetable	1	4	4

4.4 **Staffing**

None Directly

4.5 **Accommodation**

None Directly

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WATFORD BOROUGH COUNCIL

AUDIT PROGRESS REPORT - MARCH 2012

<table>
<tr><th>Work</th><th>Progress</th></tr>
<tr><td>Interim Audit</td><td>We have completed our interim audit and updated our understanding of key financial systems and completed relevant walkthroughs. The results of this work feed into our Audit Approach Memorandum. Please see separate agenda item.</td></tr>
<tr><td>IT update</td><td>As part of our audit plan we agreed to follow up on the IT Strategy review undertaken in 2010/11 and provide a quarterly update to the Audit Committee on our assessment of progress. Please see separate agenda item.</td></tr>
<tr><td>District Councils – Technical Training update</td><td>We presented our annual Technical Training Update for District Councils on 1 March 2012 and are pleased to note that representatives from Watford and Three Rivers shared services attended. The course covered:

recap on IFRS implementation
accounting and reporting changes under the 2011 Code
current accounting issues including:

components
restructuring provisions and impairments
exit packages
accounting for joint working arrangements
carbon reduction accounting
heritage assets

proposed changes under the 2012 Code
future changes on the horizon
</td></tr>
</table>

Audit Fee (12/13)	The Audit Commission is currently consulting on its work programme and scale of fees for 2012/13. This consultation document is publically available on their website: http://www.audit-commission.gov.uk/SiteCollectionDocuments/Downloads/2012-13propossed-sof-lg-cs.pdf For 2012/13, the Commission proposes reducing audit fees for audited bodies by 10 per cent from the published 2011/12 scale fees, reflecting the Commission's continued reduction in costs. The current proposed fee for Watford Borough Council is £102,600. This compares to £114,000 for 2011/12.
Publications	In March 2012 Grant Thornton publish " High Pressure System Local Government Governance Review". A comprehensive review of Annual Governance Statements produced by Local Authorities in 2010/11. The report identifies some key strengths such as: • over 90% of respondents said that their council had effective and embedded risk management arrangements • 89% of those surveyed said that officers and members were clear on respective roles and responsibilities when the council works in partnership • 92% of senior officers and members said that their council had put in place effective additional Bribery Act and anti-fraud controls to manage increasing fraud However our review identified scope for improvement in areas such as: • the annual review of governance is often seen as a 'tick the box' exercise rather than a genuine effort to achieve best practice • the membership and focus for Audit and Scrutiny committees will be key to their future effectiveness as the agenda becomes more challenging • Very few councils are achieving more than basic compliance with their explanatory forewords, suggesting that they should be fundamentally reviewed from a user perspective

Three Rivers DC/Watford BC

External Audit 2011-12

IT Shared Services Update

February 2012

Status of IT Shared Services - for presentation to Audit Committee March 2012

SCOPE OF AUDIT WORK

As part of our 2011-12 audit plan we have identified the need to review the arrangements in respect of the ICT Shared Service for both Watford BC ('WBC') and Three Rivers DC ('TRDC'), in particular to understand the plans for implementing recommendations from external consultants and audit, internal and external, and to assess the proposed scope for reviewing the future viability of the service. This work will inform our opinion for the 2011-12 accounts.

Our summary below is based on a number of key documents from both Councils including:

-ICT Roadmap 2012

-ICT 2012-15 Service Plan

-Actica Consulting's (third party consultants) reports on Service delivery and the Options Appraisal - both delivered in 2011

-Service Highlight reports to the Joint ICT Steering Group and the Joint Committee

We have discussed the above reports/documents with the Head of ICT but we have not performed any additional work to date to test the operating effectiveness of the controls in place to manage the service not the project plans to help deliver the future of the service.

During the 2010-11 audit year, we made a number of recommendations around controls relating to the key finance systems. We will follow up on this work during mid-March as part of our annual visit and will report separately

BACKGROUND AND CONTEXT

In November 2009, WBC and TRDC established a shared ICT service to provide a number of common applications. WBC has always provided its own IT service. From 2005 until 2009 the IT service for TRDC was provided by a third party, Steria.

This ICT service is resourced internally by both Councils with an annual cost circa £1.4m. It is based at TRDC under a single Head of Service, supported by three managers, and provides the following services:

- operating a single helpdesk
- implementing new IT projects including business process re-engineering
- providing application administration, web development and IT implementations
- managing the separate network infrastructures of each Council.

The ICT Shared Service currently provides thirty six applications to both Councils. Some shared systems are in place, such as the Revenues and Benefits and the main finance system. Work is in progress to continue to harmonise the ICT infrastructure and front-line applications to reduce costs, improve performance and increase resilience.

The ICT Shared Service was reviewed by an independent third party in May 2011. The review assessed the complete service as provided to both Councils and the resulting report made a significant number of recommendations for the ICT Shared Service to implement if it was to provide the service its users needed.

CURRENT PROVISION OF SERVICE

A Joint ICT Steering Group, whose role is to agree and prioritise ICT projects for both Councils, has been set up. With its support, the ICT Shared Service implemented a twelve week infrastructure programme, running between 20 October 2011 and 20 January 2012, to deal with urgent change/maintenance requests.

The programme consisted of seven key work streams covering both Councils. This included work around improvements to the network, virtualisation[1], backup re-design, TRDC SAN, security patch management, WBC thin client improvement, and replacement of critical hardware. This programme has helped prioritise key issues and associated projects. Key improvements have included:

- Helping to improve performance and resilience by establishing a new virtual server farm. This has meant replacing or decommissioning old servers. This has included the server supporting the Revenues and Benefits system
- Improving the log in times for WBC and Shared Services staff through reconfiguration and additional memory
- Increasing backed up data capacity by replacing hardware, including the purchase of additional back up tape drives
- Improving IT disaster recovery through the virtualisation project although there is much more to do in this area, particularly around further virtualisation. IT disaster recovery will be subject to an Internal Audit review during 2011-12 and we will assess the report's findings at the end of March 2012. In addition, the Head of ICT has arranged to meet one of the Councils' DR partner at the end February 2012 to discuss new tests following the changes made to improve resiliency and back up arrangements
- Improving network monitoring through the use of automated tools to allow problems to be monitored and dealt with in a more proactive manner.

There is, however, much that still needs to be done to improve existing service delivery, performance and controls. The ICT Shared Service has identified additional work in this respect and plans for subsequent phases are being drawn up.

All ICT Shared Service vacancies are currently frozen. However, to deliver some of the project work in progress and outlined above, the ICT Shared Service has had to rely on contractors. This has, therefore, resulted in additional staff costs.

SERVICE PERFORMANCE

Formal Service Level Agreements (SLAs) have been agreed between the ICT Shared Service and its customers at both Councils, as well as the Joint Committee. As part of the SLAs, performance standards have been identified as well as performance indicators that will be used internally by the Shared Service and are included in the 2012-15 Service Plan.

The defined key performance indicators are not all being monitored as outlined due to other priorities and the quality of the data available from systems. Performance, where the data ia available, is reported monthly on the Shared Services intranet site and bi-monthly at the Shared Services Joint Committee. These reports only provide limited information on incident resolution and service availability. Set targets are yet to be consistently met with the service availability for WBC below target much more so than TRDC. Management are aware of the issues affecting performance and are working to resolving these, as witnessed by the twelve week programme of work.

[1] A virtual infrastructure lets you share your physical resources, creating 'virtual' multiple machines, across your entire infrastructure for maximum efficiency. This in turn provides a good level of resilience to ensure the availability of IT services and can help to improve IT disaster recovery. The ICT Shared Service has started on a programme of work to 'virtualise' its key servers.

FUTURE OF THE SERVICE

The independent review of ICT Shared Services in May 2011 recommended that improvements were required to governance arrangements, the ICT infrastructure, service delivery and the future ICT strategy.. A key recommendation was that if improvements in the Shared Service were not seen within twenty four months, the Councils should consider the options with regard to future provision.

In July 2011, the Joint Management Committee agreed to proceed immediately with investigations into alternative models of service delivery. An options appraisal study and outline business case has been commissioned from Actica Consulting. The intention is to go live with the new service, in whichever format is finally agreed, from October 2012.

The consultants advised that the following options were open to the Councils:

- do nothing and continue with existing ICT Shared Service
- public sector partnership, such as a third authority who would take the lead,
- multi-sourcing model, a combination of one of more of the following:
    i. one or more services managed\hosted externally (e.g. server maintenance)
    ii. some service areas outsourced fully (e.g. infrastructure and service desk)
    iii. some work retained to maintain a pool of business and local knowledge (e.g. applications analysis, project management, business analysis and web development)
- full private sector outsourcing of the whole service with only a client contract management function in house
- full private sector outsourcing by joining the framework agreement already in place between Hertfordshire County Council (HCC) and SERCO.

The Councils are currently exploring the options of joining the framework agreement with HCC or outsourcing completely. This was agreed as the way forward by the Shared Services Joint Committee in November 2011. The recommended option based on Actica Consulting advice is joining the HCC framework as '*it (offers) value for money…together with the likelihood that it will meet all of the Councils' ICT requirements*'.

Actica Consulting's initial predictions suggest this option would cost £1,150,000 p.a. with £63,000 in transition costs. (It should be noted that Actica Consulting state that the likely costs associated with implementing the recommendations above are to an accuracy of +/- 50% based on the current information available). Although the current staff costs are high in comparison to proposed outsourcing models, it should be noted that they cover a significant proportion of project and support costs that would still need to be procured from a third party supplier.

The Councils have now drawn up the draft requirements specification to further explore this option. The final specification will be taken to the Shared Services Joint Committee on 5 March 2012. The following significant targets are in place:

- End June \ Early July - Advertise Invitation to Tender (if required, dependent on decision at Joint Committee)
- End July - Review tenders and award contract
- August onwards - Transition to new provider with service fully operational from October 2012

RISK MANAGEMENT

We acknowledge that many key risks relating to the options appraisal and the introduction of a new way of working have been identified by Actica Consulting and the Councils are continuing to use Actica Consulting to draw up the requirements specification. We reinforce the guidance provided by Actica Consulting, in particular, that full consideration should continue to be given to the following:

1	A financial business case is needed to support any change in ICT sourcing strategy, and a high level appraisal of the likely cost savings has been prepared. Additional due diligence with the preferred supplier and some external market testing will be needed to confirm the financial case. The due diligence should accurately reflect the needs of the Councils and the service the third party is to provide. This should be documented in detail and should include: • Transition timescales and costs • Business as usual costs and SLAs • TUPE arrangements • Council ICT staff roles and responsibilities • Project roles and responsibilities • Project costs • Reporting arrangements • ICT hardware ownership The business case produced should be challenged robustly by the Councils and market tested with other potential suppliers, based on the detailed specification. The preferred supplier's service catalogue should be reviewed and confirmed at this stage to understand if it can fully meet the Councils' needs.
2	The Councils should confirm that their procurement and legal departments are happy that they can pursue a single supplier tender or if a full OJEU tender process will need to be followed. The Councils may need specialist procurement advice to ensure that the requirements specification is sufficiently detailed. This would also apply to drawing up any tender documentation.
3	The Councils should also consider whether they will consider a preferred supplier if it intendeds to sub-contract its services
4	The Councils should use a pre-defined scoring mechanism to assess the suitability of suppliers to meet the Councils' needs
5	The Councils should consider the financial and legal implications of transition to a third party, such issues relating to TUPE transfer of staff. However, we accept that this may not be possible to consider until after the preferred option has been selected.

In addition, we also bring to the attention of the Audit Committee the following areas that we believe need to be actively managed, should the Councils decide to use a third party to manage its ICT service:

6	The Councils should ensure that specialist advice on drawing up IT contracts is sought before the contract (s) is signed to assess their needs and responsibilities, including the right to audit.
7	Consideration should also be given to the length of the contract(s) and the inclusion of penalties, in addition to the Councils' exit strategy
8	The contract(s) should clearly stipulate how the proposed benefits will be measured and realised and how would this will be detailed via contractual terms
9	The contract(s) should also outline the type of governance arrangements needed for contract review and monitoring purposes
10	The contract should clearly stipulate the information security requirements as mandated by external regulatory bodies.

TIMETABLE AND PERSONNEL INVOLVED

We propose to carry out the regular updates between spring and the autumn 2012 and will report to the respective Audit Committee meetings for both Three Rivers DC and Watford BC.

The work has been performed by Negat Sultan, a Senior Manager within our Technology Risk Services team and has been overseen by Paul Dossett, Partner.

Grant Thornton UK LLP
February 2012

Grant Thornton

Watford Borough Council

Accounts Audit Approach Memorandum

March 2012

Contents

Appendices

Our accounts audit approach

This memorandum is intended to provides additional detail regarding our audit approach, as set out in our 2011/12 Audit Plan issued in January 2012, as well as an update on our response to key risks from the results of interim audit work carried out to date.

Audit approach reminder

We will:

- work closely with the finance team to ensure that we meet audit deadlines and conduct the audit efficiently
- plan our audit on an individual task basis at the start of the audit, and agree timetables with all staff involved; and
- consider the materiality of transactions when planning our audit and when reporting our findings

The logistical details of our annual accounts audit, as agreed with the Head of Strategic Finance, are detailed in Appendix A to this memorandum.

Planning	• Updating our understanding of the Council through discussions with management and a review of in year internal financial reporting • Identifying and resolving specific accounting treatment issues
Control evaluation	• Reviewing the design effectiveness and implementation of internal financial controls including IT, where they impact the financial statements • Assessing audit risk and developing and implementing an appropriate audit strategy • Testing the operating effectiveness of selected controls • Assessing the Council's arrangements for complying with tax legislation and Bribery Act requirements • Assessing the effectiveness of internal audit
Substantive procedures	• Reviewing material disclosure issues in the financial statements • Performing analytical review • Verifying all material income and expenditure and balance sheet accounts, taking into consideration whether audit evidence is sufficient and appropriate
Completion	• Performing overall evaluation of our work on the financial statements to determine whether they give a true and fair view • Determining an audit opinion • Reporting to Finance, Audit and Risk Committee through our ISA 260 report and Annual Audit Letter

Materiality
An item would be considered material to the financial statements if, through its omission or non-disclosure, the financial statements would no longer show a true or fair view.

Materiality is set at the outset of planning to ensure that an appropriate level of audit work is planned. It is then used throughout the audit process in order to assess the impact of any item on the financial statements. Any identified errors or differences greater than 2% of materiality will be recorded on a schedule of potential misstatements.

These are assessed individually and in aggregate, communicated to you and, if you agree with any management decisions to not adjust for such items, signed off by you in your letter of representation to us, confirming your view that they are immaterial to the financial statements.

An item of low value may be separately judged to be material by its nature, for example any item that affects the disclosure of directors' emoluments. An item of higher value may equally be judged not material if it does not distort the truth and fairness of the financial statements.

Reliance on internal audit
We work with the internal audit function to ensure our audit approach takes account of the risks identified from reviews they have conducted relevant to the financial statements, subject to our review of the effectiveness of the internal audit function.

Where significant risks to the financial statements are identified from our own work, it may be possible to coordinate with the work of internal audit to avoid unnecessary duplication of effort. Where such reliance takes place this will be specifically detailed in the reporting of our results.

Review of IT
Our audit approach assumes that our clients utilise complex computer systems and accounting applications to routinely process large numbers of transactions. These may be used either directly or indirectly in preparing financial reporting information, including the annual accounts. Accordingly, our approach requires a review of the internal controls in the Council's information technology (IT) environment.

Based on our assessment of the complexity of the overall IT environment and the results of an independent review of the IT Shared Services in May 2011, we have involved specialist Technology Risk Services (TRS) team members in our audit work in order to undertake a review of the overall IT control environment . Where significant systems are outsourced, or new systems or applications introduced in year, additional review work may be undertaken on this risk assessed basis.

Internal controls
Auditing standards require that we evaluate the design effectiveness of internal controls over the financial reporting process to identify areas of weakness that could lead to material misstatement. Therefore, we will focus our control review on the high risk areas of the financial statements.

In order to assess whether controls have been implemented as intended, we will conduct a combination of inquiry and observation procedures, and, where appropriate, transaction walkthroughs. Where further assurance or audit efficiency may be gained, we will consider directly testing any controls that we may consider to be key in relation to the identified risk.

However, our controls work cannot be relied upon to identify all defalcations or other irregularities, or to include all possible improvements in internal control that a more extensive controls review exercise might identify.

Update on accounts audit risk assessment

As part of our planning and control evaluation work we have reviewed the key audit risks identified in our Audit Plan 2011/12 and have set out in Table 1 below the outcome of work completed to date and further work planned.

Our updated review of the key risks facing the Council has not identified any new risk areas.

We will report our full findings and conclusions in respect of each risk identified in our Annual Report to Those Charged with Governance (ISA 260) on completion of our final accounts audit.

Table 1. Key accounting risks and planned assurances

Issue	Audit areas affected	Work completed to date	Further work planned
Accounting for Property, Plant and Equipment	**All areas of the financial statements**	• Walkthrough testing and tests of controls have been performed on the majority of the Property, Plant and Equipment System, with exception to valuations, impairments and depreciation.	• This work is on-going. The valuations reports was unavailable at the time of the audit and this work has accordingly been scheduled for completion in July 2012. • We will work with the Council during our final accounts fieldwork to ensure they have correctly valued and disclosed their heritage assets.

Table 1. Key accounting risks and planned assurances (continued)

Issue	Audit areas affected	Work completed to date	Assurances gained
Control weaknesses in the Council's IT systems are not addressed	**All areas of the financial statements**	• A report has been produced on the Status of the IT Shared Service in March 2012.	• This work is on-going, a report will be completed in June 2012 updating on the progress of implementation of the recommendations issued in the independent IT review. • We will also be conducting our annual review of the overall IT control environment.
Weaknesses within Revenues & Benefits system	**All areas of the financial statements**	• Walkthrough testing and test of controls have been performed on the council tax system.	• In relation to the council tax system it has been concluded that the controls are operating as documented and at this stage no risks to material misstatement were identified. • Further assurance conclusions will be reached with regard to the benefits and national non-domestic rates system during our final accounts fieldwork.

Results of interim audit work

Scope

As part of the interim audit work, and in advance of our final accounts audit fieldwork, we considered:

- the effectiveness of the Internal Audit function;
- internal audit's work on the Council's key financial systems;
- a review of closedown procedures in preparation for the final accounts;
- journal entry controls;
- walkthrough testing and tests of controls to confirm whether controls are implemented as per our understanding in areas where we have identified significant accounting assertion risk; and
- a review of Information Technology controls

The internal audit function

We have reviewed internal audit's overall arrangements against the 2006 CIPFA Internal Audit Standards. Where the arrangements are deemed to be adequate, we can gain assurance from the overall work undertaken by internal audit and can conclude that the service itself is contributing positively to the internal control environment and overall governance arrangements within the Council.

Closedown procedures

Our review considered the Council's timetable for closedown and the arrangements for preparing the draft accounts, including guidance provided on working papers required to be made available as part of the closedown process.

The Council has established a suitable timetable and expects to meet the deadline for submission of the accounts. The Council also expects be able to provide detailed working papers to support the accounts at the start of our final accounts audit fieldwork, which is scheduled to commence on 16 July 2012, as well as providing the draft Annual Governance Statement and explanatory foreword in advance of this date.

Walkthrough testing and tests of controls

Walkthrough tests and tests of controls were completed in relation to the specific accounts assertion risks which we consider to present a significant risk of material misstatement to the financial statements.

We have not yet been able to complete all our work in the area of property, plant and equipment due to the timing of the availability of the asset valuation report and year end depreciate and impairment calculations. This work has accordingly been scheduled for completion in July 2012 and the results will be considered as part of our accounts audit planning process prior to the commencement of our final accounts audit fieldwork.

No significant issues were noted where walkthrough testing was able to be completed as planned and in-year internal controls were observed to have been implemented and operated satisfactorily in accordance with our documented understanding with exception to one control, detailed below.

We found that the year-end bank reconciliation control for the creditors module within the Academy system was not being prepared on a timely basis. This is a reconciliation between one bank account used for housing benefits payments only, back to the Academy system.

At the end of 2010/11 the year end bank reconciliation was performed and, some assumptions had to be made to complete the reconciliation. In February 2012 a full reconciliation was performed for the 2010/11 year end bank reconciliation,. The overall difference between the two reconciliations was less than £5,000 .

During 2011/12 a process has been implemented that runs automatic reports, which allows the reconciliation to be completed promptly. This process was put in place from February 2012.

The finance staff were aware that an automatic report running function would be available and therefore took the decision to delay performing reconciliations until the functionality was available. The difference between the manual and automatic year end 2010/11 year end reconciliations was £5,000.

The finance team declined to perform the reconciliations on a monthly manual basis and have elected to perform an automatic year end reconciliation. At this stage this is not deemed a significant risk.

During our final accounts fieldwork we will review the reconciliation for accuracy and completeness and if necessary, report any issues and associated recommendations.

Additional assurance work

To support the audit opinion for 2011/12, we are in the process of undertaking brief reviews in the following areas:

- VAT - a checklist of the Council's current arrangements will be completed to identify whether they are appropriate to ensure VAT is accounted for correctly and in accordance with current legislation
- PAYE - a checklist of the arrangements the Council has in place regarding taxation associated with payroll, including National Insurance and PAYE will be completed in order to provide assurance that figures recorded within the financial statements are true and fair and calculated appropriately and in accordance with current legislation
- Fraud - our forensic team will be reviewing the overall adequacy of the Council's arrangements to ensure that the risk of fraud and corruption is managed effectively.

Any issues identified with the above reviews will be reported where necessary.

Review of information technology controls

Our information systems specialist has yet to perform a review of the general IT control environment, as part of the overall review of the internal controls system. This will be completed in March 2012 and conclusions will be reported thereafter.

Our specialist have also performed a follow up of the issues that have been raised as part of the May 2011 independent review of the IT Shared Service. A quarterly report on our review has been issued in March 2012 and another will be issued in June 2012. At this stage considerations of particular risk areas has been raised with more details and possible recommendations to be reported as part of the June 2012 report.

Journal entry controls

We have reviewed the Council's journal entry policies and procedures as part of determining our journal entry testing strategy and have not identified any material weaknesses which are likely to adversely impact on the Council's control environment or financial statements.

To date we have undertaken detailed testing on journal transactions recorded for the first ten months of the financial year by extracting 'unusual' entries for further review. No issues have been identified that require to be reported.

We will review 'unusual' year end journal entries as part of our final accounts audit and report on any significant issues identified resulting from our work.

Key accounting issues

Asset valuation

Asset valuation should be performed in accordance with IAS 16 'Property, plant and equipment'. There have been changes in the accounting for assets:

•The classification between operational, investment, assets held for sale and surplus assets should be considered to ensure the conditions of the asset use require a change of classification.

•Component accounting, involves the valuation of various components of the asset , there was limited application last year. It will only be required where significant components have different useful lives to the remainder of the asset.

Heritage assets

Heritage assets, the code requires the adoption of heritage assets in 2011/12 for the first time. Heritage assets are to be carried at valuation where possible with requirements for additional disclosures.

Grants

.The code has become more stringent on the accounting for grants, particularly in:

•Recognition, the grant amount shall be recognised immediately unless any conditions have not been met.

•Condition, determine if there is a restriction on the use of the grant to be used for a specific purpose. Any grant monies conditions that have not been met will result in the money being repaid.

Whole of government accounts

There has been an increase in accounting requirements surrounding the whole of government accounts ('WGA') submission:

•The unaudited WGA pack is to be submitted in draft format in July with the audited WGA pack being submitted to the CLG by 5 October 2012.

•Infrastructure assets, currently accounted for on a historic cost basis which is not compatible with the valuation basis under WGA, accounts are to continue to be prepared o the same basis but expect more data collection in 2011/12.

•H..M Treasury and Audit Commission to comment on late returns in 2010/11.

Appendices

A. Logistics

Timetables and milestones

The following proposed timetable and deadlines have been set and agreed with management:

Event	Date
Pre year end fieldwork including internal controls review	March 2012
Completion of outstanding internal controls reviews and preliminary housing benefits testing	June 2012
Statutory accounts emailed to auditor	30 June 2012
Commence accounts audit fieldwork	16 July 2012
Partner visit to review work	17 August 2012
Clearance meeting to discuss our findings	24 August 2012
Draft ISA 260 report to be issued by	7 September 2012
Report to Finance Audit Committee (ISA 260)	25 September 2012

The audit process is underpinned by effective project management to ensure that we co-ordinate and apply our resources efficiently to meet your deadlines. It is therefore essential that we work closely with your team to achieve this timetable. An agreed format and schedule of informal update arrangements will be maintained throughout the course of our audit fieldwork in support of this aim.

Engagement team

In accordance with our Audit Plan 2011/12 issued January 2012, the main engagement team for the accounts audit will include:

Name	Role	Contact details
Paul Dossett	Engagement partner	T: 020 7728 318 E: paul.dossett@uk.gt.com
Richard Lawson	Audit manager	T: 07766442038 E: richard.lawson@uk.gt.com
Gurpreet Dulay	Audit senior	T: 0207 728 2515 / 07802665663 E: gurpreet.dulay@uk.gt.com

Information requirements

The information and working paper requirements that would assist us in an efficient and timely audit of the year-end financial statements have been communicated to the finance team within our Arrangements Letter, issued in January 2012.

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Report to:	**Audit Committee**
Date of Meeting:	**14th March 2012**
Report of:	**Head of Strategic Finance**
Title:	**Treasury Management Annual Report and Actual Prudential Indicators 2010/11, Mid Year Treasury Management Monitoring Report for 2011/12 and Treasury Management Strategy Statement 2012/13 – 2014/15 (DCRG)**

1.0 SUMMARY

1.1 To inform Members of Treasury Management Annual Report and Prudential Indicators for 2010/11; to present to Members a mid year review of the Treasury Management function in 2011/12; and to report the Treasury Management Strategy for 2012/13 – 2014/15.

2.0 RECOMMENDATIONS

2.1 That the Committee notes the Treasury Management Annual Report and Actual Prudential Indicators 2010/11, Mid Year Treasury Management Monitoring Report 2011/2012, and Treasury Management Strategy Statement 2012/13 – 2014/15 (Appendices 1, 2 & 3).

2.2 The Audit Committee is recommended to approve each of the key elements of the Treasury Management Strategy Statement (Appendix 3), and recommend these to Council:

- The Prudential Indicators and Limits for 2012/13 to 2014/15, including the Authorised Limit Prudential Indicator.
- The Minimum Revenue Provision (MRP) Statement which sets out the Council's policy on MRP.
- The Treasury Management Strategy 2012/13 to 2014/15 and the treasury Prudential Indicators.
- The Investment Strategy 2012/13 and the detailed criteria contained in the treasury management strategy.

2.3 That the Audit Committee recommend to Council that the facility to borrow up to a maximum of £10m from external parties be approved and that all Treasury Management Strategy Statements be amended accordingly.

3.0 SALIENT ISSUES

3.1 This report has a similar problem to the Statutory Statement of Accounts namely that it is largely incomprehensible to a lay person but regrettably has to be followed as it is a format devised by professional experts (CIPFA) and has been fleshed out by the Council's Treasury adviser, Sector (and will be widely adopted by most local authorities).

3.2 This ''introduction'' attempts to draw out the key issues reflected within subsequent sections of this report.

3.3 **Appendix 1** formally reviews the Councils activities/ performance during 2010/2011 and has been reported previously in regular reports to the Audit Committee. It confirms the Council did not incur any external debt, only invested with approved counterparties, and outperformed the investment return benchmark.

3.4 **Appendix 2** reports upon the half year treasury management activities/ performance and has again been reported to Audit Committee (in a more concise form) at its meeting on 29th September 2011. It again reports no external debt, investments only with approved counterparties; a forecast investment rate of return of 1.24% (original estimate 1.3%); and an expectation that £346k of cash will accrue on our investments (as per Original estimate).

3.5 **Appendix 3** is the most interesting part of the report and details the parameters for borrowing and investments within which officers are required to operate. In essence it recommends the ability to borrow up to a maximum of £10m (and reflects the probability of an interest free loan from the Herts Local Enterprise Partnership and funding from the West Herts Hospital Trust); and the criteria for determining to whom the Council should be lending its money. The next section of this report discusses in greater depth the issues surrounding external borrowing longer than 12 months duration.

4.0 DEBT FREE STATUS

4.1 Under previous capital finance regulations there was a requirement that a proportion of capital receipts had to be 'set aside' to cover any outstanding external debt and could not therefore be used to finance future capital investment. If however an authority was debt free then all capital receipts could be accessed for future development. For the past few years the regulations have been changed and all receipts can be accessed providing any local authority is able to make repayments of this debt (and associated interest) from its annual revenue budget. This is called the 'Prudential Borrowing' test and from that point of view there is no absolute advantage in being debt free other than having no annual debt repayments to make.

4.2 Watford Council has had/ has an ambitious capital programme which has included the provision of new leisure facilities (circa £20m of investment); remodelling of existing facilities such as Colosseum (£6m) and 'green spaces' in its widest sense (£6m); and regeneration projects such as Charter Place (a £60m project) and the Health Campus (£500m). The consequence of this is that our accumulated holding of capital receipts has been/ will be used for investment projects for the benefit of the community rather than sitting in the bank accruing a small rate of return.

4.3 Reports relating to the Health Campus have been regularly considered by the Major Projects Board and Cabinet and have included significant external investment related to the Croxley Rail Link (£120m); and funding of £7m from the West Herts Hospital Trust for a new road and bridge (a pre requisite before the construction of a new hospital). Watford Council is close to finalising an agreement with a Private Sector Partner (PSP) to set up a Local Asset Backed Vehicle (LABV) whereby the PSP provides the construction costs and WBC primarily provides the land and some element of infrastructure expenditure. Best and Final Offers are anticipated to be finalised in the Summer and the Council would hope to get a return on its investment by way of a combination of a capital receipt and an annual rental income. Details have yet to be finalised at this stage.

4.4 Central Government has recently changed the way in which regional investment is distributed and has involved the demise of Development Agencies such as EEDA and the creation of Local Enterprise Partnerships. For the Hertfordshire area an LEP has been set up contiguous with existing Hertfordshire boundaries and has been allocated circa £11m to support priority infrastructure projects. The LEP is considering county wide 'bids' and has a short list of 5 competing projects and which includes infrastructure costs associated with the Health Campus. Should the Council be successful, then any support from the LEP would be by way of an interest free loan repayable to correspond to the investment return arising out of the Campus Development. A decision from the LEP is anticipated in early April 2012.

4.5 From the Council's point of view, providing the financial modelling associated with the Health Campus Development shows a positive return, then access to an interest free loan would make financial sense. Section 6 of this report also relates to a contribution from the West Herts Hospital Trust (anticipated to be received prior to 31st March 2012) and the potential implications are that technically we would no longer be debt free and Council will need to agree that an external borrowing facility should be permitted. **It is recommended therefore** that the Treasury Management Strategy Statement should include the ability for the Council to borrow up to £10m for longer than a twelve month period and this is reflected within the attached Treasury Management Strategy at Appendix 3.

5.0 DETAILED EXPLANATION OF THE TREASURY MANAGEMENT REPORTS

5.1.1 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. "

5.1.2 The reports meet the requirements of both the Chartered Institute of Public Finance and Accountancy's (CIPFA) Code of Practice on Treasury Management and the CIPFA Prudential Code for Capital Finance in Local Authorities and complies with the Local Government Act 2003.

5.2 Treasury Management Annual Report and Actual Prudential Indicators 2010/11 (Appendix 1)

5.2.1 This report provides details of actual prudential and treasury indicators and actual treasury operations during 2010/11 compared to the estimates within the strategy. The report is made in line with the Council's approved policy on Treasury Management.

5.2.2 During 2010/11, the Council complied with its legislative and regulatory requirements. Other prudential and treasury indicators are to be found in Appendix 1. The Head of Strategic Finance confirms that the statutory borrowing limit (the authorised limit), was not breached.

5.2.3 The financial year 2010/11 continued the challenging environment of previous years; low investment returns and continuing counterparty risk continued.

5.2.4 The Head of Strategic Finance also confirms that no borrowing was undertaken. At 31 March 2011, the Council had no external debt and its investments totalled £31.874m (£34.827m at 31 March 2010)

5.2.5 This report contains:

- Capital activity during the year;
- Reporting of the required prudential and treasury indicators;
- Impact of this activity on the Council's underlying indebtedness (the Capital Financing Requirement);
- Overall treasury position and the impact on investment balances;
- Summary of the economy and interest rates;
- Investment Rates in 2010/11
- Investment Outturn for 2010/11

5.3 Mid Year Treasury Management Monitoring Report (APPENDIX 2)

5.3.1 This report updates members with the progress of the capital position, amending prudential indicators as necessary, and whether the treasury strategy is meeting the strategy or whether any policies require revision.

5.3.2 The underlying economic environment remains difficult for the Council, foremost being the concerns over investment counterparty risk. This background encourages the Council to continue maintaining investments short term and with high quality counterparties. The downside of such a policy is that investment returns remain low.

5.3.3 The basis of the treasury management strategy, the investment strategy and the performance indicators are not changed.

5.3.4 The prudential code requires the Council to update:

- The Council's capital expenditure plans;
- How these plans are being financed;

These requirements are met by the Council's Budget Monitoring & reporting framework, which includes revised capital expenditure and funding statements in the Budget Book.

5.4 Treasury Management Strategy Statement 2012/13 – 2014/15 (APPENDIX 3)

5.4.1 The Council is required to operate a balanced budget, which broadly means that cash raised during the year will meet cash expenditure. Part 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 in low risk counterparties or instruments commensurate with the Council's low risk appetite, providing adequate liquidity initially before considering investment returns.

5.4.2 This report covers two main areas:

Capital Issues
- the capital plans and the prudential indicators 2012/13 – 2014/15;
- the Minimum Revenue Provision strategy and policy statement

Treasury management Issues
- the current portfolio position;
- treasury indicators: limits to borrowing activity;
- prospects for interest rates;
- the borrowing strategy;
- annual investment strategy;
- reporting requirments;
- policy on use of external service providers; and
- member and officer training

5.4.3 The Treasury Management Policy Statement, stating the policies, practices, objectives and approaches to risk management of its treasury management activities, has previously been adopted by the Audit Committee. There are no changes to the Treasury Management Policy Statement to report and the treasury service confirm that they are complying with all aspects of the the Treasury Policy Statement and will continue to comply in future years.

5.4.4 It should be noted however that the criteria for placing any investments have been tightened (see very last page of this report) whereby only building societies having an asset base in excess of £5,000m qualify; and the maximum ceiling on any cumulative bank investment has been reduced to £5m (was £10m) and reflects best practice in 'spreading risk'. There is an exception with regard to the National Westminster 'call account' where a £10m ceiling applies.

5.4.5 It is necessary for Council to agree the degree of risk to which it is prepared to expose the investment portfolio. The Head of Strategic Finance would define this as follows:

- Low Risk—limited to use of the Debt Management Office facility and other UK sovereign financial instruments; major clearing banks possessing high credit rating (or substantially owned by the UK Government); triple AAA money market funds; local authorities.
- Medium Risk—the use of Building Societies with an asset base above £5,000m as this sector is generally not rated by the Credit Rating Agencies;
- High Risk—low rated clearing banks; banks based outside the UK (this is a generalisation as many German/ Dutch/ Scandinavian/ and French banks would almost certainly be deemed too big to fail); building societies having a small asset base.

5.4.6 By the above 'crude' criteria, Watford might be considered to have a medium appetite for risk and the Audit Committee and Council will need to feel comfortable with this approach.

6.0 WEST HERTS HOSPITAL TRUST (WHHT)

The WHHT has been notified that it will receive £7m of financial support towards the construction of a road and bridge at the Health Campus and it is probable that this money will be transferred over to WBC prior to 31st March 2012 to invest until such time as the construction commences. This £7m will be kept separate from WBC's own investment portfolio and all interest earned will accrue to the construction project. As this money is effectively being held 'in trust' for the WHHT it is intended that it only be invested in low risk counterparties as detailed at Paragraph 5.4.5 above. All such investments will not affect the financial criteria detailed at the end of this report but can be additional to the recommended ceilings. So for example, even where the WBC investment portfolio has £5m investment with a UK clearing bank, that will not preclude part of the £7m WHHT portfolio from having a tranche of its money similarly invested.

7.0. IMPLICATIONS

7.1 Financial

7.1.1 The Head of Strategic Finance comments that the Treasury Management Statements have no direct financial implications although Appendix 3 does, in particular, set parameters within which officers should operate and could result in indirect financial implications which are not possible to evaluate at this time.

7.1.2 The proposal to enable the Council to enter into a loan facility of up to a £10m maximum ceiling does not of itself have financial implications as the take up of any loan facility will need to be evaluated at the time that any drawdown is contemplated.

7.2 **Legal Issues** (Monitoring Officer)

7.2.1 The Head of Legal and Property Services comments that It is a statutory requirement that the Treasury Management Strategy and Treasury Management Practices are reviewed annually by the Audit Committee and Full Council.

7.3 Potential Risks

Potential Risk	Likelihood	Impact	Overall Score
That the Council will exceed its borrowing parameters	1	3	3
That the Council will be unable to service its annual borrowing costs	1	3	3
That the Council will be unable to repay any loans at maturity date	1	4	4
Investment placed with a non approved body	1	3	3
Investment with a counterparty that subsequently defaults	1	4	4

Background papers:
UK Economic Forecasts provided by Sector, the Council's treasury advisors.
CIPFA Prudential Code for Capital Finance in Local Authorities, 2011 Edition
CIPFA Treasury Management in the Public Services – Code of Practice and Cross-Sectoral Guidance Notes, 2011 Edition
CIPFA Treasury Management in the Public Services, Guidance Notes for Local Authorities, 2011 Edition
Outturn figures from E Financials, Logotech Treasury Management and Statement of Accounts.

Contact Officer:
For further information on this report please contact: Richard Hammerman, Senior Accountant,
telephone: 01923 727440, e-mail: richard.hammerman@threerivers.gov.uk

ANNUAL REPORT ON THE TREASURY MANAGEMENT SERVICE 2010/11 APPENDIX 1
(INCORPORATING OUTTURN PRUDENTIAL INDICATORS)

1. The Council's Capital Activity during 2010/11

The Council undertakes capital expenditure on long-term assets. These activities may either be:

- Financed immediately through the application of capital or revenue resources (capital receipts, capital grants, revenue contributions etc.), which has no resultant impact on the Council's borrowing need; or
- If insufficient financing is available, or a decision is taken not to apply resources, the capital expenditure will give rise to a borrowing need.
- The Council did not borrow during 2010/11.

2. Reporting of the Required Prudential and Treasury Indicators

- During 2010/11, the Council complied with its legislative and regulatory requirements. The key actual prudential and treasury indicators detailing the impact of capital expenditure activities during the year, with comparators, are as follows:

Actual prudential and treasury indicators	2009/10 Actual	2010/11 Actual
Actual capital expenditure	£8.887m	£10.311m
Total Capital Financing Requirement:	£3.000m	£3.000m
Net borrowing	-£34.827m	-£31.874m
External debt	Nil	Nil
Investments - under 1 year	£34.827m	£31.874m

The actual capital expenditure forms one of the required prudential indicators. The table below shows the actual capital expenditure and how this was financed.

	2009/10 Actual	2010/11 Estimate	2010/11 Actual
Capital expenditure	£8.887m	£10.192m	£10.311m
Total capital expenditure			
Resourced by:			
• Capital receipts	£7.721m	£8.577m	£9.007m
• Capital grants and other contributions	£0.938m	£1.369m	£1,564m
• Other contributions and MRP	£0.079m	£0.200m	£0.214m
Unfinanced capital expenditure	**£0.149m**	**£0.046m**	**-£0.474m**

3. Impact of this activity on the Council's underlying indebtedness (the Capital Financing Requirement);

The Council's underlying need to borrow for capital expenditure is termed the Capital Financing Requirement (CFR). This figure is a gauge of the Council's debt position. The CFR results from the capital activity of the Council and what resources have been used to pay for the capital spend. It represents the 2010/11 unfinanced capital expenditure (see above table), and prior years' net or unfinanced capital expenditure which has not yet been paid for by revenue or other resources.

The Council's CFR for the year was -£474k. This includes leasing schemes on the balance sheet, which increase the Council's borrowing need, the CFR. No borrowing is actually required against these schemes as a borrowing facility is included in the contract (if applicable).

The borrowing activity is constrained by prudential indicators for net borrowing and the CFR, and by the authorised limit.

The authorised limit - the authorised limit is the "affordable borrowing limit" required by section 3 of the Local Government Act 2003. The Council does not have the power to borrow above this level. The table below demonstrates that during 2010/11 the Council has maintained gross borrowing within its authorised limit.

The operational boundary – the operational boundary is the expected borrowing position of the Council during the year. Periods where the actual position is either below or over the boundary is acceptable subject to the authorised limit not being breached.

Actual financing costs as a proportion of net revenue stream - 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.

	2009/10 Actual	2010/11 Actual
Authorised limit	£7m	£7m
Maximum gross borrowing position	£5m	£5m
Operational boundary	£5m	£5m
Average gross borrowing position	Nil	Nil
Financing costs(+) / income (-) as a proportion of net revenue stream	-3.18%	-4.34%

4. Overall treasury position and the impact on investment balances

The Council's debt and investment position is organised by the treasury management service in order to ensure adequate liquidity for revenue and capital activities, security for investments and to manage risks within all treasury management activities. Procedures and controls to achieve these objectives are well established both through Member reporting detailed in the summary, and through officer activity detailed in the Council's Treasury Management Practices. At the beginning and the end of 2010/11 the Council's treasury position was as follows:

	31 March 2010 Principal	Rate/ Return	31 March 2011 Principal	Rate/ Return
Total debt	Nil		Nil	
CFR	Nil		Nil	
Investments - in house	£34.827m	1.57%	£31.874m	1.24%
Total investments	***£34.827m***	***1.57%***	***£31.874m***	***1.24%***

The maturity structure of the investment portfolio was all under one year.

The exposure to fixed and variable rates was as follows:

	31 March 2010 Actual	31 March 2011 Actual
Fixed rate (principal)	£29.000m	£24.000m
Variable rate (principal)	£5.827m	£7.874m

5. Summary of the Economy and Interest Rates

The expectation for interest rates within the strategy for 2010/11 anticipated low but rising Bank Rate (starting in quarter 4 of 2011) with similar gradual rises in medium and longer term fixed interest rates over 2010/11. Variable or short-term rates were expected to be the cheaper form of borrowing over the period. Continued uncertainty in the aftermath of the 2008 financial crisis promoted a cautious approach, whereby investments would continue to be dominated by low counterparty risk considerations, resulting in relatively low returns compared to borrowing rates.

In this scenario, the treasury strategy was to postpone borrowing to avoid the cost of holding higher levels of investments and reduce counterparty risk.

The actual movement in interest rates broadly followed the expectations in the strategy, as detailed in the following section.

2010/11 proved to be another watershed year for financial markets. Rather than a focus on individual institutions, market fears moved to sovereign debt issues, particularly in the peripheral Euro zone countries. Local authorities were also presented with changed circumstances following the unexpected change of policy on Public Works Loan Board (PWLB) lending arrangements in October 2010. This resulted in an increase in new borrowing rates of 0.75 – 0.85%, without an associated increase in early redemption rates. This made new borrowing more expensive and repayment relatively less attractive.

UK growth proved mixed over the year. The first half of the year saw the economy outperform expectations, although the economy slipped into negative territory in the final quarter of 2010 due to inclement weather conditions. The year finished with prospects for the UK economy being decidedly downbeat over the short to medium term while the Japanese disasters in March, and the Arab Spring, especially the crisis in Libya, caused an increase in world oil prices, which all combined to dampen international economic growth prospects.

The change in the UK political background was a major factor behind weaker domestic growth expectations. The new coalition Government struck an aggressive fiscal policy stance, evidenced through heavy spending cuts announced in the October Comprehensive Spending Review, and the lack of any “giveaway” in the March 2011 Budget. Although the main aim was to reduce the national debt burden to a sustainable level, the measures are also expected to act as a significant drag on growth.

Gilt yields fell for much of the first half of the year as financial markets drew considerable reassurance from the Government’s debt reduction plans, especially in the light of Euro zone sovereign debt concerns. Expectations of further quantitative easing also helped to push yields to historic lows. However, this positive performance was mostly reversed in the closing months of 2010 as sentiment changed due to sharply rising inflation pressures. These were also expected (during February / March 2011) to cause the Monetary Policy Committee to start raising Bank Rate earlier than previously expected.

The developing Euro zone peripheral sovereign debt crisis caused considerable concerns in financial markets. First Greece (May), then Ireland (December), were forced to accept assistance from a combined EU / IMF rescue package. Subsequently, fears steadily grew about Portugal, although it managed to put off accepting assistance till after the year end. These worries caused international investors to seek safe havens in investing in non-Euro zone government bonds.

Deposit rates picked up modestly in the second half of the year as rising inflationary concerns, and strong first half growth, fed through to prospects of an earlier start to increases in Bank Rate. However, in March 2011, slowing actual growth, together with weak growth prospects, saw consensus expectations of the first UK rate rise move back from May to August 2011 despite high inflation. However, the disparity of expectations on domestic economic growth and inflation encouraged a wide range of views on the timing of the start of increases in Bank Rate in a band from May 2011 through to early 2013. This sharp disparity was also seen in MPC voting which, by year-end, had three members voting for a rise while others preferred to continue maintaining rates at ultra low levels.

Risk premiums were also a constant factor in raising money market deposit rates beyond 3 months. Although market sentiment has improved, continued Euro zone concerns, and the significant funding issues still faced by many financial institutions, mean that investors remain cautious of longer-term commitment. The European Commission did try to address market concerns through a stress test of major financial institutions in July 2010. Although only a small minority of banks “failed” the test, investors were highly sceptical as to the robustness of the tests, as they also are over further tests now taking place with results due in mid-2011.

Chart 1: Bank Rate v LIBID investment rates

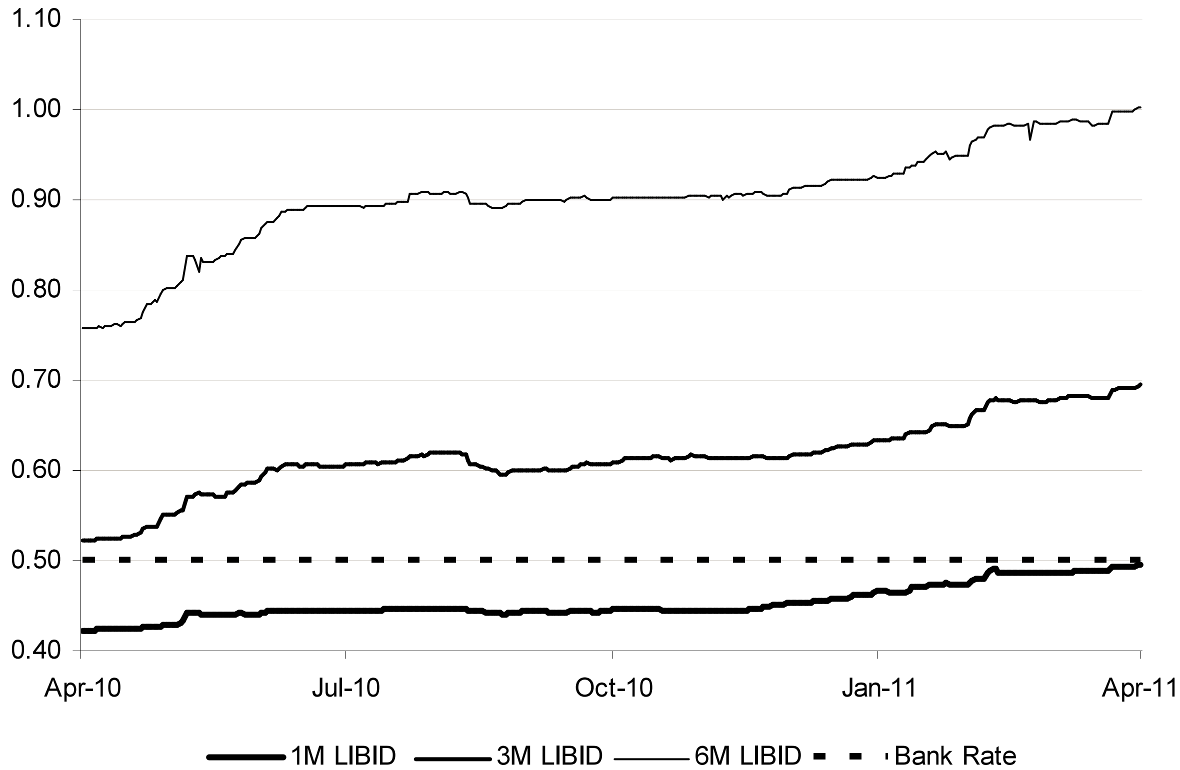
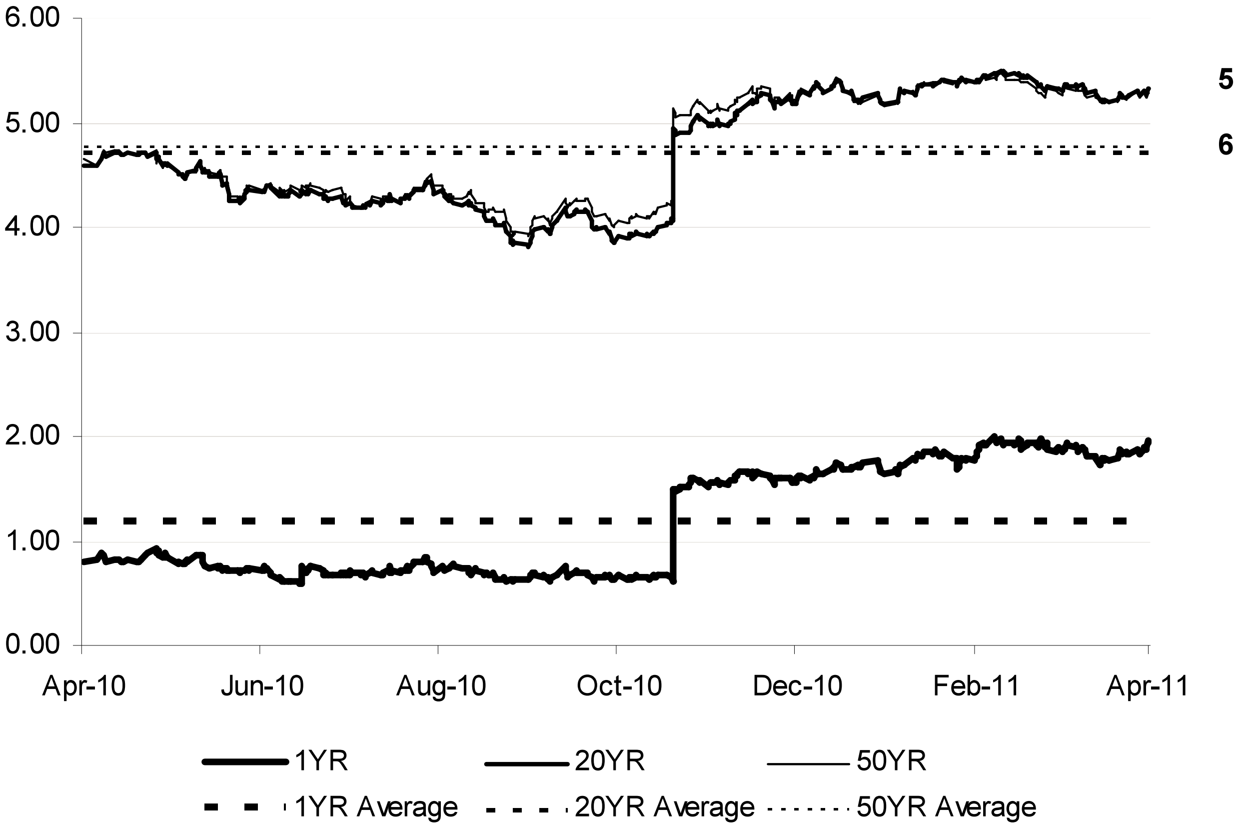


Chart 2: Average v new borrowing rates

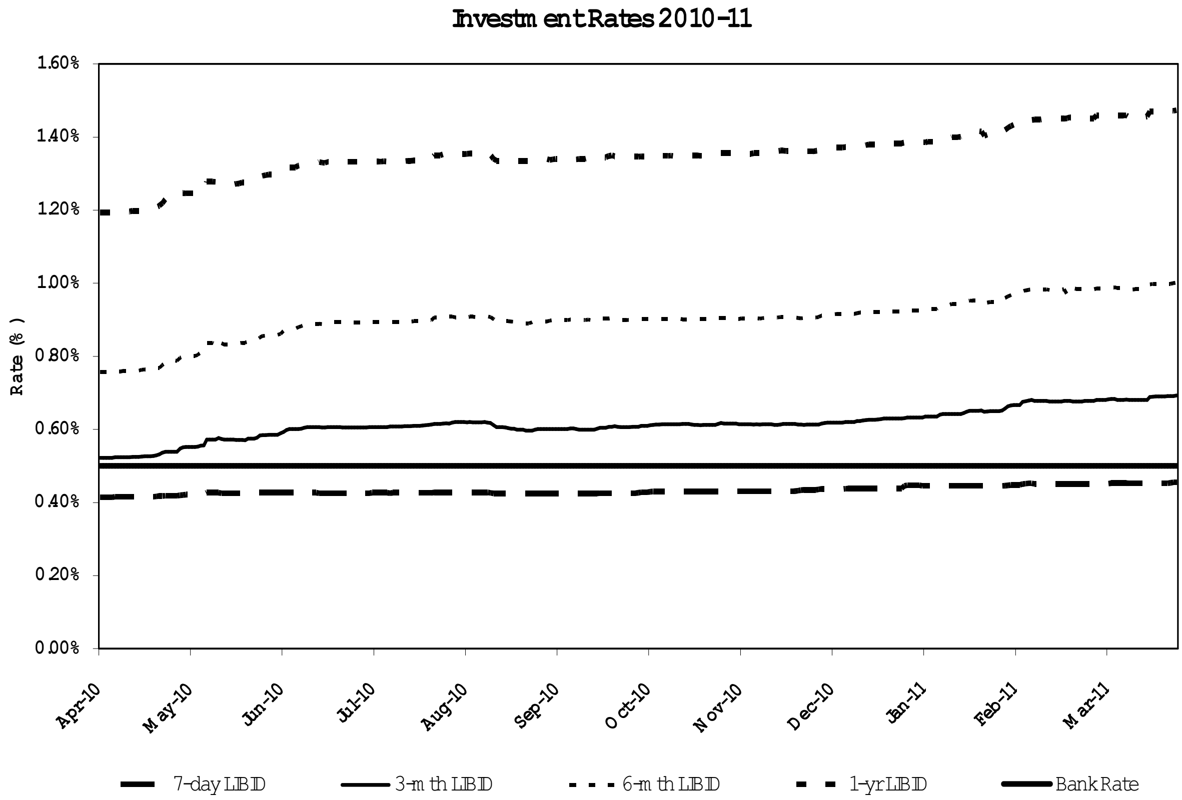


6. Investment Rates in 2010/11

The tight monetary conditions following the 2008 financial crisis continued through 2010/11 with little material movement in the shorter term deposit rates. Bank Rate remained at its historical low of 0.5% throughout the year, although growing market expectations of the imminence of the start of monetary tightening saw 6 and 12 month rates picking up.

Overlaying the relatively poor investment returns was the continued counterparty concerns, most evident in the Euro zone sovereign debt crisis which resulted in rescue packages for Greece, Ireland and latterly Portugal. Concerns extended to the European banking industry with an initial stress testing of banks failing to calm counterparty fears, resulting in a second round of testing currently in train. This highlighted the ongoing need for caution in treasury investment activity.

	Overnight	7 Day	1 Month	3 Month	6 Month	1 Year
01/04/2010	0.41%	0.41%	0.42%	0.52%	0.76%	1.19%
31/03/2011	0.44%	0.46%	0.50%	0.69%	1.00%	1.47%
High	0.44%	0.46%	0.50%	0.69%	1.00%	1.47%
Low	0.41%	0.41%	0.42%	0.52%	0.76%	1.19%
Average	0.43%	0.43%	0.45%	0.61%	0.90%	1.35%
Spread	0.03%	0.04%	0.07%	0.17%	0.24%	0.28%
High date	31/12/2010	30/03/2011	31/03/2011	31/03/2011	31/03/2011	31/03/2011
Low date	01/04/2010	01/04/2010	01/04/2010	01/04/2010	01/04/2010	01/04/2010



7. Investment Outturn for 2010/11

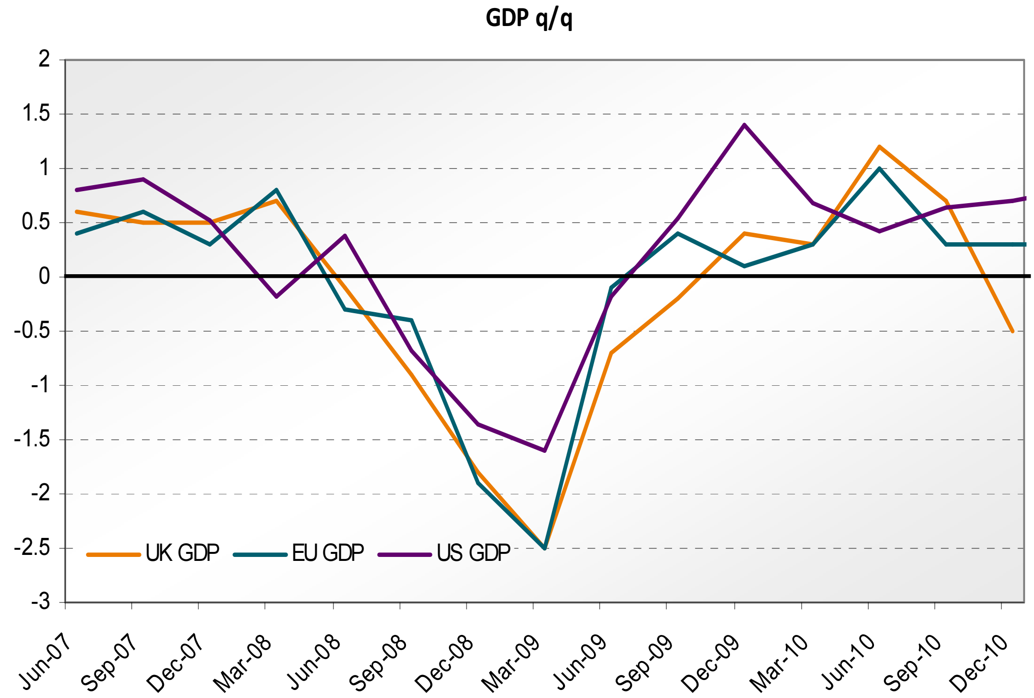
Investment Policy – the Council's investment policy is governed by CLG guidance, which was been implemented in the annual investment strategy approved by the Council on 22 February 2011. This policy sets out the approach for choosing investment counterparties, and is based on credit ratings provided by the three main credit rating agencies supplemented by additional market data (such as rating outlooks, credit default swaps, bank share prices etc.).

The investment activity during the year conformed to the approved strategy, and the Council had no liquidity difficulties.

Resources – the Council's longer term cash balances comprise, primarily, revenue and capital resources, although these will be influenced by cash flow considerations. The Council's core cash resources comprised as follows, and met the expectations of the budget:

Balance Sheet Resources	31 March 2010	31 March 2011
General Fund	£1.696m	£1.350m
Earmarked reserves	£9.295m	£11.655m
Housing Revenue Surplus Reserve	£1.251m	£0.000m
Usable capital receipts	£26.646m	£19.413m
Total	**£38.888m**	**£32.418m**

Investments held by the Council - the Council maintained an average balance of £33.350m of internally managed funds. The internally managed funds earned an average rate of return of 1.24%. The comparable performance indicator is the average 3 month LIBID rate, which was 0.61%.


GDP q/q
2
1.5
1
0.5
0
-0.5
-1
-1.5
-2
-2.5
-3
UK GDP
EU GDP
US GDP
Jun-07
Sep-07
Dec-07
Mar-08
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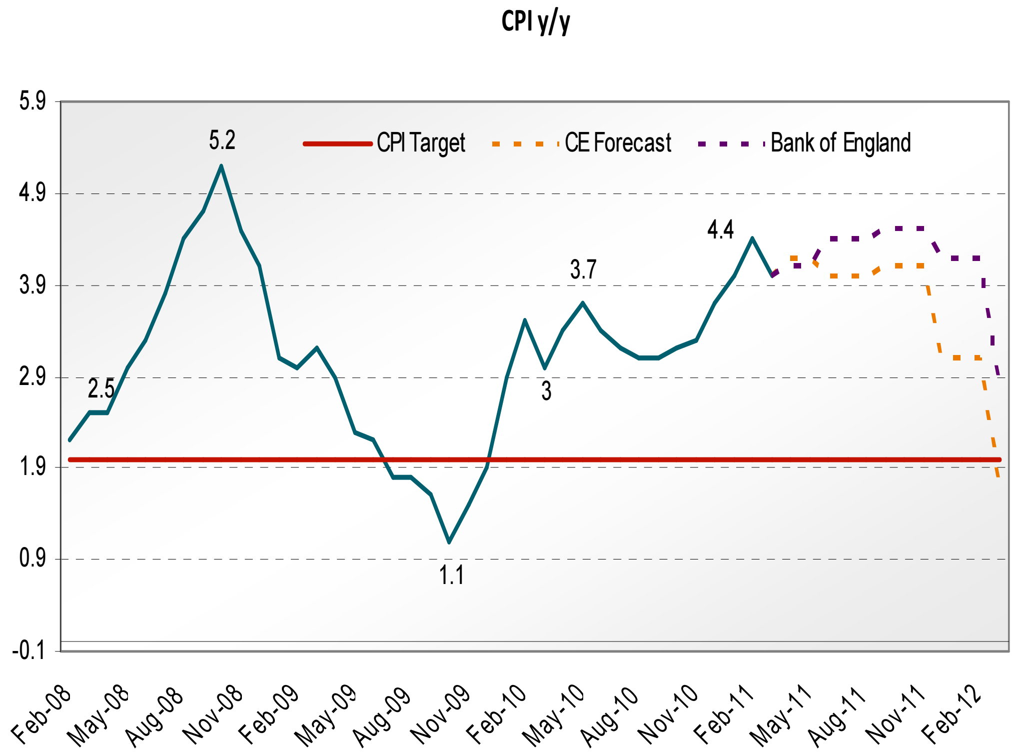
CPI y/y
5.9
4.9
3.9
2.9
1.9
0.9
-0.1
CPI Target
CE Forecast
Bank of England
5.2
2.5
4.4
3.7
3
1.1
Feb-08
May-08
Aug-08
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Feb-12

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MID YEAR TREASURY MANAGEMENT MONITORING REPORT **APPENDIX 2**

1. Capital Financing Requirement (CFR), External Debt and Operational Boundary

The CFR and Operational Boundary estimates are shown below:

Prudential Indicator £m	**2011/12 Original Estimate**	**Current Borrowing Position**	**2011/12 Revised Estimate**
Capital Financing Requirement	3	3	3
External Debt / the Operational Boundary			
Long Term Borrowing	0	0	0
Short Term Borrowing*	3	3	3

Limits to Borrowing Activity
The first key control over the treasury activity is a PI to ensure that over the medium term, net borrowing (borrowings less investments) will only be for a capital purpose. As the Council is debt free, this control will always be met.

2. The Authorised Limit

This PI, which is required to be set and revised by Members, controls the overall level of borrowing and represents the limit beyond which borrowing is prohibited. It reflects the level of borrowing which, while not desired, could be afforded in the short term, but is not sustainable in the longer term. It is the expected maximum borrowing need with some headroom for unexpected movements. This is the statutory limit determined under section 3 (1) of the Local Government Act 2003.

Authorised limit for external debt £m	**2011/12 Original Indicator**	**Current Borrowing Position**	**2011/12 Revised Indicator**
Short Term Borrowing	7	0	7

3. Interest Rate Movements and Expectations

The information relating to the interest rate movements and future expectations is shown within the Treasury Management Strategy Statement 2012/13 – 2014/15.

4. Current Investment Position

This information is reported in the Members Information Bulletins.

The Council's held £30.7m of investments at 30 September 2011 and the list of investments and counterparties is shown below:

Sector	Country	Up to One Year
Banks	UK	£22.7m
Building Societies	UK	£8.0m

List of Investments as at 30 September 2011

Counterparty	Principal
Clydesdale BS	£3.0m
Natwest	£7.0m
Co-Operative Bank	£3.7m
Nationwide BS	£2.0m
Barclays Bank	£3.0m
Skipton BS	£2.0m
Santander UK Ltd	£3.0m
Yorkshire BS	£2.0m
Lloyds Bank	£3.0m
Coventry BS	£2.0m
	£30.7m

The Council has no sums invested for greater than 364 days.

The revised budget position for investment income, on an accruals basis, is:

	2011/12 Original Estimate	2011/12 Half Year Estimate	2011/12 Full Year Estimate
Interest Receivable	£0.346m	£0.346m	£0.346m

The following reports the current position against the benchmarks originally approved.

5. Security

The Council's maximum security risk benchmark for the current portfolio, when compared to these historic default tables, was set as follows:
0.01% historic risk of default when compared to the whole portfolio.

Note: The benchmarks are an average risk of default measure, and would not constitute an expectation of loss against a particular investment. The benchmarks are embodied in the criteria for selecting cash investment counterparties and these will be monitored and reported to Members. As this data is collated, trends and analysis will be collected and reported. Where counterparty is not credit rated a proxy rating will be applied.

The Head of Strategic Finance can report that the investment portfolio was maintained within this overall benchmark during this year to date.

6. Liquidity

The Council set liquidity facilities/benchmarks to maintain:

- Bank overdraft - £0.5m
- Liquid short term deposits of at least £2m available with a week's notice.
- Weighted Average Life benchmark is expected to be 0.5years, with a maximum of 10 years.

The Head of Strategic Finance can report that liquidity arrangements were adequate during the year to date.

7. Yield

Local measures of yield benchmarks are:

- Investments – returns 0.12% above average bank rate

The Head of Strategic Finance can report that return up to 30 September 2011 averaged 1.24%, against a benchmark rate of 0.62%. The actual investment interest rate is therefore 0.62% (100%) above the benchmark rate.

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TREASURY MANAGEMENT STRATEGY STATEMENT 2012/13 – 2014/15 APPENDIX 3

Introduction

The Local Government Act 2003 requires the Council to adopt the CIPFA Prudential Code and produce prudential indicators. Each indicator either summarises the expected capital activity or introduces limits upon that activity, reflecting the outcome of the Council's underlying capital appraisal systems. This report updates currently approved indicators.

Within this overall prudential framework there is an impact on the Council's treasury management activity – as it will directly impact on borrowing or investment activity. As a consequence the treasury management strategy for 2012/13 to 2014/15 is included to complement these indicators. Some of the prudential indicators are shown in the treasury management strategy to aid understanding.

The Capital Plans and the Prudential Indicators 2012/13 – 2014/15

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

Capital Expenditure

The Council's capital expenditure plans were approved by Cabinet and Council on 16th January and 25th January 2012 respectively and form the first of the prudential indicators. A certain level of capital expenditure is grant supported by the Government; any decisions by the Council to spend above this level will be considered unsupported capital expenditure. This unsupported capital expenditure needs to have regard to:

- Service objectives (e.g. strategic planning);
- Stewardship of assets (e.g. asset management planning);
- Value for money (e.g. option appraisal);
- Prudence and sustainability (e.g. implications for external borrowing and whole life costing);
- Affordability (e.g. implications for the council tax);
- Practicality (e.g. the achievability of the forward plan).

The revenue consequences of capital expenditure, particularly the unsupported capital expenditure, will need to be paid for from the Council's own resources.

This capital expenditure can be paid for immediately (by applying capital resources such as capital receipts, capital grants etc., or revenue resources), but if these resources are insufficient any residual capital expenditure will add to the Council's borrowing need.

The key risks to the plans are that the level of Government support has been estimated and is therefore maybe subject to change. Similarly some estimates for other sources of funding, such as capital receipts, may also be subject to change over this timescale. For instance anticipated asset sales may be postponed due to the poor condition of the property market.

Approving capital expenditure plans is the first prudential indicator.

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

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

Following accounting changes, the CFR includes any other long term liabilities (e.g. finance leases) brought onto the balance sheet. Whilst this increases the CFR, and therefore the Council's borrowing requirement, these types of scheme include a borrowing facility and so the Council is not required to separately borrow for these schemes. The Council is asked to approve the CFR projections below:

£m	2010/11 Actual	2011/12 Estimate	2012/13 Estimate	2013/14 Estimate	2014/15 Estimate
Capital Financing Requirement	**3.0**	**3.0**	**3.0**	**3.0**	**3.0**
Adjustment A	**3.1**	**3.1**	**3.1**	**3.1**	**3.1**
Movement in the CFR	**0**	**0**	**0**	**0**	**0**

The Council is required to pay off an element of the accumulated General Fund capital spend each year (the CFR) through a revenue charge (the Minimum Revenue Provision - MRP), although it is also allowed to undertake additional voluntary payments if required (Voluntary Revenue Provision - VRP).

Watford Council's approach has been to comply with the previous MRP regulations which allowed for an adjustment A which allowed debt free authorities to continue to not make an MRP. Any new capital expenditure if unfunded and requiring credit cover above adjustment A would need to generate a MRP.

Minimum Revenue Provision (MRP) Strategy and Policy Statement

Communities and Local Government Regulations have been issued which require full Council to approve an MRP Statement in advance of each year. A variety of options are provided to councils, so long as there is a prudent provision. The Council is recommended to approve the following MRP Statement

The Council has no debt and a zero adjusted Capital Financing Requirement (CFR), so will not be making a Minimum Revenue Provision for the repayment of debt. Section 4 of the covering report refers to the potential requirement to receive interest free funding from the Hertfordshire Local Enterprise Partnership by way of a maturity loan. The borrowing will be matched by capital expenditure on the Health Campus scheme as onward funding to the Local Asset Backed Vehicle (LABV), so will have no effect on the Council's overall Capital Financing Requirement and, hence, requirement to make a Minimum Revenue Provision. Principal repayments will be linked to receipts from the LABV, so that repayment of the loan will also have no effect on the Balance Sheet or the CFR.

For unsupported borrowing as a result of Finance Leases, the MRP policy will be either:

- **Asset Life Method –** MRP will be based on the estimated life of the assets, in accordance with the proposed regulations (this option must be applied for any expenditure capitalised under a Capitalisation Direction) (Option 3); or
- **Depreciation method –** MRP will follow standard depreciation accounting procedures (Option 4);

These options provide for a reduction in the borrowing need over approximately the asset's life.

Watford made a voluntary MRP for finance leases in 2008-09 and will continue to do so for new finance leases under option 3 of the revised guidance based on asset life.

The Use of the Council's Resources and the Investment Position

The application of resources (capital receipts, reserves etc.) to either finance capital expenditure or other budget decisions to support the revenue budget will have an ongoing impact on investments unless resources are supplemented each year from new sources (asset sales etc). More details can be found in the medium term financial strategy and in particular the forecast of future years investment interest..

Affordability Prudential Indicators

The previous sections cover the overall capital and control of borrowing prudential indicators, but within this framework prudential indicators are required to assess the affordability of the capital investment plans. These provide an indication of the impact of the capital investment plans on the Council's overall finances. The Council is asked to approve the following indicators:

Actual and estimates of the ratio of financing costs to net revenue stream

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.

Estimates of the incremental impact of capital investment decisions on council tax

This indicator identifies the revenue costs associated with proposed changes to the three year capital programme recommended in this budget report compared to the Council's existing approved commitments and current plans. The assumptions are based on the budget, but will invariably include some estimates, such as the level of Government support, which are not published over a three year period.

Treasury Management Issues

1. Treasury Management Strategy

The treasury management strategy is an important part of the overall financial management of of adopting the Code the Council also adopted a Treasury Management Policy Statement. This adoption is the requirements of one of the prudential indicators.

The Constitution requires a strategy to be reported to Council outlining the expected treasury activity for the forthcoming 3 years. A key requirement of this report is to explain both the risks, and the management of the risks, associated with the treasury service. A further treasury report is produced after the year-end to report on actual activity for the year. A new requirement of the revision to the Code of Practice requires a mid-year monitoring report although for Watford, the Council's investment strategy is reported in detail to every meeting of the Audit Committee..

This strategy covers:

- The Council's debt and investment projections;
- The Council's estimates and limits on future debt levels(borrowing activity);
- The expected movement in interest rates;
- The Council's borrowing and investment strategies;
- Specific limits on treasury activities;
- Treasury performance indicators;
- Treasury Advice
- Training of Officers and Members

The capital expenditure plans set out to provide details of the service activity of the Council. The treasury management function ensures that the Council's cash is organised in accordance with the the relevant professional codes, so that sufficient cash is available to meet this service activity. This will involve both the organisation of the cash flow and, where capital plans require, the organisation of approporiate borrowing facilities. The strategy covers the relevant treasury / prudential indicators, the current and projected debt positions and the annual investment strategy.

1.1 Current Portfolio Position

The Council's treasury portfolio position at 31 March 2011, with forward projections are summarised below.

£m	2010/11 Actual	2011/12 Estimate	2012/13 Estimate	2013/14 Estimate	2014/15 Estimate
External borrowing	**N/A**	**N/A**	**N/A**	**N/A**	**N/A**
Investments					
Total investments 31st March	31.874m	30.000m	20,000m	10.000m	8.000m
Investment change	-8.48%	-5.88%	-33.33%	-50.00%	-20.00%

Another key prudential indicators is that the Council needs to ensure that its total borrowing, net of any investments, 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 2012/13 and the following two financial years (shown as net borrowing above). This allows some flexibility for limited early borrowing for future years, but ensures that borrowing is not undertaken for revenue purposes.
The Head of Strategic 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 plans, and the proposals in this budget report including the potential maturity loan from the Local Enterprise Partnership.

1.2 Treasury Indicators: Limits to Borrowing Activity

The Operational Boundary. This is the limit beyond which external borrowing is not normally expected to exceed. In most cases, this would be a similar figure to the CFR, but may be lower or higher depending on the levels of actual borrowing.

Operational boundary £m	2011/12 Estimate	2012/13 Estimate	2013/14 Estimate	2014/15 Estimate
Borrowing	5	7	7	7
Other long term liabilities	0	0	0	0
Total	5	7	7	7

The Authorised Limit for external borrowing. A further key prudential indicator represents a control on the maximum level of borrowing. This represents a limit beyond which external borrowing is prohibited, and this limit needs to be set or revised by the Council. It reflects the level of external borrowing which could be afforded in the short term, but is not sustainable in the longer term.

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' plans, or those of a specific council, although this power has not yet been exercised.

The Council is asked to approve the following Authorised Limit and Maximum Gross Borrowing Position:

Authorised limit & Maximum Gross Borrowing Position £m	2011/12 Estimate	2012/13 Estimate	2013/14 Estimate	2014/15 Estimate
Borrowing	7	10	10	10
Other long term liabilities	0	0	0	0
Total	7	10	10	10

1.3 Prospects for Interest Rates

The Council has appointed Sector 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 the Sector central view.

Annual Average %	Bank Rate	Money Rates		PWLB Borrowing Rates		
		3 month	1 year	5 year	25 year	50 year
March 2012	0.50	0.70	1.50	2.30	4.20	4.30
June 2012	0.50	0.70	1.50	2.30	4.20	4.30
Sept 2012	0.50	0.70	1.50	2.30	4.30	4.40
Dec2012	0.50	0.70	1.60	2.40	4.30	4.40
March 2013	0.50	0.75	1.70	2.50	4.40	4.50
June 2013	0.50	0.80	1.80	2.60	4.50	4.60
Sept 2013	0.75	0.90	1.90	2.70	4.60	4.70
Dec 2013	1.00	1.20	2.20	2.80	4.70	4.80
March 2014	1.25	1.40	2.40	2.90	4.80	4.90
June 2014	1.50	1.60	2.60	3.10	4.90	5.00

Growth in the UK economy is expected to be weak in the next two years and there is a risk of a technical recession (i.e. two quarters of negative growth). Bank Rate, currently 0.5%, underpins investment returns and is not expected to start increasing until quarter 3 of 2013 despite inflation currently being well above the Monetary Policy Committee inflation target. Hopes for an export led recovery appear likely to be disappointed due to the Eurozone sovereign debt crisis depressing growth in the UK's biggest export market. The Comprehensive Spending Review, which seeks to reduce the UK's annual fiscal deficit, will also depress growth during the next few years.

Fixed interest borrowing rates are based on UK gilt yields. The outlook for borrowing rates is currently much more difficult to predict. The UK total national debt is forecast to continue rising until 2015/16; the consequent increase in gilt issuance is therefore expected to be reflected in an increase in gilt yields over this period. However, gilt yields are currently at historically low levels due to investor concerns over Eurozone sovereign debt and have been subject to exceptionally high levels of volatility as events in the Eurozone debt crisis have evolved.

This challenging and uncertain economic outlook has a several key treasury mangement implications:

- The Eurozone sovereign debt difficulties, most evident in Greece, provide a clear indication of much higher counterparty risk. This continues to suggest the use of higher quality counterparties for shorter time periods;
- Investment returns are likely to remain relatively low during 2012/13;
- Borrowing interest rates are currently attractive, but may remain low for some time. The timing of any borrowing will need to be monitored carefully;
- There will remain a cost of capital – any borrowing undertaken that results in an increase in investments will incur a revenue loss between borrowing costs and investment returns.

1.4 Borrowing Strategy

The Council became debt-free during the financial year 2000/01 and, as a general principle, it is anticipated that there will be potential limited capital borrowing during the next three years.

1.5 Annual Investment Strategy

1.5.1 Key Objectives

The Council's investment strategy's primary objectives are safeguarding the re-payment of the principal and interest of its investments on time, and then ensuring adequate liquidity, with the investment return being the final objective. Following the economic background above, the current investment climate has one over-riding risk, counterparty security risk. As a result of these underlying concerns officers are implementing an operational investment strategy which tightens the controls already in place in the approved investment strategy.

1.5.2 Investment Policy

The Council's investment policy has regard to the CLG's Guidance on Local Government Investments ("the Guidance") and the 2011 revised CIPFA Treasury Management in Public Services Code of Practice and Cross Sectoral Guidance Notes ("the CIPFA TM Code"). The Council's investment priorities will be security first, liquidity second, then return.

Investment instruments identified for use in the financial year are listed below under the 'Specified' and 'Non-Specified' Investments categories. Counterparty limits will be as set through the Council's Treasury Management Practices – Schedules.

1.5.3 Creditworthiness policy

The Council will ensure:

- It maintains a policy covering both the categories of investment types it will invest in and the 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.
- 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.

The Head of Strategic 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. This criterion is separate to that which chooses Specified and Non-Specified investments as it provides an overall pool of counterparties considered high quality the Council may use rather than defining what its investments are.

The rating criteria use 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. This is in compliance with a CIPFA Treasury Management Panel recommendation in March 2009 and the CIPFA Treasury Management Code of Practice.

Credit rating information is supplied by our treasury consultants on all active counterparties that comply with the Council's criteria. Any counterparty failing to meet the criteria would be omitted from the counterparty (dealing) 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 criterion will be suspended from use, with all others being reviewed in light of market conditions.

Counterparty Categories

The Council uses the following criteria in choosing the categories of institutions in which to invest:

- **Banks 1 - Good Credit Quality**
  The Council will only use UK banks which meet the Rating criteria given in the table below
- **Banks 2 – Eligible Institutions**
  The Council will use organisations considered an Eligible Institution for the HM Treasury Credit Guarantee Scheme initially announced on 13 October 2008, with the necessary short and long term ratings required in Banks 1 above.
- **Banks 3 – The Council's own banker**
  For transactional purposes, if the bank falls below the above criteria, it will be included, although in this case balances will be minimised as far as possible in both monetary size and time within operational constraints.
- **Bank Subsidiary and Treasury Operations –** the Council will use these where the parent bank has the necessary ratings outlined above.
- **Building Societies**
  the Council will use all Societies which:
  either
  i. meet the ratings for banks outlined above
  or
  ii. are eligible Institutions; and have assets in excess of limits for each category
- **Specific Public Bodies**
  The Council may lend to Public Bodies other than Local Authorities. The criterion for lending to these bodies is that the loan has been approved by Council.
- **Local Authorities**
  A limit of £2m per authority will be applied.
- **Money Market Funds** having a triple AAA credit rating.
- **Government Debt Management Office (DMO) Account**

Country and sector considerations

Due care will be taken to consider the country, group and sector exposure of the Council's investments. In part, the country selection will be chosen by the credit rating of the Sovereign state in Banks 1 above. In addition:

- Currently, the Council only invests in UK institutions;
- Limits in place above will apply to Group companies;
- Sector limits will be monitored regularly for appropriateness.

Use of additional information other than credit ratings

Additional requirements under the Code of Practice require the Council to supplement credit rating information. Whilst the above criteria rely primarily on the application of credit ratings to provide a pool of appropriate counterparties for officers to use, additional operational market information will be applied before making any specific investment decision from the agreed pool of counterparties. This additional market information (for example Credit Default Swaps, negative rating watches/outlooks) will be applied to compare the relative security of differing investment counterparties.

Time and Monetary Limits applying to Investments

The time and monetary limits for institutions on the Council's Counterparty List summarised in the table below, are driven by the above criteria. These limits will cover both Specified and Non-Specified Investments.

The Council's investment policy has regard to the CLG's Guidance on Local Government Investments ("the Guidance") and the 2011 revised CIPFA Treasury Management in Public Services Code of

Practice and Cross Sectoral Guidance Notes ("the CIPFA TM Code"). The Council's investment priorities will be security first, liquidity second, then return.

Exceptional Circumstances

The criteria for choosing counterparties set out above provide a sound approach to investment in "normal" market circumstances. Whilst Members are asked to approve this base criteria above, under the exceptional current market conditions The Head of Strategic Finance may temporarily restrict further investment activity to those counterparties considered of higher credit quality than the minimum criteria set out for approval. These restrictions will remain in place until the banking system returns to "normal" conditions. Similarly, the time periods for investments will be restricted.

Examples of these restrictions would be the greater use of the Debt Management Deposit Account Facility (DMO) – a Government body which accepts local authority deposits), Money Market Funds, and strongly rated institutions. The credit criteria have been amended to reflect these facilities.

Sensitivity to Interest Rate Movements

Future Council accounts will be required to disclose the impact of risks on the Council's treasury management activity. Whilst most of the risks facing the treasury management service are addressed elsewhere in this report (credit risk, liquidity risk, market risk, maturity profile risk), the impact of interest rate risk is discussed but not quantified. The table below highlights the estimated impact of a 1% increase/decrease in all interest rates to the estimated treasury management costs/income for next year. That element of the debt and investment portfolios which are of a longer term, fixed interest rate nature will not be affected by interest rate changes.

	2012/13 Estimated + 1% £m	**2012/13 Estimated - 1% £m**
Revenue Budgets		
Interest on Borrowing	N/A	N/A
Net General Fund Borrowing Cost	N/A	N/A
Investment income	0.250	-0.250

1.5.4 Investment Strategy

In-house funds. Investments will be made with reference to the core balance and cash flow requirements and the outlook for short-term interest rates (i.e. rates for investments up to 12 months).

Investment returns expectations. Bank Rate is forecast to remain unchanged at 0.5% before starting to rise from quarter 3 of 2013. Bank Rate forecasts for financial year ends (March) are:

2011/ 2012 0.50%
2012/ 2013 0.50%
2013/ 2014 1.25%
2014/ 2015 2.50%

There are downside risks to these forecasts (i.e. start of increases in Bank Rate is delayed even further) if economic growth remains weaker for longer than expected. However, should the pace of growth pick up more sharply than expected there could be upside risk, particularly if Bank of England inflation forecasts for two years ahead exceed the Bank of England's 2% target rate.

The suggested budgeted investment earnings rates for returns on investments during each financial year for the next four years are as follows:

2012/13	1.30%
2013/14	1.60%
2014/15	2.50%
2015/16	3.50%

Invesment 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, and are based on the availability of funds after each year-end.

The Council is asked to approve the treasury indicator and limit: -

Maximum principal sums invested > 364 days			
£m	**2012/13**	**2013/14**	**2014/15**
Principal sums invested > 364 days	£2m	£2m	£2m

Treasury Management Limits on Activity

There are three debt related treasury activity limits which are:

- **The authorised limit for borrowing** - the authorised limit is the "affordable borrowing limit" required by section 3 of the Local Government Act 2003. The Council does not have the power to borrow above this level. Proposed limit of £10m for 2012/13 to 2014/15.

- **The operational boundary** – the operational boundary is the expected borrowing position of the Council during the year. Periods where the actual position is either below or over the boundary is acceptable subject to the authorised limit not being breached. Proposed limit of £7m for 2012/13 to 2014/15.

- **Maximum gross borrowing position** – this is the absolute value of borrowing excluding investment balances – Proposed limit £10m for 2012/13 to 2014/15.

1.5.5 Investment Risk & Security Benchmarking

These benchmarks are simple guides to maximum risk and so may be breached from time to time, depending on movements in interest rates and counterparty criteria. The purpose of the benchmark is that officers will monitor the current and trend position and amend the operational strategy to manage risk as conditions change. Any breach of the benchmarks will be reported, with supporting reasons in the Mid-Year or Annual Report.

Security - The Council's maximum security risk benchmark for the current portfolio, when compared to these historic default tables, is:

- 0.01% historic risk of default when compared to the whole portfolio.
  Liquidity – In respect of this area the Council seeks to maintain:
- Bank overdraft - £0.5m
- Liquid short term deposits of at least £2m available with a week's notice.
- Weighted Average Life benchmark is expected to be 0.5years, with a maximum of 10 years for an individual loan with a public body.
  Yield - Local measures of yield benchmark is (Performance Indicator):
- Investments – returns 0.12% above average bank rate

Security of the investments – In context of benchmarking, assessing security is a much more subjective area to assess. Security is currently evidenced by the application of minimum credit quality criteria to investment counterparties, primarily through the use of credit ratings supplied by the three main credit rating agencies (Fitch, Moody's and Standard and Poors). Whilst this approach embodies security considerations, benchmarking levels of risk is more problematic. One method to benchmark security risk is to assess the historic level of default against the minimum criteria used in the Council's investment strategy. The table beneath shows average defaults for differing periods of investment grade products for each Fitch/Moody's Standard and Poors long term rating category over the period 1990 to 2009.

Years	**1**	**2**	**3**	**4**	**5**
AAA	0.00%	0.01%	0.05%	0.10%	0.17%
AA	0.03%	0.06%	0.08%	0.14%	0.20%
A	0.08%	0.22%	0.37%	0.52%	0.70%
BBB	0.24%	0.68%	1.19%	1.79%	2.42%
BB	1.22%	3.24%	5.34%	7.31%	9.14%
B	4.06%	8.82%	12.72%	16.25%	19.16%
CCC	24.03%	31.91%	37.73%	41.54%	45.22%

The Council's minimum long term rating criteria is currently "AA", meaning the average expectation of default for a one year investment in a counterparty with an "AA" long term rating would be 0.03% of the total investment (e.g. for a £1m investment the average loss would be £300). This is only an average - any specific counterparty loss is likely to be higher - but these figures do act as a proxy benchmark for risk across the portfolio.

The Council's investments in rated institutions are all for periods of less than one year, so the average loss will be scaled down by the length of investment.

The Council's maximum security risk benchmark for the whole portfolio, when compared to these historic default tables, is:

- 0.01% historic risk of default when compared to the whole portfolio.

As the Council has no investment in rated institutions for more than 364 days, the security benchmark for more than one year is not applicable:

	1 year	2 years	3 years	4 years	5 years
Maximum	**0.01%**	**N/A**	**N/A**	**N/A**	**N/A**

Note: This benchmark is an average risk of default measure, and would not constitute an expectation of loss against a particular investment.

1.5.6 Performance Indicators

The Code of Practice on Treasury Management requires the Council to set performance indicators to assess the adequacy of the treasury function over the year. These are distinct historic indicators, as opposed to the prudential indicators, which are predominantly forward looking. The performance indicators used by this Council for the treasury function is:

- Investments – returns 0.12% above average bank rate

The results of this indicator will be reported in the Treasury Annual Report.

1.5.7 Liquidity and Yield Benchmarking

A proposed development for Member reporting is the consideration and approval of liquidity benchmarks. These benchmarks are targets and so may be breached from time to time. Any breach will be reported, with supporting reasons, in the Annual Treasury Report.

Yield – These benchmarks are currently widely used to assess investment performance. The Local measure of yield benchmark is:

- Investments – returns 0.12% above average bank rate

Liquidity – This is defined as "having adequate, though not excessive cash resources, borrowing arrangements, overdrafts or standby facilities to enable it at all times to have the level of funds available to it which are necessary for the achievement of its business/service objectives" (CIPFA Treasury Management Code of Practice). In respect of this area, the Council seeks to maintain:

- Bank overdraft - £0.5m
- Liquid short term deposits of at least £2m available with a week's notice.

The availability of liquidity and the term risk in the portfolio can be benchmarked by the monitoring of the Weighted Average Life (WAL) of the portfolio – shorter WAL would generally embody less risk. In this respect, the proposed benchmark is to be used:

- WAL benchmark is expected to be 0.5 years, with a maximum of 10 years.

1.6 Reporting Requirments

End of year investment report - At the end of the financial year, the Council will report on its investment activity as part of its Annual Treasury Management Report.

Mid-year investment report - In the middle of the financial year, the Council will report on its investment activity as part of its Mid Year Treasury Management Report. In addition the Audit Committee will receive quarterly investment reports.

1.7 Policy on the use of external service providers

The Council uses Sector as its external treasury management advisors.

The Council recognises that responsibility for treasury management decisions remains with the organisation at all times and will ensure that undue reliance is not placed upon our external service providers.

It also recognises that there is value in employing external providers of treasury management services in order to acquire access to specialist skills and resources. The Council will ensure that the terms of their appointment and the methods by which their value will be assessed are properly agreed and documented, and subjected to regular review.

1.8 Member and Officer Training

The increased Member consideration of treasury management matters and the need to ensure officers dealing with treasury management are trained and kept up to date requires a suitable training process for Members and officers. This Council has addressed this important issue by:

- Ensuring that officers attend suitable courses and seminars to keep their technical knowledge up to date
- Keeping up to date with CIPFA publications on Treasury Management
- Regular briefings both by e mail and face to face with the Council's consultants
- Membership of the CIPFA Corporate Services Benchmarking Club for Treasury Management
- Reports and briefing sessions to Members on major changes to Treasury policies and strategies

Interest Rate Forecast 2011/2015

Sector's Interest Rate View	Now	Dec-11	Mar-12	Jun-12	Sep-12	Dec-12	Mar-13	Jun-13	Sep-13	Dec-13	Mar-14	Jun-14	Sep-14	Dec-14	Mar-15
Sector's Bank Rate View	**0.50%**	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	0.75%	1.00%	1.25%	1.50%	2.00%	2.25%	2.50%
3 Month LIBID	**0.87%**	0.70%	0.70%	0.70%	0.70%	0.70%	0.75%	0.80%	0.90%	1.20%	1.40%	1.60%	2.10%	2.40%	2.60%
6 Month LIBID	**1.16%**	1.00%	1.00%	1.00%	1.00%	1.00%	1.10%	1.20%	1.40%	1.60%	1.80%	2.00%	2.50%	2.70%	2.90%
12 Month LIBID	**1.65%**	1.50%	1.50%	1.50%	1.50%	1.60%	1.70%	1.80%	1.90%	2.20%	2.40%	2.60%	3.10%	3.20%	3.30%
5yr PWLB Rate	**2.25%**	2.30%	2.30%	2.30%	2.30%	2.40%	2.50%	2.60%	2.70%	2.80%	2.90%	3.10%	3.30%	3.50%	3.70%
10yr PWLB Rate	**3.33%**	3.30%	3.30%	3.30%	3.40%	3.40%	3.50%	3.60%	3.70%	3.80%	4.00%	4.20%	4.40%	4.60%	4.80%
25yr PWLB Rate	**4.24%**	4.20%	4.20%	4.20%	4.30%	4.30%	4.40%	4.50%	4.60%	4.70%	4.80%	4.90%	5.00%	5.10%	5.20%
50yr PWLB Rate	**4.26%**	4.30%	4.30%	4.30%	4.40%	4.40%	4.50%	4.60%	4.70%	4.80%	4.90%	5.00%	5.10%	5.20%	5.30%
Bank Rate															
Sector's View	**0.50%**	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	0.75%	1.00%	1.25%	1.50%	2.00%	2.25%	2.50%
UBS	**0.50%**	0.50%	0.50%	0.50%	0.50%	0.50%	-	-	-	-	-	-	-	-	-
Capital Economics	**0.50%**	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	-	-	-	-	-
5yr PWLB Rate															
Sector's View	**2.25%**	2.30%	2.30%	2.30%	2.30%	2.40%	2.50%	2.60%	2.70%	2.80%	2.90%	3.10%	3.30%	3.50%	3.70%
UBS	**2.25%**	-	-	-	-	-	-	-	-	-	-	-	-	-	-
Capital Economics	**2.25%**	2.00%	2.00%	2.00%	2.00%	2.00%	2.00%	2.00%	2.00%	2.00%	-	-	-	-	-
10yr PWLB Rate															
Sector's View	**3.33%**	3.30%	3.30%	3.30%	3.40%	3.40%	3.50%	3.60%	3.70%	3.80%	4.00%	4.20%	4.40%	4.60%	4.80%
UBS	**3.33%**	3.45%	3.45%	3.50%	3.60%	3.65%	-	-	-	-	-	-	-	-	-
Capital Economics	**3.33%**	3.00%	3.00%	3.00%	3.00%	3.00%	3.00%	3.00%	3.00%	3.00%	-	-	-	-	-
25yr PWLB Rate															
Sector's View	**4.24%**	4.20%	4.20%	4.20%	4.30%	4.30%	4.40%	4.50%	4.60%	4.70%	4.80%	4.90%	5.00%	5.10%	5.20%
UBS	**4.24%**	4.80%	4.90%	4.90%	4.90%	4.90%	-	-	-	-	-	-	-	-	-
Capital Economics	**4.24%**	4.30%	4.30%	4.30%	4.30%	4.30%	4.30%	4.30%	4.30%	4.30%	-	-	-	-	-
50yr PWLB Rate															
Sector's View	**4.26%**	4.30%	4.30%	4.30%	4.40%	4.40%	4.50%	4.60%	4.70%	4.80%	4.90%	5.00%	5.10%	5.20%	5.30%
UBS	**4.26%**	4.80%	4.95%	4.95%	5.00%	5.00%	-	-	-	-	-	-	-	-	-
Capital Economics	**4.26%**	4.40%	4.40%	4.40%	4.40%	4.40%	4.40%	4.40%	4.40%	4.40%	-	-	-	-	-

Economic Background

Global economy

The outlook for the global economy remains clouded with uncertainty with the UK economy struggling to generate sustained recovery that offers any optimistim for the outlooks for 2011 and 2012, or possibly even into 2013. Consumer and business confidence levels are low and with little to boost sentiment, it is not easy to see potential for a significant increase in the growth rate in the short term.

At the centre of much of the uncertainty is the ongoing Eurozone sovereign debt crisis which has intensified, rather than dissipated throughout 2011. The main problem has been Greece, where, even with an Eurozone/IMF/ECB bailout package and the imposition of austerity measures aimed at deficit reduction, the lack of progress and the ongoing deficiency in addressing the underlying lack of competitiveness of the Greek economy, has seen an escalation of their problems. These look certain to result in a default of some kind but it currently remains unresolved if this will be either “orderly” or “disorderly”, and/or also include exit from the €uro bloc.

As if that were not enough there is growing concern about the situation in Italy and the risk that contagion has not been contained. Italy is the third biggest debtor country in the world but its prospects are limited given the poor rate of economic growth over the last decade and the lack of political will to address the need for fundamental reforms in the economy. The Eurozone now has a well established track record of always doing too little too late to deal with this crisis; this augurs poorly for future prospects, especially given the rising level of electoral opposition in northern EU countries to bailing out profligate southern countries.

The US economy offers little to lift spirits. With the next Presidential elections due in November 2012, the current administration has been hamstrung by political gridlock with the two houses split between the main parties. In quarter 3 the Federal Reserve started “Operation Twist” in an effort to re-ignite the economy in which growth is stalling. High levels of consumer indebtedness, unemployment and a moribund housing market are weighing heavily on consumer confidence and so on the abiltity to generate sustained economic growth.

Hopes for broad based recovery have, therefore, focussed on the emerging markets but these areas have been struggling with inflationary pressures in their previously fast growth economies. China, though, has maintained its growth pattern, despite tightening monetary policy to suppress inflationary pressures, but some forward looking indicators are causing concern that there may not be a soft landing ahead, which would then be a further dampener on world economic growth.

Economy

The Government’s austerity measures, aimed at getting the public sector deficit into order over the next four years, have yet to fully impact on the economy. However, coming at a time when economic growth has virtually flatlined and concerns at the risk of a technical recession (two quarters of negatibe growth) in 2012, it looks likely that the private sector will not make up for the negative impact of these austerity measures given the lack of an export led recovery due to the downturn in our major trading partner – the EU. The housing market, a gauge of consumer confidence, remains weak and the outlook is for house prices to be little changed for a prolonged period.

Economic Growth - GDP growth has, basically, flatlined since the election of 2010 and, worryingly, the economic forcecasts for 2011 and 2012 have been revised lower on a near quarterly basis as the UK recovery has, effectively, stalled. With fears of a potential return to recession the Bank of England embarked on a second round of Quantitive Easing to stimulate ecomnomic activity.

Unemployment - With the impact of the Government's austerity strategy impacting the trend for 2011 of steadily increasing unemployment, there are limited prospects for any improvement in 2012 given the deterioration of growth prospects.

Inflation and Bank Rate - For the last two years, the MPC's contention has been that high inflation was the outcome of temporary external factors and other one offs (e.g. changes in VAT); that view remains in place with CPI inflation standing at 5.2% at the start of quarter 4 2011. They remain of the view that the rate will fall back to, or below, the 2% target level within the two year horizon.

AAA rating - The ratings agencies have recently reaffirmed the UK's AAA sovereign rating and have expressed satisfaction with Government policy at deficit reduction (although one of the agencies, Moody's has recently placed the UK on 'negative' watch). They have, though, warned that this could be reviewed if the policy were to change, or was seen to be failing to achieve its desired outcome. This credit position has ensured that the UK government is able to fund itself at historically low levels and with the safe haven status from Eurozone debt also drawing in external investment the pressure on rates has been down, and looks set to remain so for some time.

Sector's forward view

Economic forecasting remains troublesome with so many extermal influences weighing on the UK. There does, however, appear to be consensus among analysts that the economy remains weak and whilst there is still a broad range of views as to potential performance, they have all been downgraded throughout 2011. Key areas of uncertainty include:

- a worsening of the Eurozone debt crisis and heightened risk of the breakdown of the bloc or even of the currency itself;
- the impact of the Eurozone crisis on financial markets and the banking sector;
- the impact of the Government's austerity plan on confidence and growth and the need to rebalance the economy from services to exporting manufactured goods;
- the under-performance of the UK economy which could undermine the Government's policies that have been based upon levels of growth that inceasingly seem likely to be undershot;
- a continuation of high levels of inflation ;
- the economic performance of the UK's trading partners, in particular the EU and US, with some analysts suggesting that recession could return to both;
- stimulus packages failing to stimulate growth;
- elections due in the US, Germany and France in 2012 or 2013;
- potential for protectionism i.e. an escalation of the currency war / trade dispute between the US and China.

The overall balance of risks remains weighted to the downside. Lack of economic growth, both domestically and overseas, will impact on confidence putting upward pressure on unemployment. It will also further knock levels of demand which will bring the threat of recession back into focus.

Sector believes that the longer run trend is for gilt yields and PWLB rates to rise due to the high volume of gilt issuance in the UK, and the high volume of debt issuance in other major western countries.

Given the weak outlook for economic growth, Sector sees the prospects for any interest rate changes before mid-2013 as very limited. There is potential for the start of Bank Rate increases to be even further delayed if growth disappoints.

Treasury Management Practice (TMP1)

Credit and Counterparty Risk Management

The CLG issued Investment Guidance in 2010, and this forms the structure of the Council's policy below. These guidelines do not apply to either trust funds or pension funds, which operate under a different regulatory regime.

The key intention of the Guidance is to maintain the current requirement for councils to invest prudently, and that priority is given to security and liquidity before yield. In order to facilitate this objective the guidance requires this Council to have regard to the CIPFA publication Treasury Management in the Public Services: Code of Practice and Cross-Sectoral Guidance Notes. This Council has adopted the Code and will apply its principles to all investment activity. In accordance with the Code, the Head of Strategic Finance has produced its Treasury Management Practices (TMPs). This part, TMP 1(5), covering investment counterparty policy requires approval each year.

Annual Investment Strategy - The key requirements of both the Code and the investment guidance are to set an annual investment strategy, as part of its annual treasury strategy for the following year, covering the identification and approval of following:

- The strategy guidelines for choosing and placing investments, particularly non-specified investments.
- The principles to be used to determine the maximum periods for which funds can be committed.
- Specified investments that the Council will use. These are high security (i.e. high credit rating, although this is defined by the Council, and no guidelines are given), and high liquidity investments in sterling and with a maturity of no more than a year.
- Non-specified investments, clarifying the greater risk implications, identifying the general types of investment that may be used and a limit to the overall amount of various categories that can be held at any time.

The investment policy proposed for the Council is:

Strategy Guidelines – The main strategy guidelines are contained in the body of the treasury strategy statement.

Specified Investments – These investments are sterling investments of not more than one-year maturity, or those which could be for a longer period but where the Council has the right to be repaid within 12 months if it wishes. These are considered low risk assets where the possibility of loss of principal or investment income is small. These would include sterling investments which would not be defined as capital expenditure with:

1. The UK Government (such as the Debt Management Account deposit facility, UK Treasury Bills or a Gilt with less than one year to maturity).
2. A local authority, parish council or community council.
3. A body that is considered of a high credit quality (such as a bank or building society) with a minimum short term rating of F-1 (or the equivalent) as rated by Standard and Poor's, Moody's or Fitch rating agencies or a Building Society with assets over £5,000m.
4. Money Market Funds (triple AAA rated only).

Within these bodies, and in accordance with the Code, the Council has set additional criteria to set the time and amount of monies which will be invested in these bodies. These criteria are defined in the Treasury Management Strategy.

Non-Specified Investments – Non-specified investments are any other type of investment (i.e. not defined as Specified above). The identification and rationale supporting the selection of these other investments and the maximum limits to be applied are set out below. Non specified investments would include any sterling investments with:

	Non Specified Investment Category	Limit (£ or %)
a.	Any bank or building society that has a minimum long term credit rating of A (or equivalent), for deposits with a maturity of greater than one year (including forward deals in excess of one year from inception to repayment).	**£2m or 10%**
b.	The Council's own banker if it fails to meet the basic credit criteria.	**£5m maximum ceiling**
c.	**Building societies not meeting the basic security requirements under the specified investments**. The operation of some building societies does not require a credit rating, although in every other respect the security of the society would match similarly sized societies with ratings. The Council may use such building societies which were originally considered Eligible Institutions and have a minimum asset size of £5,000m, but will restrict these type of investments to £2m for one month	**£2m**
d.	**Specific Public Bodies** The Council can seek Member approval to make loans to other public bodies for periods of more than one year.	**£2m**
e.	**Other Local Authorities**	**£2m**

In accordance with the Code, the Council has developed additional criteria to set the overall amount of monies which will be invested in these bodies. These criteria are defined in the Treasury Management Strategy.

In respect of categories d and e, these will only be considered after obtaining external advice and subsequent Member approval.

The Monitoring of Investment Counterparties - The credit rating of counterparties will be monitored regularly. The Council receives credit rating information (changes, rating watches and rating outlooks) from Sector as and when ratings change, and counterparties are checked promptly. On occasion ratings may be downgraded when an investment has already been made. The criteria used are such that a minor downgrading should not affect the full receipt of the principal and interest. Any counterparty failing to meet the criteria will be removed from the list immediately by the Head of Strategic Finance, and if required new counterparties which meet the criteria will be added to the list.

Institution Type	Max Amount:			£2m	£5m	£5m	£5m	£5m
	Max Length:			10 Years	364 Days	6 Months	3 Months	1 Month
	Minimum Short Term Ratings							
	Fitch	Moody's	S&P					
UK Banks								
Banks with Clearing Status in the United Kingdom	F1	P-1	A-1		Backed up by AA(F), Aa2(M) and AA(S&P) long term credit rating	Backed up by single A long term ratings by all agencies	Backed up by lower than A long term rating	Backed up by lower than A long term rating
National Westminster Bank: Call Account a £10m maximum ceiling. The funds are capable of being 'called back' with one day's notice.	F1	P-1	A-1		Not Applicable	Not Applicable	Not Applicable	Not Applicable
The Council's own Bankers	F1	P-1	A-1	If Council's own bankers fall below the minimum long term criteria for UK banks, cash balances will be managed within operational liquidity constraints and up to a maximum of £5m.				
Wholly Owned Subsidiaries of UK Clearing Banks - Parent Ratings	F1	P-1	A-1		Backed up by AA(F), Aa2(M) and AA(S&P) long term credit rating	Backed up by single A long term ratings by all agencies	Backed up by lower than A long term rating	Backed up by lower than A long term rating
UK Building Societies								
Either	F1	P-1	A-1		Backed up by AA(F), Aa2(M) and AA(S&P) long term credit rating	Backed up by single A long term ratings by all agencies	Backed up by lower than A long term rating	Backed up by lower than A long term rating
Or					Assets over £5,000m	Assets over £5,000m	Assets of £5,000m	Assets over £5,000m
Specific Public Bodies				As approved by Members				
UK Local Authorities				The Council can invest in all UK Local Authorities whether rated or not				

Notes

1 F1+, P-1 and A-1+ are the highest short term credit ratings of Fitch, Moody's and Standard and Poor's respectively

2 Minimum Short Term Ratings - Where given, these must be met, for all categories

3 Building Societies - A Building Society has to meet either the ratings criteria or the assets criterion to be included in the category, not both

4 Maximum amount is the maximum, in total, over all investments, with any one institution

Agenda Item 7

PART A

Report to: Audit Committee

Date of meeting: 14 March 2012

Report of: Head of Strategic Finance

Title: Treasury Management Update Report

1.0 SUMMARY

1.1 This report provides the regular 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 global situation remains volatile with continuing problems within the eurozone. To some extent the announcement by the European Central Bank (ECB) in December 2011 that it would make an unlimited three year lending facility available to all eurozone banks @ 1% rates of interest has relieved a considerable amount of pressure from the financial system. To date, the ECB has loaned 1 trillion euros to European banks (489 billion euros in December; 530 billion end February 2012). UK Banks have taken a very small part of this loan facility (Lloyds 11.4bn; Barclay's 8.2 billion; RBS 10 billion; and HSBC 350million). In all these instances the loans have been taken out to cover some exposure in Europe. Italian and Spanish institutions are believed to have taken half of the money on offer.

3.2 The size of the funding already taken up reveals the extent of the problems within the euro zone where there is a strong suspicion that a lot of losses within the banks have yet to be reported / covered by alternative funding. The ECB bail out whilst apparently attractive (1% rate of interest for up to three years) does mean that the ECB becomes the 'preferred creditor' and all other depositors/ shareholders are effectively down graded to junior status.

3.3 Problems continue in Greece where social and political unrest are likely to reach breaking point in the near future. The latest 'bail out' package to Greece of circa 130 billion euros will only exacerbate the situation as the conditions for such a loan imposed principally by Germany/ Holland/ Finland/ and Austria will increase resentment. The Greek general election in April is likely to return a socialist government and a reversal of current austerity measures may well be the result. Private holders of Greek sovereign debt will probably be required to write off 70% of their holdings (and includes French and German banks; UK banks having very limited exposure). The funding source from the ECB has effectively cushioned the effects of this 'haircut' but a write down of debt is still not good news for the affected banks.

3.4 The probability of Greece being forced out of the eurozone remains high as the northern European countries now believe that any consequent 'contagion' can be contained. Portugal, Spain, Ireland and Italy are all experiencing, to some degree, an increase in unemployment and economies that are contracting. This situation is likely to continue for the foreseeable future and will continue to place strains upon the eurozone as a whole.

3.5 The rating agency Standard and Poors has recently downgraded a number of European countries with another agency Moody's putting the UK on negative watch. The 'markets' have taken this in their stride and the cost of lending to most sovereign countries has generally stabilised/ fallen.

3.6 As a consequence of all the activity over the past 3 months (and particularly the lending facility made available by the ECB) it is less likely that a wider banking crash will now occur and it is opportune for the Council to reconsider its current investment strategy for 2012/2013.

4.0 Current 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 investments and, the current practise has been to restrict all investments in banks to £3m or less per institution and to £2m for the top 5 building societies (the Treasury Policy Statement approved by Council permits a higher ceiling to apply). Council has also approved the placing of overnight money with Nat West (maximum ceiling £10m) and the Co-op (maximum ceiling £5m).

4.3 Due to the prevailing uncertainty within Europe the Council's portfolio has been kept of relative short maturity and this has affected the investment return achievable. It is probably the case that the situation has stabilised and a slightly longer maturity profile can be considered for 2012/2013. The portfolio will therefore be structured whereby circa 33% of funds will be invested up to 12 months duration; 33% of medium term duration—up to six months; and 33% will be kept with a maturity of less than two months. Counterparty limits may also revert to up to £5m with any one financial institution and £3m with any of the top 5 building societies. The use of Nat West and the Co-operative Bank for overnight facilities of £10m and £5m respectively will continue to be utilised.

4.4 The current portfolio attached at **Appendix 1** does not reflect the revised maturity strategy referred to in paragraph 4.3 (but it is likely that an updated portfolio to be handed at the meeting will do so). It will be evident by comparing the two portfolios that the return on investments is greater with a longer maturity profile.

5.0 IMPLICATIONS

5.1 **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 1.17% but due to a slightly larger investment portfolio it is anticipated that the £346k will be achieved.

5.2 For 2012/2013, an average rate of interest of 1.3% has again been assumed and with a slightly longer maturity profile, should be achieved. In cash terms the estimates for 2012/2013 has assumed £325k of income will accrue and will be dependent upon the degree to which the investment portfolio will be drawn down to finance the Council's Capital Programme.

5.3 **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.

5.4 **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.			

5.5 **Staffing**

None Directly

5.6 **Accommodation**

None Directly

Loan Ref	Lender	Loan Type	Broker	Profile	Fix/Var	Notice	Start Date	Maturity	Principal	Rate
1005	CLYDESDA	D		V	V		06-Apr-10	- -	-3,000,000.00	0.85
1010	NATWESTS	D		V	V		27-Apr-10	- -	-6,000,000.00	0.90
1025	CO-OP	D		V	V	C	01-Jul-10	- -	-2,450,000.00	0.56
1038	NATWESTS	D		M	F		19-May-11	18-May-12	-2,000,000.00	1.51
1039	SKIPTON	D	STER	M	F		27-Jul-11	25-Jul-12	-2,000,000.00	2.00
1042	YORKSHIR	D	PREB	M	F		05-Sep-11	03-Sep-12	-2,000,000.00	1.50
1048	LLOYDSTS	D		M	F		06-Dec-11	06-Mar-12	-3,000,000.00	1.30
1049	SANTAND	D		M	F		07-Dec-11	07-Mar-12	-3,000,000.00	1.35
1050	COVENTRY	D	TRAD	M	F		09-Dec-11	09-Mar-12	-2,000,000.00	0.96
1051	BARCLAYS	D	TRAD	M	F		15-Dec-11	14-Mar-12	-2,000,000.00	0.88
1052	LLOYDSTS	D		M	F		15-Dec-11	13-Apr-12	-3,000,000.00	1.70
1053	LEEDS BS	D		M	F		16-Feb-12	16-Aug-12	-1,000,000.00	1.38
1054	NATIONWI	D	STER	M	F		23-Feb-12	21-Feb-13	-2,000,000.00	1.85
									-33,450,000.00	

Investment Portfolio
APPENDIX 1
As at 2nd March 2012

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Report to: Audit Committee
Date of meeting: 14 March 2012
Report of: Head of Strategic Finance
Title: Strategic Risk Register

1.0 SUMMARY

1.1 This report informs the Committee of the Strategic Risk Register which was reviewed and approved by Leadership Team on 6th March 2012. This register will be deposited upon the Council's Intranet and is reviewed on a regular basis.

2.0 RECOMMENDATIONS

2.1 That the Strategic Risk Register at **Appendix 1** is approved.

3.0 DETAILED PROPOSAL

3.1 The Strategic Risk register is reported annually to the Audit Committee (last report 16th March 2011) and is constantly being reviewed. The next section of this report provides some necessary background context.

3.2 Strategic Risk Register (SRR)

3.2.1 This seeks to identify key strategic risks and should not seek to replicate all the detail within service risk registers. For example, a project such as the Health Campus has over 50 detailed risks within its project documentation whereas the SRR has identified 4 overarching risks. Equally there will be some risks that relate purely to a service area and have no place within the corporate Strategic Risk Register.

3.2.2 It is also necessary to consider the volume of risks within the SRR, the ideal number probably being 12 whereas the current SRR has 20 such risks. This reflects the fact that Watford is not a normal authority and has a number of major investment projects.

3.2.3 The SRR continues to be structured as follows:

- Major Investment
- Service Delivery
- Reputational
- Functional

3.2.4 Inevitably, a key risk will generally start life as a ‘red’ denoting high risk (if it started life as a ‘green’ then it shouldn’t feature on the register in the first place). A two stage ‘control’ process then occurs which should have reduced the risk to a manageable situation (and invariably shows as a yellow traffic light). In some cases the risk can be managed down to ‘green’ but equally there will be instances where the risk remains ‘red’ and will require further actions to be taken to reduce down the risk.

4.0 IMPLICATIONS

4.1 Financial

The Head of Strategic Finance comments that there are no financial implications arising directly out of this report.

4.2 Legal Issues

The Head of Legal and Property Services comments that there are no legal implications arising out of this report.

4.3 Potential Risks

Potential Risk	Likelihood	Impact	Overall Score
That the register fails to identify all key risks	2	3	6
That the necessary controls are not put in place to manage down the risk	2	3	6
That the register is not regularly reviewed	2	3	6

DATE: February 2012 | NAME: LEADERSHIP TEAM | WATFORD BC

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RISK TYPE: ALL STRATEGIC

CODE	OBJECTIVE	Value of investment £	RISK	CAUSES	ASSESSMENT OF RISK (no controls in place for first assessment and controls in place thereafter) Categories of risk (Please see appendix 1 for categories of risk)	SEVERITY	LIKELIHOOD	RISK RATING	ASSESSMENT OF RISK (With controls in place – Residual Risk Rating) Control measures in place? (Please see Treatment Plan for more detail)	SEVERITY	LIKELIHOOD	RESIDUAL RISK RATING	CONSEQUENCES	FURTHER CONTROLS REQUIRED	SEVERITY	LIKELIHOOD	MITIGATED RISK RATING	REVIEW FREQUENCY (A, Q, M)	DATE OF NEXT REVIEW	OWNER
	MAJOR INVESTMENT																			
1	**Health Campus**	**£500M**	West Herts Hospital Trust	Failure to obtain trust status	Customer / Citizen Economic/ financial	4	4	16	West Herts Hospital Trust has produced a business case and is awaiting Treasury approval (October 2012)--having cleared the first stage process (Monitor)	4	3	12	The Health Campus will only part achieve its aims without new hospital. Will also have severe effect upon financial viability	Funding of £10m has been allocated by Government for bridge, road, heat and power plant for new hospital.	4	2	8	Q	ongoing	Manny Lewis
	Health Campus		Bridge and Link Road not built	Funding not available	Economic/ Financial Reputational	4	4	16	Central Government has announced £7m of funding available to WHHT. WBC has made a bid for an interest free loan of £3m from Growing Places Fund	4	2	8	Without appropriate funding the project will not be completed in its entirety and a fragmented development will occur	A review of costing for construction of bridge and road is essential (prior to tender) to ensure funding will be sufficient.	4	2	8	Q	ongoing	Manny Lewis
	Health Campus		Land assembly not achieved	Land Holdings held by individuals/Government	Economic/ Financial	4	3	12	Negotiations with land holders being pursued with purchase of EEDA land being achieved. Alternative scheme design to avoid ransom strips	3	3	9	problems with land assembly could result in delays	Health Campus wide CPO likely to ensure no impediment to development.	3	2	6	Q	ongoing	Manny Lewis
	Health Campus		Private Sector Partner not identified	Scheme not considered to be financially viable	Economic/ Financial Reputational	4	4	16	Procurement process well advanced with 4 PSPs working up proposals. Short list of two and final BAFO scheduled for July 2012.	4	3	12	If scheme not financially viable then potential PSP will withdraw.	Continuous review of viability and options to increase profitability should result in a Local Asset Backed Vehicle being achieved.	4	2	8	Q	ongoing	Manny Lewis
2	**Croxley Rail Link**	**£120m**	Scheme does not proceed	Community reject project. Bad publicity about consequences for Metro Station/ local traffic congestion..	Reputational	4	3	12	Extensive consultation. Advantages of scheme to be emphasised	4	2	8	Adverse effect upon economy of town & regeneration projects such as Health Campus and Charter Place.	Ensure wider political backing for project is maintained	4	1	4	Q	ongoing	Manny Lewis
	Croxley Rail Link		Scheme exceeds available budget.	Specification too high; adverse ground conditions; CPO compensation too high; lack of interest from tenderers leads to high contract sum	Economic/ Financial/ Reputational	4	4	16	Detailed costings in place. CPO assessment realistic. Current construction market has low profit margins.	4	3	12	A significant overspend occurs; specification is cut back producing a sub standard product.	Need to obtain a fixed price procurement and to keep a tight control on specification and variation orders..	4	2	8	Q	ongoing	Manny Lewis
	Croxley Rail Link		Transport and Works Act Order will not be approved	Herts County Council & London Underground will not complete necessary work	Economic/ Financial/ Reputational	4	3	12	Outline Planning/ Land transfers and CPO processes being progressed . Statutory Orders published (Dec 2011)	4	2	8	Public Enquiry will follow (Summer 2012) & confirmation Winter 2012	Carry out Procurement (Winter 2013); obtain full approval from DFT (Winter 2013). Start on site Summer 2014	4	2	8	Q	ongoing	Jane Custance
3	**Charter Place Redevelopment**	**Phase 1 only £60m**	Preferred developer withdraws from Phase 1	Lack of economic viability,	Economic/ Financial Reputational	4	3	12	Continuous dialogue with developer / existing tenants / CSC (for car park). Review of viability of Scheme ongoing.	4	3	12	The Development Agreement will not be agreed/ signed.	Council may need to be flexible regarding its short and long term financial return.	3	3	9	M	ongoing	Manny Lewis
	Charter Place Redevelopment		The current facilities do not get re-modelled/ refurbished (status quo is not an option)	Lack of finance/ economic viability	Economic/ financial/ Reputational	4	3	12	Development does not get wider retail support and pre lets are not forthcoming	4	2	8	Negotiations between preferred developer and wider retail market are not successful	Scheme needs to be realistic about what is achievable/ financially viable	4	2	8	M	ongoing	Manny Lewis
	Charter Place Redevelopment		Planning & CPO approvals not obtained	Scheme does not comply with LDF. CPO Enquiry not successful	Reputational	3	3	9	Detailed discussions with WBC/ HCC planners/ transportation should resolve any issues. Case for CPOs needs to be strong.	3	2	6	The scheme in current form would not proceed if obstacles cannot be removed	compromise on planning may be required. Strategy to overcome CPO objections needs to be developed.	3	2	6	M	ongoing	Jane Custance
	Charter Place Redevelopment		Council required to Part Fund Scheme	Lack of economic viability	Economic/ Financial	4	3	12	Limited ability for Council to allocate funding	4	3	12	Scheme will not proceed in current form	Preferred Developer needs to reconsider viability	4	2	8	M	immediate	Bernard Clarke
	Charter Place Redevelopment	**£2.5m Rent Income**	Commercial Rent Income is affected during and after development	Current tenants need to be displaced with short term rent loss. Future tenants may not be identified or require initial rent free periods.	Economical/ Financial	4	4	16	Memorandum of Understandig/ Development Agreement seek to guarantee developer will underwrite the £2.5m of rental income	4	3	12	If MOU/ DA are varied downwards then the risk of loss of income remains	Negotiations ongoing. Phase 1 seeking to exclude approx £1m of current rental income to minimise potential impact.	3	3	9	M	immediate	Alistair Burg

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	Charter Place Redevelopment	Phase 2 Unknown at this stage	Preferred Developer has not finalised proposals at this stage	Uncertain national economic environment combined with current viability of project	Economic / Financial	3	4	12	Phase 2 currently on hold whilst Phase 1 Development Agreement to be signed	3	4	12	Aspirations for a cinema and restaurant quarter may not be realised	Need to consider whether any other alternative development available	3	4	12	Q	ongoing	Manny Lewis
4	Cultural Quarter Phase 1	£4.5m	Funding is re-directed to other projects	Limited amount of Council funding. Competing strategic demands	Economic/ Financial Reputational	3	3	9	Council has sufficient funding to complete Phase 1 providing it is not re-directed	3	2	6	Scheme may need to be modified to meet funding available.	Final shape of project needs to be agreed and costed.	3	2	6	Q	Ongoing	Cate Hall
	Cultural Quarter Phase 1		Community may reject all or part of scheme	Satisfaction with current 'offer'. Reluctance to spend Council Money. Alternative projects may get more support.	Reputational	4	3	12	Consultation needs to be effective and 'visionary'	4	2	8	Scheme may not deliver original aspirations	Need to ensure wider political buy in	4	2	8	Q	ongoing	Cate Hall
5	Cassiobury Park Heritage Lottery Bid	£5m	HLF Funding may not be forthcoming	Competing local authorities bids may dilute nationally available funding.	Financial/ reputational	3	4	12	Business case need to emphasise the funding WBC is setting aside and the number of Cassiobury users who will benefit.	3	3	9	Cassiobury Park facilities will become tired, dated and not fit for purpose	Community support needs to be increased. Advantages of scheme need to be emphasised to HLF	3	2	6	Q	ongoing	Lesley Palumbo
	Cassiobury Park Heritage Lottery Bid		Operating costs at Park may increase	Additional maintenance requirement	Financial	3	4	12	Improved income generation from all activities associated with Park need to be programmed	3	3	9	If Park operating costs increase then other service areas of Council will need to cut back	Scheme needs to be designed in order to reduce maintenance liability/ supervision	3	2	6	Q	ongoing	Paul Rabbits

SERVICE DELIVERY

CODE	OBJECTIVE	Value of investment £	RISK	CAUSES	Categories of risk	SEVERITY	LIKELIHOOD	RISK RATING	Control measures in place?	SEVERITY	LIKELIHOOD	RESIDUAL RISK RATING	CONSEQUENCES	FURTHER CONTROLS REQUIRED	SEVERITY	LIKELIHOOD	MITIGATED RISK RATING	REVIEW FREQUENCY (A, Q, M)	DATE OF NEXT REVIEW	OWNER
6	Service Prioritisation Achieved	£3m of efficiencies required	total savings package not delivered	individual projects for delivering savings are cancelled. Some projects are unrealistic and cannot be achieved.	Economic/ Financial Reputational	4	3	12	A detailed monitoring process has been put in place. CMB/ Leadership/ Portfolio Holders seek to ensure limited non achievement	4	2	8	Failure to deliver efficiencies will result in alternative savings having to be achieved in order to balance the budget.	A Programme Board (MD, and Executive Directors) meet monthly to review all projects and limit scale of non achievement.	4	2	8	Q	ongoing	Leadership Team
7	Council Road Map Finalised	£2m of efficiencies required	savings may not be fully achieved.	Targets are unrealistic. Political pressure to change course. Potential commercial savings may not be achieved	Economic / Financial/ Reputational	4	4	16	Detailed project plans/ Business cases are being developed with external specialist help.	4	3	12	Alternative savings will need to be identified	A vigorous review of all support/ management costs needs to identify excess costs.	4	2	8	Q	ongoing	Leadership Team
8	Service Improvement Continues	£160m turnover	services deteriorate. Homelessness increases. The Town looks tired, dirty & neglected.	service efficiencies / staff rationalisation affect service standards. Budget reductions reduce allocation of resources.	Economic/ Financial Reputational	4	3	12	Performance Indicators/ officer mgement teams/ Leadership/ quarterly reviews/ scrutiny process/ community surveys all in place to monitor performance	4	2	8	a deterioration in service standards will affect the council's vision and objectives.Complaints from the community will increase.	Targetted improvement/ resourcing to some services may be necessary eg Benefits Service/ Homelessness.	4	2	8	Q	ongoing	Leadership Team
9	Partnerships/voluntary sector remain vibrant and effective to meet community need.	£2m plus loss of government specific funding	Disadvantaged/ hard to reach groups will not be supported.	Funding is being progressively reduced both by way of government grant funding and the council's service efficiency programme .	customer/ citizen legislative/ legal reputational / equalities	4	3	12	The council has a three year assessment process which identifies those voluntary sector organisations delivering best value and meeting community needs..	4	2	8	the most disadvantaged/ elderly in society might suffer economic hardship and a sense of isolation	A resilience officer has been appointed to facilitate a progressive reduction in funding and needs to monitor and report back on a regular basis.	4	2	8	Q	ongoing	Lesley Palumbo
10	Homelessness Increases placing pressures upon temporary accommodation & bed and breakfast	potentially circa £300k	homeless / vulnerable families and individuals have no accommodation or unsuitable accommodation creating health, wellbeing and safety issues	The negative impact of the downturn in the economy combined with policy changes regarding statutory homelessness	customer/ citizen legislative/ reputational/ equalities/ financial	4	4	16	Increase supply of temporary accommodation through funding within capital programme for property conversions. Secure contracts with RSLs/ private landlords for additional accommodation.	4	3	12	temporary reduction in homeless families & individuals but underlying trend is still increasing	Staffing restructure places greater emphasis upon a demand management model & should result in further contracts for supply of housing. Pump priming of further conversions with RSLs	4	2	8	M	ongoing	Lesley Palumbo
11	Ensure Housing Benefit Service is fit for purpose	£75m turnover per annum	Backlogs result in delays in making payments to client base. Quality controls on payments are insufficient and benefit grant subsidy from DWP is lost.	Use of technology is not maximised. Benefits assessors spend time dealing with routine client enquiries. Incomplete information provided by benefits clients/ recipients.	Financial / reputational/ customer/ citizen	4	4	12	Monitoring of workload being constantly reviewed. Quiet periods (no telephone calls) for skilled benefits assessors to clear backlogs. External resource engaged to process routine change of circumstances.	4	3	12	Backlogs are not fully cleared (partly due to increased volumes of applicants--due to economic recession). A danger that conveyor belt mentality will affect quality control processes.	The Customer Service Centre is screening initial applicants in order to ensure all paperwork has been provided and to relieve pressure on benefits assessors	4	2	8	M	ongoing	Phil Adlard

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12	**Shared Services Expanded/ Market Testing of services occur**	**£16m of potential future activities**	No further changes occur. Watford provides its services without taking any advantages for economies of scale and fails to achieve further efficiency savings.	political and organisational resistance	customer/ citizen economic/ financial	3	3	9	The Shared Services Management Board/ Watford Council continuously explore opportunities for more effective service delivery.	3	2	6	Failure to identify further opportunities to deliver more effective services will result in no further efficiency savings.	The Council Roadmap initiative is programmed to test the market for circa £8m of servive/ support activity.	3	2	6	Q	ongoing	Leader ship Team
	REPUTATIONAL																			
13	**Continue to Progress Equalities within the Council and across all service delivery**	**Not Quantifiable**	Service efficiencies result in the pursuit of equalities being down graded.	staff rationalisation results in equalities being given a lower priority both within the Council and in the provision of services to all the community.	Customer / Citizen Legislative/Legal Reputational	4	2	8	Equalities champions at Executive Director/ Cabinet level are in place.Quarterly reviews are held. Legislative changes to equalities are being monitored.	4	2	8	The Council will not be seen to support individuals and the community. It will not be recognised as a fair/ good employer.	Leadership Team need to review equalities regularly.. Statistics relating to usage of facilities and complaints processes need to be closely monitored.	3	2	6	Q	Leadership Team Review June 2011	Cate Hall
14	**Failure to adequately support the London 2012 Olympics/ Paralympics**	**Not Quantifiable**	Internationa reputation of UK will suffer. Could result in serious security issues.	Emergency Resonse Plan is deficient. Staff all take leave during Olympic/ paralympic period and results in a lack of volunteer/ support resource to assist visitors	Customer/ Citizen Reputational	4	3	12	Monitoring of Leave put in place. Strategic Risk Management Group / Leadership Team reviewing arrangements.	4	3	12	Council will not have a firm programme detailing how visitors/ security will be dealt with	Emergency/ BCP exercise needs to be tested prior to commencement of Games	4	2	8	M	prior to 27th July 2012.	Bernard Clarke
15	**Hot issues are minimised/have urgent response**	**Not Quantifiable**	Local sensitive issues are not anticipated	Poor customer service/ ill judged policy actions	Customer / Citizen Reputational	3	3	9	service management teams/ Leadership/ quarterly reviews/ Portfolio Holders all in place to anticipate/ avoid adverse issues arising.	3	2	6	Ill judged actions can affect the community and could lead to customer disadvantage/reputational damage. Also lead to financial and legal consequences.	Regular Leadership team meetings include an Agenda Item "hot issues". Portfolio Holders review monthly all sensitive issues	3	2	6	M	ongoing	Leader ship Team
	FUNCTIONAL																			
16	**Rationalisation of staffing is seamless**	**Not Quantifiable**	The service prioritisation programme will result in staff rationalisation. Any consequent gaps need to be identified so that service delivery/ statutory requirements are not affected.	service efficiency programme will result in reduced staffing levels	Customer / Citizen Legislative/Legal Reputational	3	3	9	Rationalisation commenced in Spring 2011. No deficiencies have been identified to date..	3	3	9	Lack of staff resource / management capability will result in potential breakdown in service delivery.	Phase 2 of staff rationalisation to commence in Spring 2012 and Leadership Team need to closely monitor.	3	2	6	Q	Jul-12	Leader ship Team
17	**ICT platform fit for purpose**	**Not Quantifiable**	Unreliability of system affects corporate efficiency and results in considerable staff downtime and failure to deliver full service to the public.	configuration of servers/ SAN not efficient	Customer / Citizen Econmic/ Financial Reputational	4	3	12	External assistance has been engaged. Server replacement/ SAN programme well advanced.	4	3	12	Service delivery and staff efficiency badly affected	Current proposals to change platform structure needs to be completed urgently.	4	2	8	M	Jun-12	Avni Patel
18	**Ensure the Control Environment across the authority reflects the changing nature of fraudulent activity**	**Not Quantifiable**	Increasing sophistication of fraud, particularly cyber fraud could result in significant financial losses	moral standards in society falling. Financial hardship encouraging innovative ways to obtain money.	Financial / reputational/	4	3	12	Regular fraud up dates distributed to all staff. E learning module on intranet	4	3	12	Risks of fraudulent access to council's accounts still remain	Annual Audit Plan includes resources to test the council's resiliance against cyber crime	4	2	8	Q	ongoing	Alan Power
19	**Review Corporate/ Service Plans**	**Not Quantifiable**	Corporate and Service Plans become stale and fail to engage with staff.	Other competing priorities has meant the CP/ SP process has been treading water.	Customer / Citizen Reputational	3	3	9	service management teams/ quarterly reviews/Leadership Team need to give this a higher priority.	3	3	9	The Vision , values & key objectives are not recognised by all staff.	Learning and Development initiatives to encourage awareness. Staff survey carried out. Appraisals in place	3	2	6	Q	Sep-12	Kathryn Robson
20	**Assess impact of major changes to funding by Government through Business rates Retention and Local Council Tax Benefits schemes**	**Not Quantifiable**	WBC may lose a significant amount of financial support from Central Governemnt	Complete overhaul of the way local authorities are funded combined with the need to reduce public expenditure	Financial/ Reputational/ Citizen/ customer	4	4	16	5 Year projections of business rate base to take place. Local council tax benefit scheme to be drawn up	3	3	9	Unless the new systems are understood there is a danger that the Council will fail to plan for their consequences	Discussions with County Council and other herts districts to potentially reduce our risk exposure.	3	2	6	Q	Jul-12	Bernard Clarke

GUIDANCE ON COMPLETING THE RISK ASSESSMENT MATRIX

DATE: *when evaluation completed*		***NAME:*** *of person completing assessment; may vary from risk*			***POST:*** *of person completing assessment*						***DEPT/ UNIT: Risk***				
RISK ASSESSMENT MATRIX v 1.6															
RISK ASSESSMENT NUMBER: ***consecutively from 1 (the 1st assessment) this allows for accurate version control and provides an audit trail of treatment/controls etc***															
BUSINESS OBJECTIVE: *External Relations:* *Please state your departmental objective here - as risks to achieving this objective should be considered*															
RISK TYPE: STRATEGIC, OPERATIONAL or BOTH (delete as necessary) strategic type would affect the 3-5 year planning process, operational type would affect day-to-day activities & both is an operational risk with a strategic impact															
CODE	***RISK***	***CAUSES***	***ASSESSMENT OF RISK*** (no controls in place for first assessment and controls in place thereafter)				***ASSESSMENT OF RISK*** (With controls in place – Residual Risk Rating)				***CONSEQUENCES***	***FURTHER CONTROLS REQUIRED***	***REVIEW FREQUENCY (A, Q, M)*** annually, quarterly or monthly	***DATE OF NEXT REVIEW***	***OWNER***
			Categories of risk	***SEVERITY***	***LIKELIHOOD***	***RISK RATING***	***Control measures in place?***	***SEVERITY***	***LIKELIHOOD***	***RESIDUAL RISK RATING***					
sequential numbering of risks - see appendix 2. If risk is no longer relevant number must **NOT** be reused	A risk is the threat that an event or action will affect the Council's ability to achieve its objectives and to successfully execute strategies. To help identify risks one can think of political, environmental, social technological, economical and legal threats. In addition to this please consider the risks that can occur which may prevent your area from achieving objectives as set in the Corporate/Community Plan; impact on Use of Resources and also CPA/CAA etc	these are the events, circumstances and/or situations that give rise to the risk being created	see Appendix 1 - Categories, you can include 1 or more categories depending on the risk	scored on a scale of 1 - 4; 1 being the lowest and 4 the highest; **before controls** in place		automatically calculated and formatted	these are controls currently in place which have currently reduced the likelihood of the risk materialising; these are usually in the form of internal controls systems, policies and procedures, regular meetings etc	scored on a scale of 1 - 4; **with controls** in place		automatically calculated and formatted	this is the result of the risk if and when it occurs and can include loss of business, negative/bad reputation, breakdown or partnership working, financial loss (please state financial loss in monetary terms where possible)	further controls are needed where a residual risk rating is shown as amber or red i.e. medium or high. **These risks will be shown on the treatment plan.**	this will depend on the risk rating, how effective controls are, cost implications of controls etc	this should be a **realistic** date when the next review of the risk including adequacy if the controls should be completed, this must be matched to the review frequency	the person responsible for implementing and reviewing control measures

Note

Severity can be viewed in four categories/ matched to scores

1.	Minor	Any annoyance that does not disrupt service provision or has only a localised impact contained within the council/service affected. No media or public knowledge of incident
2.	Significant	Short -term partial failure, no media interest, limited financial losses or disruption to service provision.
3.	Serious	Short-term total service failure or prolonged partial failure, possible local media interest, possible financial losses or injuries
4.	Major	Total service failure, high financial losses, possible national media criticism, local media interest or possible fatalities/severe injuries

Likelihood can be viewed in four categories/matched to scores:

1.	Remote	Little or no likelihood of occurring
2.	Unlikely	Some likelihood of occurring
3.	Likely	Significant likelihood of occurring
4.	Very likely	Near certainty of occurring

Agenda Item 9

PART A

Report to: Audit Committee

Date of meeting: 14^{th} March 2012

Report of: Audit Manager

Title: Internal Audit Strategy and Annual Work Plan 2012/2013

1.0 **SUMMARY**

This report sets out an Internal Audit Strategy and Annual Work Plan for the coming financial year for Watford BC and Three Rivers DC.

2.0 **RECOMMENDATIONS**

2.1 The 2012/2013 Internal Audit Strategy and Annual Work Plan be approved.

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

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

3.0 **DETAILS**

3.1 The Committee approves the Internal Audit Strategy and Work Plan on an annual basis. Since 2010/2011 the plans have also been approved by Three Rivers DC under the Shared Services arrangement.

3.2 The Audit Strategy sets out the objectives of Internal Audit for the coming year and the Audit Plan shows the programme of audits proposed to meet those objectives.

3.3 The Audit Plan for 2012/13 has been drawn up by the Audit Manager after reviewing the available service and corporate plans and risk registers, reviewing the recommendations from previous Internal Audit and external audit reports and consulting with senior officers. It is based on an assessment of the internal and external risks facing both councils and is designed to meet the requirements of the external auditors.

3.4 The three IT audits listed are already committed to be carried out by Deloitte. The audits of the key financial systems are also expected to be undertaken on a regular basis in accordance with the managed audit approach agreed with the external auditors.

3.5 The work will primarily be undertaken by Internal Audit (Shared Services) with additional resource being bought in (IT work only). In the last financial year the in-house resource was reduced from 3.78 FTE to 2.78 FTE, resulting in a saving of £55,230 on the Shared Service budget for Internal Audit.

3.6 Despite the reduced resource, it is considered that the planned audits for 2012/13 will provide adequate coverage of the key risks for that year, having been prepared with reference to the councils' strategic planning documents and risk registers and having consulted senior staff on their concerns for the year.

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.

4.3 Potential Risks

4.3.1

Potential Risk	Likelihood	Impact	Overall score
The plan is rejected and internal audit work is delayed until an acceptable plan can be produced.	1	3	3

<u>Appendices</u>

1 Audit Strategy 2012/13
2 Annual Audit Plan 2012/13

<u>Background Papers</u>

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 working papers

<u>File Reference</u> – None

Appendix 1

THREE RIVERS DISTRICT COUNCIL
&
WATFORD BOROUGH COUNCIL

INTERNAL AUDIT SERVICE

AUDIT STRATEGY 2012/2013

Standard 7 of the CIPFA Code of Practice for Internal Audit in Local Government in the UK (2006) requires the Audit Manager to produce an audit strategy as a high level statement of how the service will be delivered. The Standard also states that the strategy should be approved, but not directed by, the Audit Committee.

This Audit Strategy document supplements the approved Finance Service Plan with a more detailed demonstration of the link between the key corporate priorities of the two authorities, Internal Audit Service priorities and the work of individual auditors. The Strategy also records how the Service's Audit Plan priorities have been determined for 2012/13 and how the service is to be delivered.

1 Service Centre

Internal Audit Service – in-house provision with additional external resource for ICT audit.

2 Lead Officer

Mark Allen – Audit Manager

3 Service Statement

Internal Audit is an assurance function that primarily provides an independent and objective opinion to the Councils on the control environment (comprising the systems of governance, risk management and internal control) and evaluates its effectiveness in achieving the Councils' objectives. Audit objectively examines, evaluates and reports on the adequacy of the control environment as a contribution to the proper, economic, efficient and effective use of resources.

4 The Nature of the Service

4.1 The Service's overall objective is to provide an adequate and effective system of internal audit of the Councils' accounting records and systems of internal control in accordance with the proper practices in relation to internal control.

4.2 The Accounts and Audit (England) Regulations 2011 require that the Councils must undertake an adequate and effective internal audit of their accounting records and of their systems of internal control in accordance with the proper practices in relation to internal control. Guidance to the Regulations 2003, which has yet to be superseded, states that this provision should comply with CIPFA's *Code of Practice for Internal Audit in Local Government in the UK* (the Code). This Code was last revised in 2006. It requires the Audit Manager to provide a written report to those charged with governance timed to support the Annual Governance Statement. It sets out various matters to be commented on in the report including the requirement to give "an opinion on the overall adequacy and effectiveness of the Council's control environment". The work the Service undertakes throughout the year is planned to enable the Audit Manager to provide such an opinion.

4.3 Internal Audit's performance against the Code's standards will be monitored on an annual self- assessment basis with the results being reported to the two Audit Committees.

4.4 Internal control systems are all those processes which are set up by management to safeguard assets, ensure reliability of records, promote operational efficiency and monitor adherence to policies, regulations and directives. Internal Audit is not confined to the review of financial processes but has the freedom to review any council activity.

4.5 Internal Audit is an aid to, but not a substitute for, good management.

4.6 The Code also states that the audit work plan must be fixed for a period of no longer than one year. This is a reflection of the difficulty in predicting changes over the longer term when the range of services provided and the manner of service provision is likely to change substantially. The annual work plan enables Internal Audit to concentrate on issues of immediate significance to the Councils as well as covering the external auditor's requirements under the "Managed Audit" approach. A longer term database of potential areas for audit in both authorities is maintained by the Audit Manager.

4.7 When setting up the audit plan reference is made to the Councils' risk management processes (strategic and service based) to identify the key risks facing each council. The Audit Manager maintains a fraud risk register which is used as a supporting element of the planning process. Discussions are also held with heads of services to identify any areas of concern they may have which could feed into the work programme.

4.8 Reference has been made to committee minutes, corporate plans, individual service plans and previous work undertaken by the Internal and External Auditors, as sources of information for determining activities to be covered by Internal Audit. Relevant national, professional and local publications are also used as a source of planning material to ensure possible external developments are also accounted for.

4.9 Systems based audit work will be carried out in a manner which meets the requirements of the external auditors. Most resource will be directed at the key systems as defined under the "Managed Audit" approach.

4.10 As concern grows nationally about the prevalence of fraud in both the public and private sectors, a number of audits have been included in the plan which, it is intended, will provide assurance that the Councils' arrangements for the prevention and detection of fraud remain effective. These include specific audits on fraud governance and fraud risk management as well as time allocated to work on cyber crime awareness and prevention measures and the Councils wider corporate governance and risk management arrangements that contribute to the prevention of fraud.

4.11 A contingency allowance has been made for fraud investigations although this aspect of fraud work is increasingly being undertaken by the Fraud Team. As this happens, Internal Audit will work closely with the Fraud Team to identify system weaknesses which may have allowed the fraud to be committed and will recommend measures to address them. It is management's responsibility to ensure that adequate control procedures are in place to deter and detect fraudulent activity, not Internal Audit's or the Fraud Team's. Audit resources will be directed towards detecting fraud in those activities which are widely recognised as being susceptible to fraud (e.g. housing benefits), recognising that the current uncertain economic circumstances could lead to the increased risk of fraud.

4.12 Consultancy work undertaken in the past has largely consisted of providing advice and has generally been of a reactive rather than proactive nature. In a shift from the previous approach, Internal Audit will now positively seek consultancy type work. As such work is undertaken the terms of reference will make it clear that it is not being carried out in the capacity of Internal Audit's assurance provision role and the Audit Committee will be advised accordingly. The audit plan for 2012/13 reflects an allocation of time for consultancy work.

4.13 The allocation of resources will be set out in the annual audit plan. This Audit Strategy and the audit work plan will be presented to both Audit Committees for approval.

4.14 All Internal Audit recommendations will be followed up to ensure implementation. This will be through seeking written confirmation from those individuals with named responsibility for implementing specific recommendations on a quarterly basis and by review during the next audit of that activity. The follow up procedure for Watford was amended in 2011/12 to enable the provision of additional data to the Audit Committee. In the case of Three Rivers, all outstanding recommendations will then be reported to the Audit Committee.

4.15 At the end of the year the work undertaken will be sufficient to enable the Audit Manager to provide an opinion on the effectiveness of the control environment during 2012/2013.

5 Key Service Priorities for 2012/2013

5.1 For Watford, the budget reductions and subsequent introduction of new ways of working prompted by the Service Prioritisation programme and ongoing reassessment of service provision through the Road Map programme requires a significant change in the way the reorganised services will operate.

5.2 Budget pressures within services at Three Rivers and the council's continued search for new ways to improve customer service, may also have an impact on the way services operate. Audit time will be devoted to assessing the councils' processes for effectively managing these changes, including through their project and change management, risk management, corporate governance and procurement arrangements.

5.3 Further, the audits of affected functions next year, and in future years, will incorporate work to ensure that changes do not mean a weakening of controls. The work will also be aimed at providing assurance to the external auditors that the key, managed audit, systems continue to operate effectively for both councils.

5.4 The identification of opportunities for enhancing the value for money achieved by audited services will continue to be a requirement of every audit.

5.5 Internal Audit will continue to raise awareness of "best practice" in operation in both councils and seek to introduce these from one council to the other, as identified during the course of audit work.

5.6 It is widely accepted that the changed global economic circumstances are likely to result nationally in an increase in attempted fraud. Fraud risk assessments have been reviewed and the higher risk functions (especially Housing Benefit) remain a focus for Internal Audit attention. The councils' wider arrangements for the identification of fraud risks and the prevention and detection of fraud will receive specific attention in 2012/13.

5.7 Internal Audit will remain alert to the possibility of fraud in all the reviews it undertakes – recognising that robust internal controls and staff vigilance are key to minimising the risk of fraud.

5.8 As the majority of council services are now reliant on IT for their delivery, the increasing publicity highlighting the prevalence of cyber crime as a means of committing fraud and of preventing normal service delivery through Denial of Service (DoS and D(distributed)DoS) attacks has brought this to the fore as an area that Internal Audit must cover. Time allocation has been given within the audit plan for 2012/13 to work at both councils on raising awareness of, and determining the mitigating action against, the range of issues that fall under the heading of cyber crime.

5.9 The Audit Manager will continue to ensure that Internal Audit operates in accordance with CIPFA's expected standards. Procedures will also be designed to meet the external auditor's requirements. The extent to which the external auditors continue to place reliance on the work of Internal Audit will act as measure of success in achieving this objective.

6 How has the service translated the key corporate priorities into service delivery?

6.1 In overall terms the Internal Audit Service seeks to support all corporate objectives/strategic themes by promoting the economic, effective and efficient use of limited resources through a continuous process of service reviews. In addition, the Service will review the effectiveness of actions taken to mitigate those key risks likely to prevent the achievement of corporate objectives or affect the ability to provide continuity of service.

6.2 Internal Audit will also examine the integrity, accuracy and security of data produced by the various systems as this forms the base on which decisions re future service provision and other initiatives are made.

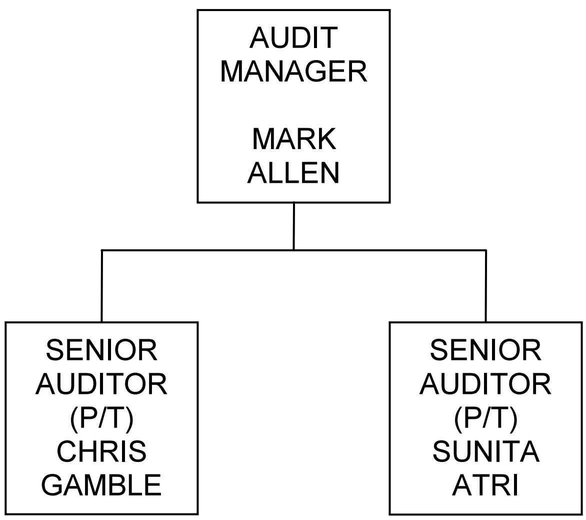
6.3 Details of the work to be undertaken by Internal Audit are set out in the 2012/2013 work plan.

7 Resource Requirement

7.1 It is anticipated that with the given contingency allowance built into the Audit Plan, the existing in-house resource supplemented by the IT audit resource from Deloitte and Touche will be sufficient to meet both Councils' requirements for 2012/2013.

7.2 The staffing resource for the in-house team has reduced from 3.8 FTE in 2010/11 to 2.8 FTE in 2012/13. In addition to the Audit Manager there are two Senior Auditors. The Audit Manager and all Senior Auditors hold recognised Institute of Internal Auditors (IIA), qualifications. In addition, the Audit Manager has the Association of Accounting Technicians qualification (AAT). All staff have in excess of 5 years experience of internal audit work in local government.

7.3 Existing in house team.



8 Monitoring and Evaluation

8.1 The Audit Manager will continuously monitor progress against the Audit Plan and local performance indicators. Progress will be reported to the Audit Committees on a quarterly basis.

8.2 Performance Indicators 2012/2013:

Indicator	Target
Actual “chargeable” days as % of planned	85%
% Audit plan completed (an annual assessment based on the number of audit projects)	92%
% Final audit reports issued on time	100%
Client satisfaction score	94%

8.3 Staff performance will be reviewed during and at the completion of individual audits by the Audit Manager and through the Watford performance appraisal process.

8.4 The external auditors review the work of Internal Audit annually to ensure that they can continue to rely on our work.

8.5 The Audit Manager’s comparison of performance against CIPFA’s Code will contribute towards the overall assessment of the effectiveness of Internal Audit.

9 Risk Assessment

Internal Audit faces one significant risk, related to the long term absence of staff affecting the delivery of the Audit Plan.

Audit Manager
February 2012

Risk Ref	Risk Title/ *Description*	Consequence	Likelihood 4=Catastrophe 1=H. Unlikely	Impact 4=Catastrophe 1=H. Unlikely	Risk Rating	Responsibility	Existing Control Procedures	Likelihood 4=Cat 1= H. U	Impact 4=Cat 1=H. U	Risk Rating
IA 1	Loss of staff for an extended period.	Failure to achieve audit plan. Failure to complete work on key systems. Criticism from external auditors and loss of internal credibility.	3	4	12	Audit Manager	Use of contingency allowance. Forward planning. Reorganise work to ensure key systems are prioritised.	2	3	6

	Options for additional/replacement control procedures	Cost/Resources	Likelihood 4=Cat 1=H. U	Impact 4=Cat 1=H. U	Risk Rating
	Buy in additional resource sufficient to achieve minimum cover required for the provision of an audit opinion re adequacy of the internal control environment.	Depends on experience of auditor and length of time involved.	2	2	2

Reviewed February 2012

Appendix 2

THREE RIVERS DISTRICT COUNCIL AND WATFORD BOROUGH COUNCIL

DRAFT ANNUAL PLAN 2012/2013

AUDIT	DAYS SHARED SYSTEMS	DAYS WATFORD BC	DAYS THREE RIVERS DC
Payroll	14		
NNDR	12		
Council Tax	12		
Benefits	15		
Creditors	11		
Debtors	11		
FMS: Reconciliations	14		
FMS: Journals and Internal Transfers	5		
Asset Management and Capital Accounting - implementation of Asset Strategy/Asset Management plans		6	6
Income Collection including post implementation review of new income management system.	16		
Treasury Management	9		
Budget Monitoring (including achievement of savings for WBC)		7	7
Recruitment - follow up	5		
eFinancials Upgrade - including preparations for close down and reconciliation of current version	7		
Benefits Subsidy Claims		5	5
Cyber-crime awareness and prevention. Include appropriate insurance cover plus implications from the national strategy. Including use and control of social media to minimise potential for reputational damage.		10	10

AUDIT	DAYS SHARED SYSTEMS	DAYS WATFORD BC	DAYS THREE RIVERS DC
Preparations for providing Council Tax support from April 2013	5		
Bribery Act 2010 and money laundering arrangements - implementation of "adequate" processes and follow up from 2011/12 work		5	5
Final Accounts 2011/12 Preparations within Finance	5		
Project Management and Change Management		6	6
Risk management arrangements - strength of identification and treatment processes and follow up on previous recommendations.		5	5
Fraud Good Governance Checklist from "Protecting Public Purse 2011" by Audit Commission + Fighting Fraud Locally NFA Strategy awaiting publication; plus Review of fraud risk identification and Fraudulent Activity Risk treatment plans		8	8
Channel Shift Programme		5	
Implementation arrangements for new ICT services:- Advisory involvement and review of key documents as they are developed in the lead up to changes to ICT service provision during 2012/13	7		
Charter Place Market and Commercial Rent Income		5	
Emergency Planning Processes (Olympics readiness)		5	5
Partnerships - management and monitoring of delivery of Community Strategy Priorities		5	5
Carbon Management - processes for measuring, monitoring and reporting on the councils' own performance.		4	4
Procurement - Development and Implementation of Action Plan from SPS Consultancy report of October 2011			5

AUDIT	**DAYS SHARED SYSTEMS**	**DAYS WATFORD BC**	**DAYS THREE RIVERS DC**
Procurement - application of best practice following employment of new Procurement Manager - to include contract management arrangements - existing and development of new ones - consistently robust approach across the council.		7	
Data Protection arrangements		5	5
Data Transparency - processes for meeting government requirements whilst minimising vulnerabilities.		5	5
Commissioning framework for Community Services - advisory role		5	
Museum - care of the collection		5	
Housing redesign - advisory support		5	
Corporate Governance arrangements		5	5
Colosseum - Post Implementation Review - lessons learned from the project		5	
Tree Surveying arrangements			5
Monitoring arrangements for Hertsmere Leisure contract			5
Leisure Developments payments operations and systems including use of the Plus II booking system.			5
Customer complaints and comments management – learning from customer feedback			5
Monitoring and management of the Sustainability Action Plan /Climate Change Strategy Plus Review of sustainable transport.			7
The South Oxhey Initiative – advice and support.			5
Online expense claims – via ResourceLink	5		

AUDIT	DAYS SHARED SYSTEMS	DAYS WATFORD BC	DAYS THREE RIVERS DC
Consultancy/VFM/project work/advisory support identified during the year *		20	5
West Herts Crematorium	4		
Special Investigations	20		
Contingency	25		
Totals **463**	**202**	**138**	**123**
Split of Days including Shared Service Time and Consultancy Time		52%	48%
Split of Days excluding Shared Service and Consultancy Time		50%	50%

* Watford will require Internal Audit to carry out company searches/credit rating and ad-hoc benchmarking exercises.

IT AUDITS FOR DELOITTES NOTE: THESE ARE SUBJECT TO CHANGE AS ICT ARRANGEMENTS EVOLVE DURING 2012/13	DAYS SHARED SYSTEMS	DAYS WATFORD BC	DAYS 3 RIVERS DC
IT - Network Infrastructure	10		
IT - Virtualisation	10		
IT Governance	9		
Totals	**29**	**0**	**0**

Agenda Item 10

PART A

Report to: Audit Committee

Date of meeting: 14th March 2012

Report of: Audit Manager

Title: Implementation of Internal Audit Recommendations

1.0 SUMMARY

This is the Audit Manager's regular report on progress with the implementation of Internal Audit recommendations. It provides an update on those recommendations reported to Audit Committee as outstanding in January with information from the first round of follow up using a new follow up process.

2.0 RECOMMENDATIONS

2.1 The contents of the report be noted.

Contact Officer:
For further information on this report please contact: Mark Allen – 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 Officers have responded well to the new follow up system, with a 100% reply rate following one reminder.

3.2 The table below summarises progress in implementation of the recommendations for 2010/11 and 2011/12 to date.

Year	Total Recommendations. made	Implemented	Not yet due	Request for extended time	Outstanding	% age Implemented
2010/11	213	184	14	15	0	86
2011/12	44	26	15	3	0	59

3.3 The 15 requests for extended time for 2010/2011 audits are broken down as follows:

Payroll = 1
Benefits Administration = 1
Council Tax Administration = 2
NNDR Administration = 3
Reconciliations = 2
Asset Management = 1
Data Quality = 1
Health & Safety = 2
IT Service Desk/Change Management = 2 on hold

3.4 **Procurement.**
Since the last report to Audit Committee (January 2012), the Procurement Manager has worked on the promotion of good procurement practice, allowing the last outstanding recommendations to be implemented.

3.5 **Health & Safety Follow Up**
34 of the original 36 recommendations are now reported to have been implemented or are no longer required. The remaining 2 recommendations have been given extended deadlines whilst progress is made towards their implementation.

3.6 **IT Service Desk / Change Management**
Following the 12 week change freeze period, 2 of the 4 outstanding recommendations from this report have now been implemented.

The final 2 recommendations, relating to the service catalogue and service desk response times, remain on hold pending the decision on the options for future ICT service provision.

3.7 **IT BACS Payments**
Transfer of BACS payments processing to Finance has been completed.

The transfer to Revenues & Benefits is in progress and is reportedly due to be completed by the start of the new financial year.

3.8 **Reconciliations**

As reported in January 2012, the significant resource input by the Finance Managers to implement the new harmonised income management system, including the need to parallel run the old and new systems to ensure that all income data is being imported correctly, limited the resources available for performing in-year reconciliations.

The Finance manager is able to run routines on eFinancials and the Axis income management system to confirm that the systems' cumulative balances align at the time the routine is run. This check has been performed on an ad-hoc basis and was last performed at the end of January 2012, at which point the two systems were in alignment. It was reported that the associated spreadsheet will form the basis of a process for full bank reconciliation. At the date of this report, there have been no formal reconciliations – i.e in a format that has been signed off - of the new income management system to the corresponding general ledger entries on eFinancials.

Bespoke reports from the Academy system have now been written that will automate the majority of the Rent Allowance bank reconciliation and provide the necessary figures for updating eFinancials. For benefit payments, the eFinancials system has been updated during the year using a combination of the payment reports from Academy and corresponding data from the bank statements. However, the formalising of responsibility for performing monthly reconciliations of the Rent Allowance bank account and of the Academy systems to the eFinancials system is still outstanding. No formal reconciliations between Academy and eFinancials or bank reconciliations for the Rent Allowance account have been produced this year.

An action plan has been developed by the Finance Manager to ensure that all in-year reconciliations will be performed effectively in 2012/13.

3.9 **Internal Audit Recommendations for 2011/2012**

Whilst there are no outstanding recommendations to report for audits completed to date for 2011/2012, three recommendations from the Money Laundering report, concerning updates to the e-learning tool, have had their deadline extended from December 2011 to June 2012.

Final reports have been issued for Section 106, Benefit Subsidy Claims, Watford Museum, IT Project Management, Decent Homes Assistance, Construction Industry Scheme, Insurance, Money Laundering and the Vehicle Maintenance contract.

3.10 **Future Reports to Audit Committee**

The information above is summarised from the responses to the last follow up conducted at the end of January/beginning of February this year. The completed table of updates runs to 36 pages.

Should the Audit Committee decide they would like to see the full table at future meetings it can, of course, be provided.

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

<u>Background Papers</u>

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

<u>File Reference</u>
None.

Agenda Item 11

PART A

Report to:	Audit Committee
Date of meeting:	14th March 2012
Report of:	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 2011/2012 Audit Plan in the period 1st April 2011 to 24th February 2012.

2.0 **RECOMMENDATIONS**

2.1 The contents of the report be noted.

Contact Officer:
For further information on this report please contact: Mark Allen – 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 January 2012 to progress the Audit Plan for 2011/2012. Appendix (1) shows the position on individual audits from the 2011/2012 Audit Plan as at 24 February 2012 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 24 February 2012 on the planned audits for 2011/2012 as listed in Appendix 1 has not, at this stage, generated issues that need to be brought to the attention of the Audit Committee, other than as previously reported and as subsequently detailed below.

3.3 **COA (eFinancials) Post Implementation Review** – the draft report for this audit has now been discussed with management and it is anticipated that the final report will be issued shortly.

Key recommendations relating to the taking of corrective action to address weaknesses identified through future penetration testing have been accepted.

3.4 **Recovery of Overpaid Benefits** – An audit management letter has been issued in respect of this audit rather than a full audit report.

The scheduler within the Academy Revenues & Benefits system, which controls the running of processes including the printing of invoices and reminders, has not been performing effectively throughout 2011/12. This, combined with issues relating to the transfer of overpayment data from the previous CIVICA system into the Academy system has meant that only limited work could be performed this year in relation to recovery of overpaid benefits from those previous claimants who are no longer entitled to benefit for either council.

As this was a significant part of the audit, it was considered appropriate to terminate the audit, report these findings, and ensure that the recovery of overpayments is included within the Benefits Administration audit work for 2012/13.

It was reported at the end of February that the issues with the scheduler have now been resolved. A recommendation has been made within the management letter to ensure that any recurrence of the issues during 2012/13 is resolved promptly to prevent an adverse effect on recovery of overpaid benefit.

It should be noted that the issues with the scheduler have not affected the recovery of overpayments through ongoing benefit wherever this is possible. This has contributed to maintaining the recovery percentages throughout 2011/12. The Recovery Team prioritise this as the method for recovery as it is the most cost effective way for the council to recover overpaid benefits.

3.5 **Reconciliations –** The eFinancials system (the general ledger) has been formally reconciled to the payroll system during the year for salaries/wages, tax and National Insurance, pension payments and sundry deductions.

The General Account bank reconciliation has now been brought up to date to the end of January 2012. This is an improvement from the previously reported position.

Reconciliations are also up to date between the general ledger and the Logotech system for treasury management transactions.

The implementation of a new income management system has, understandably, required significant input from the Finance Managers throughout 2011/2012. It is anticipated that the efficiency benefits of this new harmonised system will be fully realised in 2012/13 and this will have a positive impact on the production of regular reconciliations for cash and banking through the automation of many elements of the process. For 2011/12, the prioritisation of the income management system implementation work has limited the resource available for producing in-year reconciliations of both cash/banking systems and the revenues and benefits systems to the general ledger.

A significant piece of work has been undertaken within Revenues & Benefits to develop reporting routines that will provide expenditure data from the Academy system in a format that will simplify the updating of the general ledger and also demonstrate data integrity between the components of the Academy suite.

Whilst these reports are now being generated from the Academy Revenues & Benefits systems and ad-hoc cross-checking of the data from the Axis Income Management system to the corresponding data on eFinancials has been taking place, it remains the case that:

1. There have been no formal reconciliations during 2011/12 between the eFinancials Financial Management System (the ledger) and the Academy Revenues & Benefits systems for benefits, council tax and NNDR.

2. There have been no formal reconciliations of the eFinancials system to the Axis Income Management system. An onscreen check demonstrated that the systems were in balance at the end of January 2012.

3. The Payments Account bank reconciliation was last fully completed in September 2011. Cheque payments have been reconciled to the end of January 2012 but some outstanding items requiring recoding are preventing a full reconciliation following implementation of the Axis system.

This is a similar position to that reported last year. End of year reconciliations were produced for all systems for 2010/2011 and year end reconciliations will be produced for 2011/2012.

The importance of in-year reconciliations as a source of assurance is fully recognised and an action plan has been developed within Finance to ensure that in-year reconciliations will be produced between the general ledger (eFinancials) and all associated feeder systems throughout 2012/13 and beyond.

3.6 Members are asked to note that the remaining audits that are classed as work in progress in Appendix 1 have been scoped to enable a meaningful opinion to be provided within the remaining time available in this financial year and thereby minimise any overrun into 2012/13.

3.7 Members are also asked to note that the follow up audit of network controls has now been transferred into the audit plan for 2012/13.

This is because the required scope of the audit has changed significantly from being simply a “follow up” of the previous audit to requiring a more in depth review following the substantial changes made to the network infrastructure as a result of the Infrastructure Improvement Programme work performed by ICT.

As such, this is now one of the audits allocated to Deloittes to perform using their dedicated ICT audit team.

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
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

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.

Appendix 1

Work Progress on Individual Audits
2011/2012

Project	Progress as at 24 February 2012	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)	Updated Draft report – 17 10 11	-	
IT - Remote Working (Deloitte & Touche)	Final report – 03 01 12	-	
2010/11 Audits – Total (WBC staff days)		**-**	**26.5**
2011/2012 Audits			
Shared Audits			
Payroll	Work in Progress	15	1.4
Recruitment	Work in Progress	8	9.5
NNDR	Work in Progress	15	7.9
Council Tax	Work in Progress	15	7.9
Benefits	Work in Progress	25	0.5
Creditors	Work in Progress	15	6.7
Debtors	Work in Progress	15	3.6
FMS Reconciliations	Work in Progress	25	3.6
Insurance	Final report – 09 12 11	10	12.4

Project	Progress as at 24 February 2012	Days Allocated 2011/12	Days Taken 2011/12
IT - Network Controls – follow up	Audit Moved to 2012/13	5	
IT - Disaster Recovery and Back-up (Deloittes)	Work in Progress	10	
IT – Project Management (Deloittes)	Final report – 15 11 11	10	10.0
IT - Asset Management (Deloittes)	Work in Progress	5	
IT - Virus Protection (Deloittes)	Work in Progress	5	
COA – Post Implementation Review	Draft report stage	20	20.17
Watford BC			
Income Collection	Work in Progress	15	0.7
Benefits Subsidy Claim	Final report – 17 10 11	8	7.9
Benefits Overpayments	Management Letter to be issued	8	1.4
Treasury Management	Work in Progress	6	0.3
Budget Monitoring	Work in Progress	8	0.3
Construction Industry Scheme (CIS)	Final report 03 01 12	5	6.3
Section 106	Final report – 14 11 11	8	13.2
Financial Procedure Rules	Draft report stage	4	4.6
Hospitality	Draft report stage	3	4.7
Money laundering	Draft report – 29 09 11	5	6.1
Current Contracts (Vehicle Maintenance)	Final report – 22 02 12	10	18.6
Home Improvement Grants	Final report – 02 09 11	10	9.6
Museum	Final report – 12 08 11	10	10.2
CSC	Draft report stage	5	7.0
External Audit Recommendations – follow up	Work in Progress	8	1.6
Additional Audit			
West Herts Crematorium	Final report – 14 07 11	0	1.9

APPENDIX 2

LOCAL PERFORMANCE MEASURES 2011/2012

Criteria	**Target p.a. (as per Audit Plan)**	**Actual To 24 February 2012**	**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	2.52	
Training – average days	4	9.5	Time includes for internal and external seminars and training. All auditors hold a relevant qualification and two are studying for a higher qualification.

Criteria	**Target p.a.**	**Actual To 24 February 2012**	**Comment**
Final audit reports issued within 10 available working days of agreement to draft report.	100%	100%	
Level of customer satisfaction	94%	96.15%	Based on six surveys returned for 2011/2012 to date.

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