

# AUDIT COMMITTEE

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Tuesday, 8 November 2016 at 7.00 p.m.

Town Hall, Mulberry Place, 5 Clove Crescent, London, E14 2BG

**This meeting is open to the public to attend.**

**Members:**

Chair: Councillor Candida Ronald  
Vice-Chair: Councillor Denise Jones

Councillor Sabina Akhtar, Councillor Andrew Cregan, Councillor Ohid Ahmed,  
Councillor Harun Miah and Councillor Craig Aston

**Deputies:**

Councillor Helal Uddin, Councillor Rajib Ahmed, Councillor Marc Francis, Councillor  
Andrew Wood and Councillor Peter Golds

[The quorum for this body is 3 Members]

**Contact for further enquiries:**

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## **APOLOGIES FOR ABSENCE**

- |   |                  |
|---|------------------|
| <b>1. DECLARATIONS OF DISCLOSABLE PECUNIARY INTEREST</b>  | <b>1 - 4</b>     |
| <p>To note any declarations of interest made by Members, including those restricting Members from voting on the questions detailed in Section 106 of the Local Government Finance Act, 1992. See attached note from the Monitoring Officer.</p> |                  |
| <b>2. MINUTES OF THE PREVIOUS MEETING(S)</b>  | <b>5 - 18</b>    |
| <p>To confirm the minutes of the Audit Committee held on Tuesday 20<sup>th</sup> September and the Special Meeting held on Thursday 29<sup>th</sup> September 2016.</p>   |                  |
| <b>3. KPMG ITEMS FOR CONSIDERATION</b>  |                  |
| <b>4. TOWER HAMLETS ITEMS FOR CONSIDERATION</b>   |                  |
| <b>4 .1 Treasury Management Mid-Year Review &amp; Activities Treasury Management Strategy &amp; Investment Strategy 2016/17</b>   | <b>19 - 46</b>   |
| <b>4 .2 Progress on National Fraud Initiative 2016/17</b>   | <b>47 - 52</b>   |
| <b>4 .3 Revised Audit Plan 2016/17</b>  | <b>53 - 110</b>  |
| <b>4 .4 Changes to the Arrangement for Appointment of External Auditors</b>   | <b>111 - 118</b> |
| <b>5. ANY OTHER BUSINESS THE CHAIR CONSIDERS URGENT</b>   |                  |

**Next Meeting of the Committee:**

Tuesday, 31 January 2017 at 7.00 p.m. to be held in the Town Hall, Mulberry Place, 5 Clove Crescent, London, E14 2BG

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# Agenda Item 1

## **DECLARATIONS OF INTERESTS - NOTE FROM THE MONITORING OFFICER**

This note is for guidance only. For further details please consult the Members' Code of Conduct at Part 5.1 of the Council's Constitution.

Please note that the question of whether a Member has an interest in any matter, and whether or not that interest is a Disclosable Pecuniary Interest, is for that Member to decide. Advice is available from officers as listed below but they cannot make the decision for the Member. If in doubt as to the nature of an interest it is advisable to seek advice **prior** to attending a meeting.

### **Interests and Disclosable Pecuniary Interests (DPIs)**

You have an interest in any business of the authority where that business relates to or is likely to affect any of the persons, bodies or matters listed in section 4.1 (a) of the Code of Conduct; and might reasonably be regarded as affecting the well-being or financial position of yourself, a member of your family or a person with whom you have a close association, to a greater extent than the majority of other council tax payers, ratepayers or inhabitants of the ward affected.

You must notify the Monitoring Officer in writing of any such interest, for inclusion in the Register of Members' Interests which is available for public inspection and on the Council's Website.

Once you have recorded an interest in the Register, you are not then required to declare that interest at each meeting where the business is discussed, unless the interest is a Disclosable Pecuniary Interest (DPI).

A DPI is defined in Regulations as a pecuniary interest of any of the descriptions listed at **Appendix A** overleaf. Please note that a Member's DPIs include his/her own relevant interests and also those of his/her spouse or civil partner; or a person with whom the Member is living as husband and wife; or a person with whom the Member is living as if they were civil partners; if the Member is aware that that other person has the interest.

### **Effect of a Disclosable Pecuniary Interest on participation at meetings**

Where you have a DPI in any business of the Council you must, unless you have obtained a dispensation from the authority's Monitoring Officer following consideration by the Dispensations Sub-Committee of the Standards Advisory Committee:-

- not seek to improperly influence a decision about that business; and
- not exercise executive functions in relation to that business.

If you are present at a meeting where that business is discussed, you must:-

- Disclose to the meeting the existence and nature of the interest at the start of the meeting or when the interest becomes apparent, if later; and
- Leave the room (including any public viewing area) for the duration of consideration and decision on the item and not seek to influence the debate or decision

When declaring a DPI, Members should specify the nature of the interest and the agenda item to which the interest relates. This procedure is designed to assist the public's understanding of the meeting and to enable a full record to be made in the minutes of the meeting.

Where you have a DPI in any business of the authority which is not included in the Member's register of interests and you attend a meeting of the authority at which the business is considered, in addition to disclosing the interest to that meeting, you must also within 28 days notify the Monitoring Officer of the interest for inclusion in the Register.

### **Further advice**

For further advice please contact:-

Melanie Clay, Corporate Director of Law Probity and Governance 2017 364 4800

## APPENDIX A: Definition of a Disclosable Pecuniary Interest

(Relevant Authorities (Disclosable Pecuniary Interests) Regulations 2012, Reg 2 and Schedule)

Subject	Prescribed description
Employment, office, trade, profession or vacation	Any employment, office, trade, profession or vocation carried on for profit or gain.
Sponsorship	<p>Any payment or provision of any other financial benefit (other than from the relevant authority) made or provided within the relevant period in respect of any expenses incurred by the Member in carrying out duties as a member, or towards the election expenses of the Member.</p> <p>This includes any payment or financial benefit from a trade union within the meaning of the Trade Union and Labour Relations (Consolidation) Act 1992.</p>
Contracts	<p>Any contract which is made between the relevant person (or a body in which the relevant person has a beneficial interest) and the relevant authority—</p> <p>(a) under which goods or services are to be provided or works are to be executed; and</p> <p>(b) which has not been fully discharged.</p>
Land	Any beneficial interest in land which is within the area of the relevant authority.
Licences	Any licence (alone or jointly with others) to occupy land in the area of the relevant authority for a month or longer.
Corporate tenancies	<p>Any tenancy where (to the Member's knowledge)—</p> <p>(a) the landlord is the relevant authority; and</p> <p>(b) the tenant is a body in which the relevant person has a beneficial interest.</p>
Securities	<p>Any beneficial interest in securities of a body where—</p> <p>(a) that body (to the Member's knowledge) has a place of business or land in the area of the relevant authority; and</p> <p>(b) either—</p> <p>(i) the total nominal value of the securities exceeds £25,000 or one hundredth of the total issued share capital of that body; or</p> <p>(ii) if the share capital of that body is of more than one class, the total nominal value of the shares of any one class in which the relevant person has a beneficial interest exceeds one hundredth of the total issued share capital of that class.</p>

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## LONDON BOROUGH OF TOWER HAMLETS

### MINUTES OF THE AUDIT COMMITTEE

HELD AT 7.00 P.M. ON TUESDAY, 20 SEPTEMBER 2016

TOWN HALL, MULBERRY PLACE, 5 CLOVE CRESCENT, LONDON, E14 2BG

#### Members Present:

Councillor Candida Ronald (Chair)

Councillor Denise Jones

(Mayoral Adviser for Service Quality and Performance)

Councillor Andrew Cregan

Councillor Andrew Wood (Substitute for Councillor Craig Aston)

#### Other Councillors Present:

#### Apologies:

Councillor Ohid Ahmed

Councillor Harun Miah

Councillor Craig Aston

#### Others Present:

Ann Otesanya

– Director of Neighbourhoods Tower Hamlets Homes

John Tunney

– ?Interim Director of Asset Management Tower Hamlets Homes

#### Officers Present:

Claire Belgard

– Interim Head of Integrated Youth and Community Services

Zena Cooke

– (Corporate Director, Resources)

Ronke Martins-Taylor

– Youth Services Development Manager

Bharat Mehta

– (Audit Manager)

Kevin Miles

– (Chief Accountant, Resources)

Tony Qayum

– (Anti-Fraud Manager, Risk Management , Resources)

Antonella Burgio

– (Democratic Services)

#### 1. DECLARATIONS OF DISCLOSABLE PECUNIARY INTEREST

Councillor Denise Jones declared an interest in respect of item 4.4 in that her daughter had recently become Chair of Governors at a borough school.

#### 2. MINUTES OF THE PREVIOUS MEETING(S)

The minutes of the meeting held on 28 June 2016 were approved as a correct record of proceedings.

### 3. UNRESTRICTED KPMG REPORTS FOR CONSIDERATION

Item deferred.

### VARY ORDER OF BUSINESS

The Chair moved and it was

#### RESOLVED

That the order of business be varied. Accordingly, Item 4.4 was considered after Item 4.1. Following this the Committee considered the agenda items in the order published.

### 4. UNRESTRICTED TOWER HAMLETS REPORTS FOR CONSIDERATION

#### 4.1 Quarterly Internal Audit Assurance Report

Minesh Jani, Head of Audit and Risk Management presented the report which is summarised the work of Internal Audit for the period June to August 2016

Members noted that:

- the chart “analysis of assurance levels” indicated that, of the audits carried out during the period, 85% had returned a substantial assurance (23 audits) and 15% (four audits) had returned a limited assurance. No audits in the period had returned a nil assurance.
- discussion of the audit of Community Languages had been brought forward from the previous meeting

#### *Community Language Service*

The Head of Audit and Risk Management introduced the item informing Members that a nil assurance had been returned because of concerns around governance arrangements in the following areas:

- performance management framework and KPIs were not sufficiently robust
- some SLAs had not been properly signed
- there was no audit trail for visits undertaken
- some DBS checks were not robust
- authorisations of payments was not robust

Shazia Hussain, Service Head, Culture, Learning and Leisure responded to the matters raised. The Committee was informed:

- issues around governance had been recognised upon the transfer of the Community Language Service to CLC directorate in 2013
- a review of Teaching and Learning was undertaken swiftly
- she had requested the audit following concerns raised by the Head of Ideas Stores
- the outcome of the audit had enabled targeted intervention to be undertaken. To this end:
  - structures and processes had been put in place
  - training delivered on policies and procedures

- SLAs and the register had been standardised
- there was an ongoing service review to establish evaluation criteria

Responding to Members' questions the following were noted:

- the service standards had been regularised and now it was aimed to ensure that there was standard access across the borough and progression in the courses
- the objectives of the service were revised and integrated with formal qualifications for 6 community languages. The Primary Modern Language part of the service would be transferred to Children's Services Directorate and the Assessment Service would cease
- measurement of the effectiveness of the service was incorporated into the adult learning monitoring arrangements
- compliance with required DBS and other checks would be maintained through whole Council arrangements to audit and monitor DBS and other checks
- although Ideas stores presently were not able deliver course evaluations, they were investigating how staff could be trained to do this through Adult Learning Services
- provision of satisfactory premises would be ensured as facilities formed part of the SLA for providers
- there were 100 sessional tutors and it was intended to review these to ensure that provision was standardised

#### *Tower Hamlets Homes (THH) Major Works*

The Head of Audit and Risk Management introduced the item informing Members that a limited assurance had been returned for the following reasons:

- poor administration of notices
- some policies were out of date
- co-ordination between teams was inconsistent

Ann Otesanya and John Tunney of THH responded to matters raised and provided the following information:

- a new executive team was now in post at the organisation and a review of major works was being undertaken which included an investigation into improving consultation and communication with residents around projects
- co-ordination between teams concerned the Decent Homes Programme and this was expected to improve as this programme would now be delivered in smaller groupings/blocks
- THH would ensure that contractors had delivered the works via a clerk of works and project manager. Additionally spot-checks would be carried out and inspections with residents undertaken
- quality of works would be ensured via supplier inspections and drone surveys of roof work
- complaints regarding scaffolding have been addressed by implanting a new approach to repairs and maintenance which engages with residents from the outset to reach a consensus on repair vs replacement of fixtures

- staff would be trained to deal with vulnerable and disabled residents

#### *THH Corporate Health and Safety*

The Head of Audit and Risk Management introduced the item informing Members that a limited assurance had been returned for the following reasons:

- a dashboard indicating areas of health and safety oversight was not effective
- tracker spreadsheet is not up-to-date
- Fire marshal/first aider log is incomplete
- No schedule of visits available to inspect
- Some logs in the incident book incomplete

John Tunney of THH responded to matters raised and provided the following information:

- a health and safety manager had been recently employed to regularise arrangements
- the dashboard had been simplified and focused on key areas of compliance
- the health and safety policy had been refreshed and signed by the Chair of THH Board
- focus going forward was to be health and safety training and establishment of an inspection programme
- incident reporting has been publicised within the organisation

THH was confident that the measures reported would ensure a robust health and safety framework going forward.

#### *Award of Concession Contracts Review*

The Head of Audit and Risk Management introduced the item informing Members that a review had been carried out following a complaint about the tender of ice-cream pitches in Victoria Park. The complainant felt his complaint had not been properly addressed and made a further enquiry under the Whistleblowing procedure. The review found:

- the process was over-complicated and unclear. This led to confusion in the execution of the re-letting procedure
- there was inconsistency around assessment of applications
- some officers were involved in the whole procurement cycle
- technical matters in the original complaint were not addressed

IT had not been possible to assign an assurance level to the review as it was the result of a complaint. However an outcome of the audit is a recommendation that the historic arrangements for re-letting contracted were not continued.

Shazia Hussain, Service Head, Culture, Learning and Leisure responded to the matters raised informing the Committee that:

- the complaint had been investigated and revealed that staff had not acted improperly
- a new procedure for lettings had been adopted and a new tendering process initiated

- the procurement procedure had been simplified and an online method adopted to prevent future errors
- staff had been re-trained and support put in place

The Head of Audit and Risk Management responded to Members questions informing them that:

- the complainants concerns had been responded to
- the issue had not been picked up prior to the complaint as the matter concerns contract management and requires skills in this field to be detected
- Audit has reviewed the complaint with the Complaints Team and recommended that there are skills in the team to answer this category of complaint

The Chair asked that after the tendering letting process, that a report be made to Audit Committee

**Action by:** Shazia Hussain, Service Head, Culture, Learning and Leisure/  
Minesh Jani, Head of Audit and Risk Management

#### *Youth Services Review*

The Head of Audit and Risk Management introduced the item informing Members that a review had been carried out following a number of complaints about irregularities and fraud between 2013 and 2015. Therefore a full audit for governance, management and risk management had been carried out. The audit revealed that there had been failings in governance, financial management and monitoring. In 2016, 37 visits were undertaken which found:

- Most organisations had a good session plans
- 6 organisations provided indoor games only
- there were attendance sheet inconsistencies
- there were health and safety concerns around 8 organisations
- there were antisocial behaviour concerns around one organisation

Responding to Members' questions, the Head of Audit and Risk Management advised that:

- the issue had not been discovered sooner as although youth services were mentioned in PWC report, there was no indication that the matters/issues might be connected
- further issues came to light when statutory officers determined that a full audit was required as there were a number of issues with the provision
- remedial action was delayed because there had been insufficient management control and monitoring
- since the issues were raised in isolation, alerts to management/finance were slow to be made
- caps on spending could not be effectively implanted as monies could be spent via the Internet and other virtual methods
- Credit Card issue to staff was controlled by management.

The Committee requested an analysis of the number of credit cards issued to staff, the average spend per card and an analysis of the spend

**Action by:** Minesh Jani, Head of Audit and Risk Management

Clare Belgard, Interim Head of Integrated Youth and Community Services and Ronke Martins-Taylor Youth Services Development Manager responded to Members questions informing them that:

- Ms Belgard had been in post since November 2015 and had put in place strong controls around management and financial processes
- service plans were scrutinised to ascertain quality of delivery
- Mazars had been asked to carry out audits and their findings used to inform the introduction of a new model of delivery which contained better controls and planning
- new strategic proposals for youth services would be developed, moving away from grant-based arrangements to those based on commissioning
- commissioning basis would provide stronger procurement and specification of services
- unannounced inspection visits would be undertaken
- From September 2016, post-summer youth activities would be commissioned from the 3<sup>rd</sup> Sector on a fixed term basis with the aim of achieving better monitoring and efficient services.
- Future delivery would be safeguarded by a proactive communications strategy to promote positive messages about the service and by utilising lessons learned to inform better procedures, infrastructure and governance arrangements for the service
- Youth services employed 170 staff spread across 90FTE roles
- The 5 year plan for the service was to achieve a gold standard service and deliver a vision to reach all young people in the borough. This would be achieved by first listening and responding to young people and from there develop services that would be owned by them.

#### *Langdon Park and Stewart Headlam Schools Audits*

The schools audits carried out in the quarter were considered as part of agenda item 4.4.

### **RESOLVED**

That the contents of this report be noted and Members take account of the assurance opinion assigned to the systems reviewed during the period.

#### **4.2 Risk Management Annual Report 2015/16**

Minesh Jani, Head of Audit and Risk Management presented the report which informed members of the annual review of the Council's risks and the measures in place to categorise prioritise them and so that it can identify how deliver effective risk management.

Members considered the report and indicated that they had no comments that they wished to make.

### **RESOLVED**

1. That the contents of the report be noted;
2. That the actions highlighted at section 9 of the report be agreed;
3. That the corporate risks (table 2 on pages 7 and 8 of the attached paper) be noted ; and
4. That the risk owner(s) identified in the report requiring further scrutiny provide a detailed update on the treatment and mitigation of the risk including impact on the corporate objectives at its December meeting.

### **4.3 Annual Governance Statement 2015-16**

Minesh Jani, Head of Audit and Risk Management presented the report which provided the Audit Committee with an oversight of the authority's processes to facilitate the identification and management of its significant business risks. The report also included a summary of the Q1 2016/17 Corporate Risk Register and Risk Management Team activity over the last 12 months.

Members were asked to consider

- the actions highlighted at section 9 and whether they were minded to endorse them.
- The corporate risks identified and whether any other risks should be considered.

### **RESOLVED**

1. That the contents of the report be noted;
2. That the actions highlighted at section 9 be agreed;
3. That the corporate risks (table 2 on pages 7 and 8 of the attached paper) be noted and
4. That the risk owner(s) requiring further scrutiny provide a detailed update on the treatment and mitigation of the risk including impact on the corporate objectives at its December meeting

### **4.4 Annual Schools Report 2015/16**

Minesh Jani, Head of Audit and Risk Management presented the report which summarised the schools audit work in the year 2015/16 including the audits reported at agenda item 4.1.

Members were informed that:

- 84% of the schools audited had returned a substantial assurance.
- The issues identified fell into 3 strands/themes
  - Governance
  - Procurement and property practices
  - Management of inventory
- The themes were identified with the aim of ensuring that practices were improved. As issues were identified, proactive support would be given.

- Clerking services were available to schools via the Council but these services were chargeable

Members noted the outcomes reported and made the following comments:

- The issues identified at audit were of a repetitive nature
- The authority should look at provision of proper clerking services to schools
- There should be a better standard of governor training especially in regard to financial management

**Action by:** Minesh Jani, Head of Audit and Risk Management

## **RESOLVED**

That Members note the contents of the Annual report from Mazars and to take account of the matters raised in each of the twelve areas examined.

### **4.5 Treasury Management Report - update to 30 June 2016**

Kevin Miles, Chief Accountant presented the report which informed the Committee of the Council's treasury activities from April to June 2016.

Members were informed that:

- Performance in the period was lower than some local authorities
- Market rates had been low but stable in the period
- Performance of the Council is above the model weighted average rate of return in its investment benchmark club
- A proposal to change the investment lending strategy would be put to Full Council on 21 September 2016.

Responding to Members' questions, the Chief Accountant advised that:

- The Council's external auditors (KPMG) had not raised concerns around its exposure to Lender Option, Borrower Option (LOBO) arrangements as the investments chosen were not reverse LOBO investments
- KPMG had not resolved the annual accounts objection received around LOBOs but had indicated that no other matters prevented the sign off the accounts
- KPMG were seeking legal opinion in relation to the LOBO complaint as this also concerned a number of other local authorities and caused delays in signature
- LOBOs presented risk in a long term framework. The Council's loan had 60 months remaining and in the present investment climate presented good value in the mid term
- In regard to exposure to risk versus returns. The Council was presently looking to review its treasury management approach to generate better returns without increasing its risk profile

## **RESOLVED**

1. That the contents of the treasury management activities and performance against targets for quarter ending 30 June 2016 be noted;



2. That the Council's investments which are outstanding as at 30 June 2016 as set out in Appendix 1 be noted and that it be noted that the balance outstanding at that time was £452.95m which includes £73m, pension fund cash awaiting investment in early July.
3. That the recommendation to the Full Council to agree increasing investments over a year monetary limit from £50m to £100m as set out in section 3.12.3 be endorsed
4. That the recommendation to the Full Council to approve increasing monetary limit and duration of part nationalised banks from £25m and 3 years to £50m and 5 years as set out in section 3.12.4 be endorsed

**4.6 Forward Plan 2016/17**

Item deferred

**5. ANY OTHER BUSINESS THE CHAIR CONSIDERS URGENT**

Nil items.

The meeting ended at 9.40 p.m.

Chair, Councillor Candida Ronald  
Audit Committee

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**LONDON BOROUGH OF TOWER HAMLETS**

**MINUTES OF THE EXTRAORDINARY MEETING OF THE AUDIT COMMITTEE**

**HELD AT 8.00 P.M. ON THURSDAY, 29 SEPTEMBER 2016**

**ROOM C1, 1ST FLOOR, TOWN HALL, MULBERRY PLACE, 5 CLOVE  
CRESCENT, LONDON, E14 2BG**

**Members Present:**

Councillor Candida Ronald (Chair)  
Councillor Denise Jones  
Councillor Sabina Akhtar  
Councillor Ohid Ahmed

**Apologies:**

Councillor Andrew Cregan  
Councillor Harun Miah

**Others Present:**

Andrew Sayers (Engagement Lead Auditor, KPMG)  
Antony Smith (Engagement Manager, KPMG)

**Officers Present:**

Graham White (Interim Service Head, Legal Services,  
Law, Probity and Governance)  
Neville Murton (Service Head, Finance & Procurement)  
Brian Snary Financial Accountant - Resources  
Kevin Miles (Chief Accountant, Resources)  
Joel West (Senior Democratic Services Officer)

**1. DECLARATIONS OF DISCLOSABLE PECUNIARY INTEREST**

None were declared.

**2. CHAIR'S REMARKS**

The Chair of the Committee, Councillor Candida Ronald, asked the Committee to note that the Report to Those Charged with Governance (Item 2.1 on the agenda) had been circulated to Members late and stressed that reports must be made available to Members in good time if their duty to scrutinise information is to be discharged adequately.

### **3. KPMG ITEMS FOR CONSIDERATION**

#### **3.1 Report to Those Charged with Governance ISA 260 Report - Council and Pensions Accounts**

Andrew Sayers, KPMG, introduced the report, which summarised the key issues identified during the external auditor's audit of the financial statements for the year ended 31 March 2016 for both the Council and its pension fund; and its assessment of the Council's arrangements to secure value for money.

Mr Sayers first explained an outstanding matter, relating to an objection, for the previous year's report (2014/15). The objection relates to LOBO loans. KPMG have obtained legal advice on this matter and have concluded it will be possible to sign the 2014/15 annual report prior to resolution of this objection. The 2014/15 report will therefore be signed very shortly.

Mr Sayers then explained the key findings from the 2015/16 audit, which are contained in the 'Headlines' section of the report (pages 6-9 of the supplementary agenda). He explained that the audit opinion at Appendix 5 of the report is draft and that the Committee will be informed if any changes are made to it before it is finalised.

Mr Sayers reported that there were no material adjustments to the 2015/16 accounts and an unqualified opinion (as per appendix 5 of the report) was anticipated.

In response to questions from Members, Mr Sayers provided more details on:

- Work on grant payments. A sample of grants made will be selected and tested by KPMG. For clarity, Mr Sayers explained it was never KPMG's intention to test every grant made.
- The non-audit service work conducted (page 35 of the supplementary agenda). He explained the nature of the work requested by internal audit and stressed that all such work is cleared with Public Sector Audit Appointments Limited (PSAA).
- The statements regarding the youth service (page 17 of the report). Work in this area is ongoing but is not expected to have any effect on the final accounts.
- Work on Section 106 contributions. Work focussed on spending of s106 funds, but did not necessarily seek to identify whether all sums were collected. However, no instances of non-collection were identified.

The Chair thanked Mr Sayers and other attending employees of KPMG for their report and attendance.

**RESOLVED that the Committee notes:**

1. the draft External Audit Report 2015/16 including the key issues highlighted during KPMG audit of the financial statements for the year ended 31 March 2016 for both the Council and its pension fund;
2. KPMGs assessment of the Council's arrangements to secure value for money; and
3. that some work is still ongoing and accordingly this draft report will be updated to produce a final version at the point the financial statements are signed.

#### **4. TOWER HAMLETS ITEMS FOR CONSIDERATION**

##### **4.1 Annual Financial Report 2015/16 (Incorporating KPMG's Report to Those Charged With Governance 2015/16)**

Kevin Miles, Chef Accountant, introduced the report on the Council's financial outturn 2015/16, which he explained was materially the same as the draft report presented to the Committee in June 2016.

In response to questions from Members, Mr Miles explained

- A process to identify and validate all General Fund earmarked reserves will be taking place shortly. Neville Murton, Service Head Finance and Procurement, advised that a reserves policy is expected to be drawn up by around December 2016.
- The technicalities of LOBO loans. The Council has borrowed around £77.5 million through such loans. Mr Miles explained that the Council's decision to take these loans was based in part on predicted interest rate rises at the time, but interest rates have fallen and so have affected the Council's ability to repay the loans. The Committee heard that objections to LOBO loans have been voiced, on a national scale, that questioned their suitability for local authority borrowing. Graham White, Interim Head of Legal Services, advised of another local authority where objections regarding LOBO loans had been received. Their external auditors were satisfied LOBO loans were lawful and appropriate, as it had been shown the interest rates on the loans were competitive when compared to alternative products at that time.
- Whilst the amount of 'collectible' business rates (NNDR) is identified in the report, the level of actual collection is not. The collection level is on target to be over 99%.

Officers agreed to separately provide information on the estimated timescales for possible overage receipts related to the Blackwall Reach and Ocean Estate regeneration schemes (section 30a on page 68 of the report).

#### **RESOLVED that the Committee:**


1. approves the Annual Financial Report including the Statement of Accounts for the financial year ending 31st March 2016, having regard for the auditor's Annual Governance Report; and

2. note that the 2014/15 Accounts are still to be signed off by KPMG, however the LOBO loans objection is no longer a barrier to an audit opinion being issued.

The meeting ended at 8.35 p.m.

Chair, Councillor Candida Ronald  
Audit Committee

# Agenda Item 4.1

Non-Executive Report of the:  <b>AUDIT COMMITTEE</b>  8 <sup>th</sup> November 2016	 <b>TOWER HAMLETS</b>
<b>Report of:</b> Zena Cooke, Corporate Director of Resources	<b>Classification:</b> Unrestricted
<b>Mid - Year Review and Activities of Treasury Management Strategy and Investment Strategy for 2016/17</b>	

<b>Originating Officer(s)</b>	Bola Tobun, Investment & Treasury Manager
<b>Wards affected</b>	All wards

## Summary

This report reviews progress on the Treasury Management and Investment Strategy that was approved by Full Council on 24 February 2016 as prescribed by the Chartered Institute of Public Finance and Accountancy (CIPFA) Code of Practice on Treasury Management (Revised 2011).

The report reviews how the Treasury Management team has managed the Council's cash balances, investments, borrowings and treasury related risks. The report also sets out the economic environment and how this has impacted on investment returns.

The key messages from this report are that:

- All treasury management activities were executed by authorised officers within the parameters agreed by the Full Council.
- All investments were made to counterparties on the Council's approved lending list and within agreed limits.
- There was no short-term or long-term borrowing raised during the period to 30 September 2016.
- From the beginning of financial to 30 September 2016, the Council earned an average investment return of 0.77% on short term lending, outperforming the rolling average 7 Day LIBID rate of 0.29%.

## Recommendations

The Audit Committee is asked to recommend the report to the Council:

To Note -

- The treasury management activities and performance against targets for the six months to 30 September 2016.

- The Council's investment balance of £406.85m as at 30 September 2016 of which £131.62m was invested with money market funds (MMF) and £105m invested with UK Banks and Building Societies as set out in Appendix 1.
- The Council's position on prudential indicators as set out in Appendix 2.

## **1. REASONS FOR DECISIONS**

- 1.1 The Local Government Act 2003 and the Local Authorities (Capital Financing and Accounting) Regulations 2003 requires that regular reports be submitted to Council/Committee detailing the council's treasury management activities.
- 1.2 The Council also agreed as part of the Treasury Management Strategy Statement to receive a number of reports. Furthermore, the CIPFA Treasury Management Code of Practice requires that Full Council/Committee should receive a Mid-Year Report reviewing Treasury Management/Investment.

## **2. ALTERNATIVE OPTIONS**

- 2.1 The Council is bound by legislation to have regard to the CIPFA Treasury Management (TM) Code. The Code requires that the Council should receive a mid-year report reviewing treasury management and investment.
- 2.2 If the Council were to deviate from those requirements, there would need to be some good reason for doing so. It is not considered that there is any such reason, having regard to the need to ensure that Members are kept informed about treasury management activities and to ensure that these activities are in line with the investment strategy approved by the Council

## **3. DETAILS OF REPORT**

- 3.1 The Chartered Institute of Public Finance and Accountancy's (CIPFA) Code of Practice on Treasury Management (revised November 2011) has been adopted by the Council.
- 3.2 One of the requirements of the Code is that Full Council/Committee should receive an annual Treasury Management Strategy Statement - including the Annual Investment Strategy and Minimum Revenue Provision Policy - for the year ahead, a Mid-Year Review Report and an Annual Outturn Report (stewardship report) covering activities during the previous year.
- 3.3 The Treasury Management Strategy, Investment Strategy and Minimum Revenue Provision reports were included in the Budget Pack that was presented to Full Council on 24 February 2016. The 2015/16 Outturn report was approved by Full Council on 21 September 2016.
- 3.4 This mid - year report has been prepared in compliance with CIPFA's Code of Practice, and covers the following:
  - An economic update for the first six months of 2016/17.
  - A review of the Treasury Management Strategy Statement and Annual Investment Strategy, which constitutes the following:
    - The Council's borrowing strategy for 2016/17.
    - The Council's investment strategy for 2016/17.



- The Council's investment portfolio for 2016/17.
- The Council's capital expenditure (prudential indicators).
- A review of compliance with Treasury and Prudential Limits for 2016/17.

### **3.5 AN ECONOMIC UPDATE FOR THE FIRST SIX MONTHS OF 2016/17**

- 3.5.1 UK GDP growth rates in 2013 of 2.2% and 2.9% in 2014 were strong but 2015 was disappointing at 1.8%, though it still remained one of the leading rates among the G7 countries. Growth improved in quarter 4 of 2015 from +0.4% to 0.7% but fell back to +0.4% (2.0% y/y) in quarter 1 of 2016 before bouncing back again to +0.7% (2.1% y/y) in quarter 2. The referendum vote for Brexit in June this year delivered an immediate shock fall in confidence indicators and business surveys, pointing to an impending sharp slowdown in the economy.
- 3.5.2 The Bank of England meeting on August 4th addressed this expected slowdown in growth by a package of measures including a cut in Bank Rate from 0.50% to 0.25%. The Inflation Report included an unchanged forecast for growth for 2016 of 2.0% but cut the forecast for 2017 from 2.3% to just 0.8%.
- 3.5.3 The Inflation Report also included a sharp rise in the forecast for inflation to around 2.4% in 2018 and 2019. CPI has started rising during 2016 as the falls in the price of oil and food twelve months ago fall out of the calculation during the year and, in addition, the post referendum 10% fall in the value of sterling on a trade weighted basis is likely to result in a 3% increase in CPI over a time period of 3-4 years. However, the MPC is expected to look thorough a one off upward blip from this devaluation of sterling in order to support economic growth, especially if pay increases continue to remain subdued and therefore pose little danger of stoking core inflationary price pressures within the UK economy.

### **3.6. INTEREST RATE FORECASTS**

The Council's treasury advisor, Capita Asset Services, has provided the following forecast:

	Dec-16	Mar-17	Jun-17	Sep-17	Dec-17	Mar-18	Jun-18	Sep-18	Dec-18	Mar-19	Jun-19
<b>Bank rate</b>	0.10%	0.10%	0.10%	0.10%	0.10%	0.10%	0.25%	0.25%	0.25%	0.25%	0.50%
<b>5yr PWLB rate</b>	1.00%	1.00%	1.10%	1.10%	1.10%	1.10%	1.20%	1.20%	1.20%	1.20%	1.30%
<b>10yr PWLB rate</b>	1.50%	1.50%	1.60%	1.60%	1.60%	1.60%	1.70%	1.70%	1.70%	1.70%	1.80%
<b>25yr PWLB rate</b>	2.30%	2.30%	2.40%	2.40%	2.40%	2.40%	2.50%	2.50%	2.50%	2.50%	2.60%
<b>50yr PWLB rate</b>	2.10%	2.10%	2.20%	2.20%	2.20%	2.20%	2.30%	2.30%	2.30%	2.30%	2.40%

- 3.6.1 Capita Asset Services undertook a quarterly review of its interest rate forecasts after the MPC meeting of 4th August cut Bank Rate to 0.25% and gave forward guidance that it expected to cut Bank Rate again to near zero before the year end. The above

forecast therefore includes a further cut to 0.10% in November this year and a first increase in May 2018, to 0.25%, but no further increase to 0.50% until a year later.

- 3.6.2 The overall longer run trend is for gilt yields and PWLB rates to rise, notwithstanding gently. An eventual world economic recovery may also see investors switching from the safe haven of bonds to equities. However, we have been experiencing exceptional levels of volatility in financial markets which have caused significant swings in PWLB rates. Capita PWLB rate forecasts are based on the Certainty Rate (minus 20 bps).

### **3.7 TREASURY MANAGEMENT STRATEGY STATEMENT**

- 3.7.1 The Treasury Management Strategy Statement (TMSS) for 2016/17 was approved by the Council on 24 February 2016, and it comprised the following:

- Borrowing Strategy
- Minimum Revenue Provision
- Annual Investment Strategy
- Treasury Management Policy statement; and
- Prudential Indicators for Treasury Management

- 3.7.2 The underlying TMSS approved previously requires revision in the light of economic and operational movements during the year. The proposed changes and supporting detail for the changes are set out below and attached as Appendix 2:

<i><b>Prudential Indicator</b></i>	<i><b>2016/17 Original £m</b></i>	<i><b>2016/17 Revised £m</b></i>
Authorised Limit	312.344	313.381
Operational Boundary	292.344	293.381
Capital Financing Requirement	267.344	268.381

#### **Borrowing Strategy**

- 3.7.3 The Council's approved borrowing strategy was approved by the full council 24 February 2016. The strategy remains appropriate to meet the Council's financing needs for its capital programme and loan redemptions.

#### **Debt Portfolio**

	31 March 2016 Principal £'000	Average rate %	30 September 2016 Principal £'000	Average rate %
<b>Fixed Rate Funding:</b>				
-PWLB	10,325	7.10	10,325	7.10
-Market	0,000		17,500	4.34
<b>Total Fixed Rate Funding</b>	<b>10,325</b>	<b>7.10</b>	<b>27,825</b>	<b>5.36</b>
<b>Variable Rate Funding:</b>				
-PWLB	-		-	
-Market	77,500	4.32	60,000	4.32
<b>Total Variable Rate Funding</b>	<b>77,500</b>	<b>4.32</b>	<b>60,000</b>	<b>4.32</b>
<b>Total Loans</b>	<b>87,825</b>	<b>4.65</b>	<b>87,825</b>	<b>4.65</b>

Other Long Term Liabilities	42,039		42,039	
<b>Total Borrowing</b>	<b>129,864</b>		<b>129,864</b>	
CFR	262,588		262,588	
<b>Over/ (under) borrowing</b>	<b>(132,724)</b>		<b>(132,724)</b>	

3.7.4 The table above sets out the Council's debt as at the beginning of the financial year and 30 September 2016. There is no change to outstanding balance.

3.7.5 During this financial year, two variable rate, market loans have been reclassified as fixed rate market loans. This is because on the 22<sup>nd</sup> June 2016, Barclays Bank decided to waive their right to change the applicable interest rate of loans. As a result of this waiver, the loans effectively become fixed rate loans at their current interest rates of 4.25% for the £4.5m loan with maturity date of 23/09/2077 and 4.37% for the £13m loan with maturity date of 23/09/2077. And also the risk that the rates will be changed in the future is no longer there.

3.7.6 As at the 30 September 2016, no PWLB loans (Public Works Loans Board) matures.

3.7.7 **Borrowing Requirement:** The Council has an approved borrowing requirement of £13 million towards financing the 2016/17 Capital Programme. This has changed to £14.6m.

3.7.8 Over the next three years, forecasts indicate that investment rates are expected to be below long term borrowing rates. This would indicate that value could best be obtained by avoiding new external borrowing and by using internal cash balances to finance new capital expenditure or to replace any maturing external debt. This would maximise short term savings.

3.7.9 Hence, there has been no new borrowing during the reporting period 01 April 2016 to 30 September 2016. Total debt outstanding, stands at £129.864m, against estimated CFR of £268.381m for 2016/17, resulting in an under-borrowing position of £138.517m

3.7.10 **Debt Rescheduling:** The debt portfolio is periodically reviewed to see if cashflow benefits can be obtained from rescheduling debt. In the current interest rate environment, PWLB repayment rates are generally not favourable and any rescheduling undertaken would incur a large cash penalty payment, thus limiting opportunities. The portfolio will be kept under review and advice sought from Capita Asset Services as appropriate.

3.7.11 No debt rescheduling was undertaken during the first six months of 2016/17.

### 3.8 Minimum Revenue Provision

3.8.1 The Council has a statutory requirement to repay an element of accumulated General Fund capital expenditure each year through a revenue charge known as the Minimum Revenue Provision (MRP). The Council is required to approve each year a Minimum Revenue Provision Policy Statement and make prudent provision. Revenue Provision to repay General Fund capital expenditure debt for 2016/17 is £6.7 million and has been calculated in accordance with the policy statement.

3.8.2 With regard to assets financed under the Public Finance Initiative (PFI) and finance leases that were brought on balance sheet as a result of the accounting changes brought about by the requirement to report in accordance with International Financial Reporting

Standards, mitigating regulations allow that MRP be contained within the existing revenue charge so that the effect on the General Fund is neutral.

### **3.9 Annual Investment Strategy.**

3.9.1 The Council's Annual Investment Strategy, which is incorporated in the TMSS, outlines the Council's investment priorities as follows:

- Security of capital
- Liquidity; and
- Yield

3.9.2 **Security:** The Council has in place creditworthiness criteria, which the officers had strictly adhered to when making investment decisions during the first six months of 2016/17. Monetary and duration limits are applied to manage counterparty exposure risk. Global markets have remained uncertain and the Council continues to implement an operational investment strategy which tightens the controls already in place within the approved investment strategy. Investment processes are constantly monitored and are regularly reviewed by the Investment and Treasury Manager, Chief Accountant and the Corporate Director of Resources.

3.9.3 **Liquidity:** The Council is required to have available, or have access to, adequate resources to enable it at all times to have the level of funds which are necessary for the achievement of its service objectives. Cashflow modelling is used to meet this requirement. The liquidity of the investment portfolio is monitored regularly.

3.9.4 For debt management purposes the Council has in place overdraft facilities with the Council's banker, the Royal Bank of Scotland plc, and also has access to the PWLB and the money market to fund capital projects. Internal balances are available to temporarily fund capital expenditure. Whilst this will help reduce the need to invest any surplus cash, this must be balanced against the future requirement to replace these balances, and ensure that sufficient cash is available to meet the Council's liquidity requirements.

3.9.5 **Yield:** The Council has a good record in managing its investment portfolio and seeks to obtain the best return (yield) available on its investments, but it adheres at all times to the approved investment criteria. The Council compares the return on its investments against the seven day London Interbank Bid (LIBID) rate, which is the local authority benchmark.

3.9.6 Despite the challenging investment environment, as at 30 September 2016 the return on the Council's investments was 0.77%, which compares very favourably against 0.29%, the average seven day LIBID rate for the reporting period. Officers will continue to work to maintain and strengthen the Council's investment policy and will refer back to the Full Council with any modification thought to be beneficial to the efficient and effective management of the Council's funds.

3.9.7 Credit rating information is supplied by Capita Asset Services, our treasury advisers, on all active counterparties that comply with the criteria as shown at Appendix 3. Any counterparty failing to meet the Council's criteria would be omitted from the counterparty (dealing) list. Any credit rate 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 and also used to update the counterparty list.

3.9.8 During the first six months of the year, no short-term or long-term borrowing activities but investments activities have been in line with the Strategy, with no deviations.

### 3.10 **INVESTMENT PORTFOLIO 2016/17**

- 1) In accordance with the Code, it is the Council's priority to ensure security of capital and liquidity, and to obtain an appropriate level of return which is consistent with the Council's risk appetite. In the current economic climate it is considered appropriate to keep investments short term to cover cash flow needs, but also to seek out value available in longer periods with prudently analytical selected credit rated financial institutions, using the adopted creditworthiness criteria as approved by the Full Council including sovereign credit rating overlay approach.
- 2) Investment rates available in the market have been broadly uncertain during the reporting period and have even gone lower than the previously reported low levels as a result of the MPC to cut rate to 0.25% with other extraordinary measures such as also expanding the Quantitative Easing (QE) programme to £435bn. The level of funds available for investment purposes during the year has been fluctuating between £350m £480m. These funds were available on a temporary basis, and the level of funds available was mainly dependent on the timing of precept payments, receipt of grants and progress on the Capital Programme.
- 3) The Council's budgeted investment return for 2016/17 was £2.7m, with average rate of return 0.9% for average portfolio balances of £300m.

### **Investment performance for Mid-Year ended 30 September 2016**

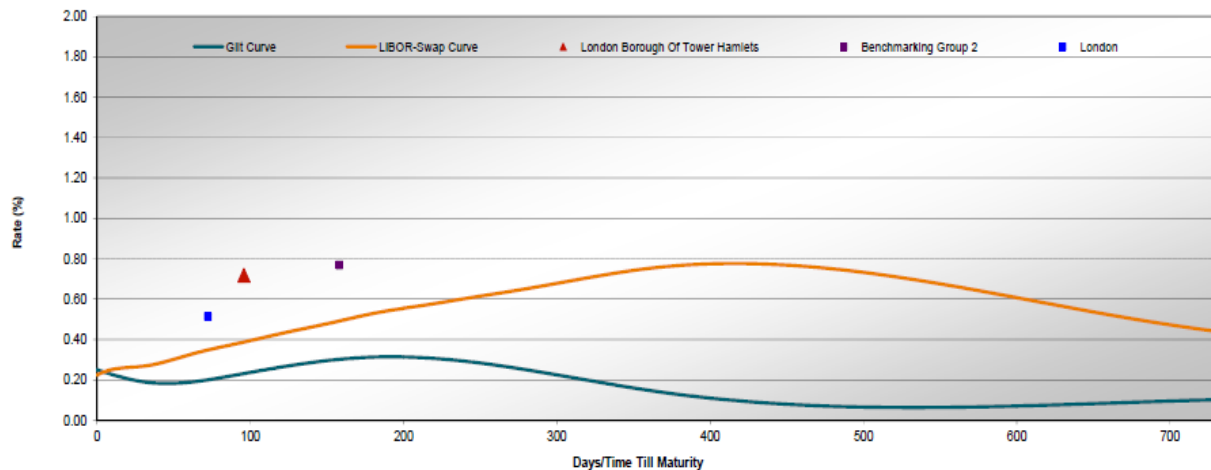
Period	Benchmark Return	LBTH Performance	Over/(Under) Performance	Investment Interest Earned £m
<b>Full Year 2015/2016</b>	0.35%	0.82%	0.47%	3.560
<b>Qtr. 1 2016</b>	0.36%	0.76%	0.40%	N/A
<b>Qtr. 2 2016</b>	0.23%	0.78%	0.55%	N/A
<b>2016/17 Year to Period</b>	0.29%	0.77%	0.48%	1.850

- 4) As illustrated above, the Council held £406.62m of investments as at 30 September 2016 and the investment portfolio yield for the first six months of the year is 0.77% against a benchmark of 0.29%, outperforming the benchmark by 48 bps. The investment interest earned as at 30<sup>th</sup> September was £1.85m; this was due to the large investment portfolio balances the Council is currently running with, the average investment portfolio balance of £416m as at 30<sup>th</sup> September 2016.
- 5) It has not been possible to re-invest matured investments at favourably rates due to the ultralow interest rate environment as Bank of England base rate is currently 0.25% with a further cut forecast at 0.10% before the calendar year end.

## INVESTMENT BENCHMARKING CLUB

- 6) LBTH participates in a benchmarking club to enable officers to compare the Council's treasury management, investment returns against those of similar authorities. The model below shows the performance of benchmark club members given the various levels of risks taken as at 30 September 2016. The Performance of Tower Hamlets is above the Model Weighted Average Rate of Return (WARoR) but below the performance of our benchmark comparators and the London benchmark.

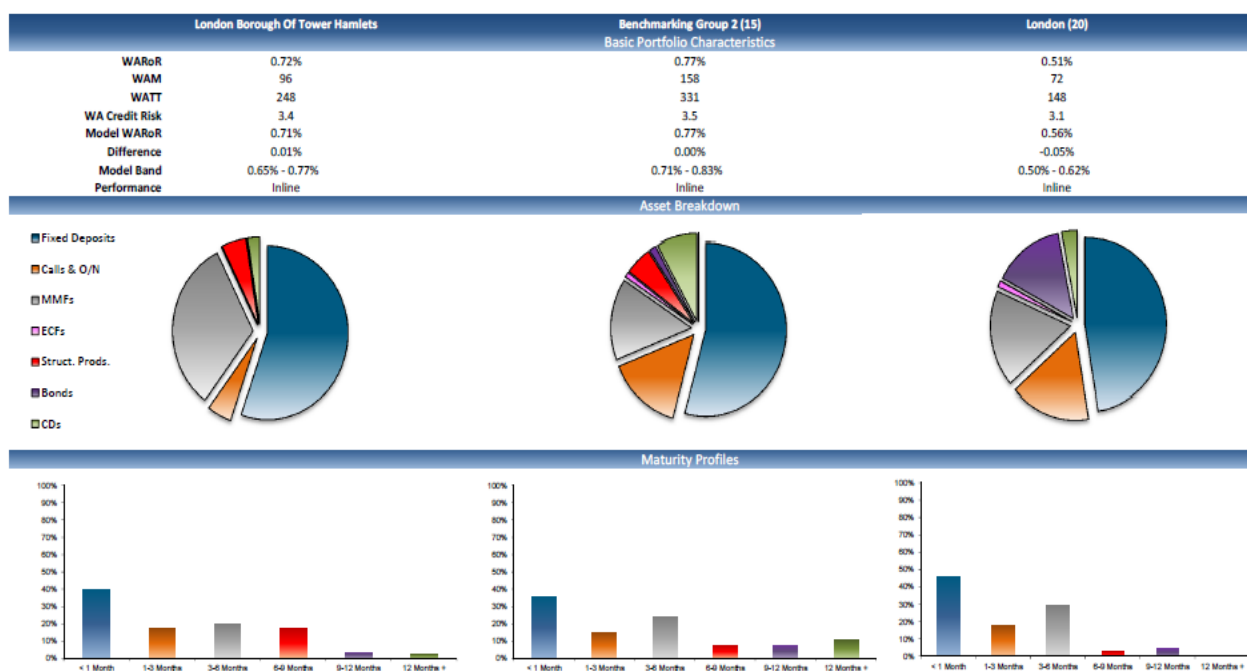
Returns Comparable Against the Risk-Free Rate and LIBOR Curve



	WARoR	WAM	WATT	WARisk	Gilt	LIBOR-Swap	Difference		Model	
							Gilt	LIBOR-Swap	Bands	Performance
London Borough Of Tower Hamlets	0.72%	96	248	3.4	0.23%	0.39%	0.49%	0.33%	0.65% - 0.77%	Inline
Benchmarking Group 2	0.77%	158	331	3.5	0.30%	0.49%	0.47%	0.28%	0.71% - 0.83%	Inline
London	0.51%	72	148	3.1	0.20%	0.35%	0.31%	0.17%	0.50% - 0.62%	Inline

## London Borough Of Tower Hamlets

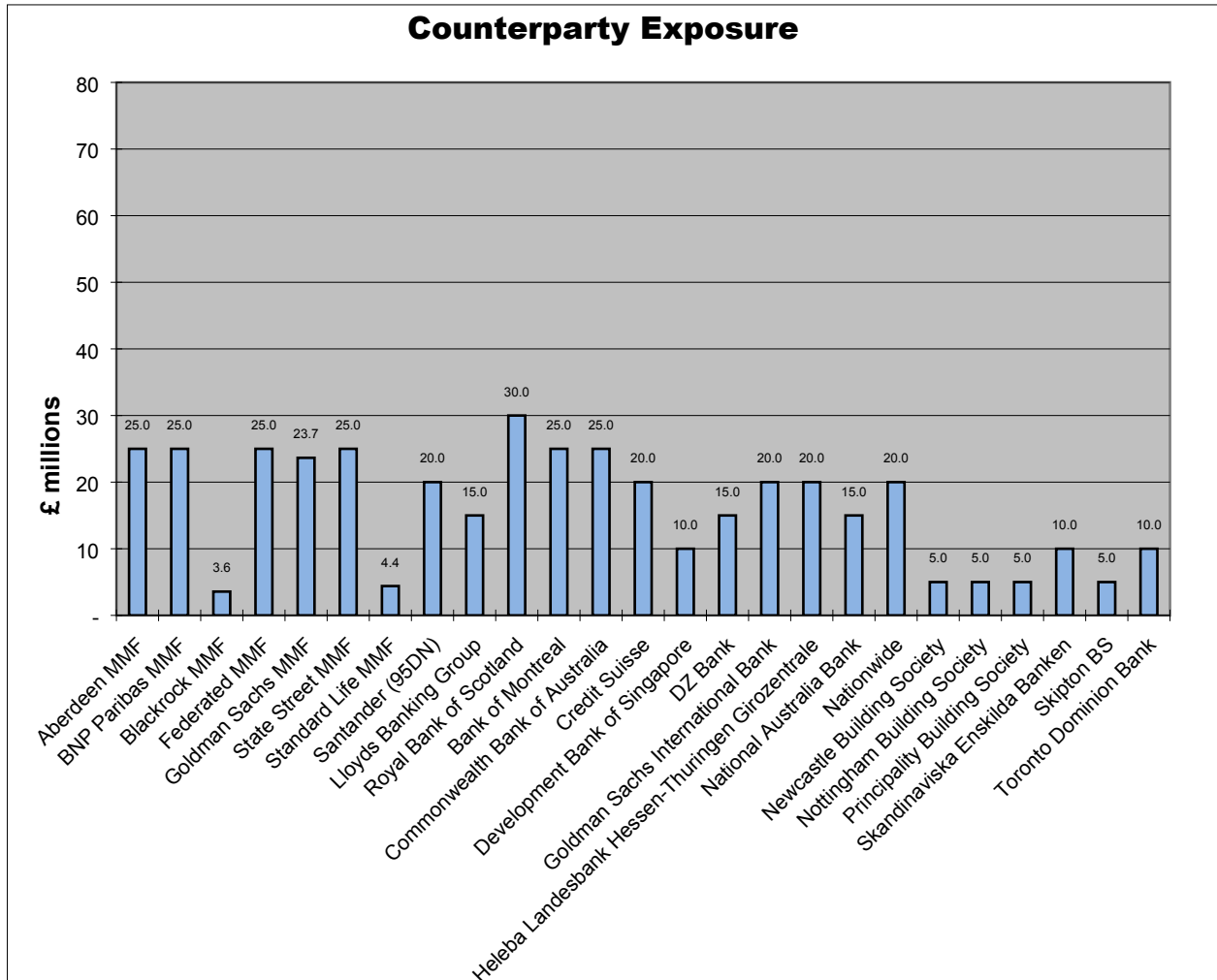
### Summary Sheet



- 7) The return on LBTH investment is commensurate with the Council's risk appetite as set out in the Investment Strategy which is reflected in the above data.
- 8) The outstanding investments of £406.62m include Pension Fund working capital of some £7.78m which is being invested and will continue to be invested in accordance with the Council's Treasury Management Strategy agreed by Full Council, under the delegated authority of the Corporate Director of Resources to manage within agreed parameters.
- 9) The table below shows the amount of investments outstanding at the end of September 2016, split according to the financial sector.

FINANCIAL SECTOR	£m	%
Banks in the UK	65.00	15.98
Building Societies in the UK	40.00	9.84
Banks in the Rest of the World	170.00	41.81
Money Market Funds	131.62	32.37
<b>Investments Outstanding as at 30/09/2016</b>	<b>406.62</b>	<b>100.00</b>

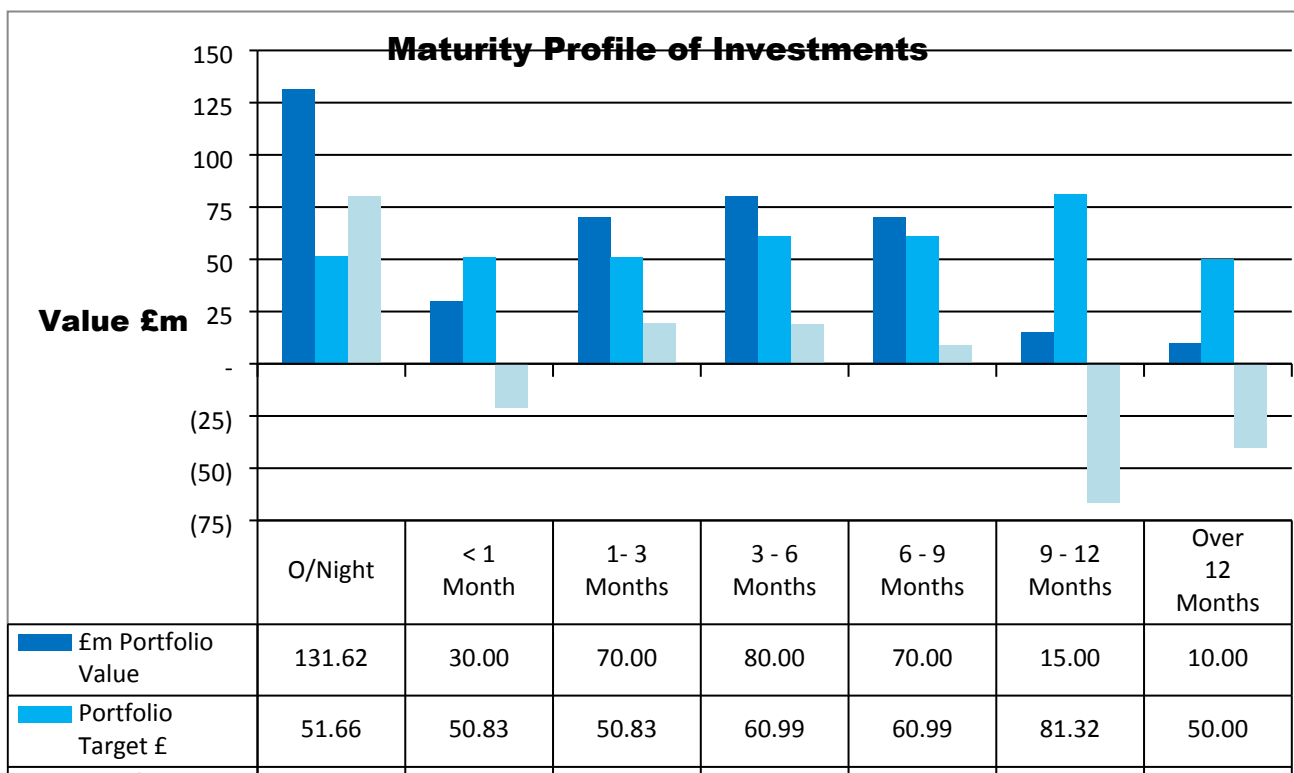
10) The below chart shows the deposits outstanding with authorised counterparties as at 30th September 2016, of which 7.38% were with part-nationalised banks (RBS Groups).



11) The chart below illustrates the maturity profile of investments at the end of September 2016 with the detailed list of investments attached as Appendix 1 of this report.



## Maturity Structure of Investments



- 12) We have £131.62m as overnight deposits, and this is essentially all Money Market Funds. The Weighted Average Maturity (WAM) for outstanding investment (excluding MMF) is 144 days for the month of September and including MMF is 96 days. This is the average number of outstanding days to maturity of each deal from 30 September 2016.
- 13) **Compliance with Treasury and Prudential Limits** - It is a statutory duty for the Council to determine and keep under review the affordable borrowing limits. The Council's approved Treasury and Prudential Indicators (affordability limits) are included in the approved TMSS.
- 14) For the financial year to reporting period the Council has operated within the treasury and prudential indicators set out in the Council's Treasury Management Strategy Statement and in compliance with the Council's Treasury Management Practices. The prudential and treasury Indicators are shown in Appendix 2.

### **General Activities Update**

- 15) UK Sovereign Rating - Standard & Poor have downgraded the UK Sovereign rating to AA from AAA with outlook remains negative, Fitch downgraded to AA from AA+ with outlook, changed to negative from stable, Moody's affirmed the rating at Aa1 with outlook changed to negative from stable. This is due to weaker economic and fiscal outlook.
- 16) In light of the recent changes in the UK sovereign rating, the Council did not exclude UK from its sovereign rating overlay criteria and still invest in UK banks and building societies. At the individual/entity level, investment counterparties still need to meet stringent criteria as laid out in the current investment strategy.

- 17) Section 7.27 of the council treasury management strategy for 2016/17, TMSS annex A, was revised at the full council meeting of September 2016, by revising the maximum nominal value of overall investments that the council should hold for more than 1 year and less than 5 years from £50m to £100m (that is Investments with maturity over a year) The prudential indicator figure of £100m was therefore approved.
- 18) The Council also changed the monetary limit and duration of investments more than one year for part nationalised bank from the original strategy limits of £25m and 3 years to £50m and 5 years duration. This is to empower the council the flexibility of placing more deposits with institution part owned by the government and be in a position to received decent return from the transaction.

### 3.11 **The Council's Capital Position (Prudential Indicators)**

3.11.1 Prudential Indicator for Capital Expenditure - This table shows the revised estimates for capital expenditure and the changes since the capital programme was agreed at February Council. The programme has been revised to take account of updated profiles; new schemes approved in-year and new capital grant receipts.

<b>Capital Expenditure by Service</b>	<b>2016/17 Original Estimate £m</b>	<b>2016/17 Revised Estimate £m</b>
<i>Adult Services</i>	5.046	7.442
<i>Children's services</i>	31.875	18.119
<i>Building Schools for the Future</i>		0.290
<i>Communities, Localities and Culture</i>	12.348	11.372
<i>Development &amp; Renewal (Excluding HRA)</i>	5.676	3.628
<i>Housing</i>	139.045	95.298
<i>Corporate General Fund Provision for Schemes under development</i>	34.000	
Total Non - HRA	89.475	77.362
HRA	138.315	92.991
<b>Total</b>	<b>227.790</b>	<b>170.353</b>

#### 3.11.2 **Changes to the Financing of the Capital Programme**

The table below draws together the main strategic elements of the capital expenditure plans, highlighting the original supported and unsupported elements of the capital programme, and the expected financing arrangements. The borrowing element of the table increases the underlying indebtedness of the Council by way of the Capital Financing Requirement (CFR), although this will be reduced in part by revenue charges for the repayment of debt (the Minimum Revenue Provision).

<b>Capital Expenditure</b>	<b>2016/17 Original Estimate £m</b>	<b>2016/17 Revised Estimate £m</b>
<b>Total Spend</b>	<b>227.790</b>	<b>170.353</b>
Financed By:		
Capital receipts	45.449	21.821
Capital Grants, Developers & SC	131.073	67.280
Major Repairs Allowance	32.860	40.160
Capital Reserves	3.400	
Revenue	2.000	23.527
<b>Total Financing</b>	<b>214.980</b>	<b>155.788</b>
Supported	0.000	0.000
Unsupported	13.010	14.565
<b>Total Borrowing Need</b>	<b>13.010</b>	<b>14.565</b>

3.11.3 Changes to the Prudential Indicators for the Capital Financing Requirement, External Debt and the Operational Boundary are detailed in the below table. The Capital Financing Requirement has been amended in line with the borrowing requirement to support the 2016/17 approved capital programme.

	<b>2015/16 Actual £m</b>	<b>2016/17 Original Estimate £m</b>	<b>2016/17 Revised Estimate £m</b>
<b>Prudential Indicator – Capital Financing Requirement</b>			
CFR – Non-HRA	192.913	187.096	186.813
CFR – HRA	69.675	80.248	81.567
Total CFR	262.588	267.344	268.381
<b>Net movement in CFR</b>		<b>4.756</b>	<b>5.793</b>
<b>Prudential Indicator – External Debt / the Operational Boundary</b>			
Borrowing	245.549	251.510	252.547
Other long term liabilities	42.039	40.834	40.834
<b>Total debt 31 March</b>	<b>287.588</b>	<b>292.344</b>	<b>293.381</b>

### **Limits to Borrowing Activity**

3.11.4 The first key control over the treasury activity is a prudential indicator to ensure that over the medium term, net borrowing (borrowings less investments) will only be for a capital purpose. Net external borrowing should not, except in the short term, exceed the total of CFR in the preceding year plus the estimates of any additional CFR for

2016/17 and next two financial years. This allows some flexibility for limited early borrowing for future years.

	<b>2015/16 Actual £m</b>	<b>2016/17 Original Estimate £m</b>	<b>2016/17 Revised Estimate £m</b>
Gross borrowing	129.864	139.780	141.335
Less investments	479.302	300.000	350.000
Net borrowing / (Investments)	(349.438)	(160.220)	(208.665)
<b>CFR (year - end position)</b>	<b>262.588</b>	<b>267.344</b>	<b>268.381</b>

3.11.5 The Corporate Director, Resources reports that no difficulties are envisaged for the current or future years in complying with this prudential indicator.

3.11.6 A further prudential indicator limits the overall level of borrowing. This is the Authorised Limit which represents the limit beyond which borrowing is prohibited, and can only be set and revised by Members. It reflects the level of borrowing which though not needed, could be afforded in the short term but unsustainable long 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.

	<b>2016/17 Original Indicator</b>	<b>2016/17 Revised Indicator</b>
<b>Authorised limit for external debt</b>		
Borrowing*	292.344	293.381
Headroom	20.000	20.000
Other long term liabilities	0.000	0.000
<b>Total</b>	<b>312.344</b>	<b>313.381</b>

\* Includes PFI schemes and finance leases etc.

#### **4. COMMENTS OF THE CHIEF FINANCE OFFICER**

4.1 The comments of the Corporate Director of Resources are incorporated in the report.

#### **5. LEGAL COMMENTS**

5.1 The Local Government Act 2003 provides a framework for the capital finance of local authorities. It provides a power to borrow and imposes a duty on local authorities to determine an affordable borrowing limit. It provides a power to invest. Fundamental to the operation of the scheme is an understanding that authorities will have regard to proper accounting practices recommended by the Chartered Institute of Public Finance and Accountancy (CIPFA) in carrying out capital finance functions.

- 5.2 The Local Authorities (Capital Finance and Accounting) (England) Regulations 2003 require the Council to have regard to the CIPFA publication “Treasury Management in the Public Services: Code of Practice and Cross-Sectoral Guidance Notes” (“the Treasury Management Code”) in carrying out capital finance functions under the Local Government Act 2003. If after having regard to the Treasury Management Code the Council wished not to follow it, there would need to be some good reason for such deviation.
- 5.3 It is a key principle of the Treasury Management Code that an authority should put in place “comprehensive objectives, policies and practices, strategies and reporting arrangements for the effective management and control of their treasury management activities”. Treasury management activities cover the management of the Council’s investments and cash flows, its banking, money market and capital market transactions, the effective control of risks associated with those activities and the pursuit of optimum performance consistent with those risks. It is consistent with the key principles expressed in the Treasury Management Code for the Council to review performance against the strategies and policies it has adopted.
- 5.4 The Treasury Management Code requires as a minimum that there be a practice of regular reporting on treasury management activities and risks to the responsible committee and that these should be scrutinised by that committee. Under the Council’s Constitution, the audit committee has the functions of monitoring the Council’s risk management arrangements and making arrangements for the proper administration of the Council’s affairs and for the proper stewardship of public funds.
- 5.5 When discharging its treasury management functions, the Council must have due regard to the need to eliminate unlawful conduct under the Equality Act 2010, the need to advance equality of opportunity and the need to foster good relations between persons who share a protected characteristic and those who don’t. Information is contained in section 15 of the report relevant to these considerations.

## **6. ONE TOWER HAMLETS CONSIDERATIONS**

- 6.1 Interest on the Council’s cash flow has historically contributed significantly towards the budget. This Council’s ability to deliver its various functions, to meet its Community Plan targets and to do so in accordance with its obligations under the Equality Act 2010 may thus be enhanced by sound treasury management.

## **7. BEST VALUE (BV) IMPLICATIONS**

- 7.1 Assessment of value for money is achieved through:
- Monitoring against benchmarks
  - Operating within budget
- 7.2 For example, investment returns exceeded the LIBID benchmark up to the end of September 2016 and the treasury function operated within budget for financial year 2016/17.

## **8. SUSTAINABLE ACTION FOR A GREENER ENVIRONMENT**

- 8.1 There are no Sustainable Actions for A Greener Environment implications.

## **9. RISK MANAGEMENT IMPLICATIONS**

- 9.1 Any form of investment inevitably involves a degree of risk. To minimise risk the investment strategy has for example a restriction exposure of council cash balances to non-UK banks or institutions only with sovereign rating of AAA, with prudent short term rating or strong long term rating of individual institution.

## **10. CRIME AND DISORDER REDUCTION IMPLICATIONS**

- 10.1 There are no crime and disorder reduction implications arising from this report.

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**Linked Reports, Appendices and Background Documents: None**

### **Appendices**

Appendix 1: Investment Portfolio as at 30<sup>th</sup> September 2016

Appendix 2: 2016-17 Revised Prudential and Treasury Management Indicators

Appendix 3: Counterparty List

Appendix 4: Glossary

**Local Government Act, 1972 Section 100D (As amended)**

### **List of “Background Papers” used in the preparation of this report**

Capita Treasury Advisory Services - Investment Reports & Benchmarking club report

### **Officer contact details for documents:**

Bola Tobun Ext. 4733 Mulberry Place, 3<sup>rd</sup> Floor

**Investments Outstanding at 30 September 2016**

<b>Maturity</b>	<b>Counterparty</b>	<b>From</b>	<b>Maturity</b>	<b>Amount £m</b>	<b>Rate</b>	
<b>Overnight</b>	Aberdeen MMF		<b>MMF</b>	25.00		
	BNP Paribas MMF		<b>MMF</b>	25.00		
	Blackrock MMF		<b>MMF</b>	3.57		
	Federated MMF		<b>MMF</b>	25.00		
	Goldman Sachs MMF		<b>MMF</b>	23.65		
	Standard Life MMF		<b>MMF</b>	4.40		
	State Street MMF		<b>MMF</b>	25.00		
	<b>SUB TOTAL</b>			<b>131.62</b>		
<b>&lt;1 Month</b>	DZ Bank	04/07/2016	04/10/2016	10.00	0.51%	
	Skandinaviska Enskilda Banken	05/10/2015	05/10/2016	5.00	0.92%	
	DZ Bank	05/04/2016	05/10/2016	5.00	0.68%	
	Goldman Sachs International Bank	23/10/2015	24/10/2016	10.00	1.00%	
	<b>SUB TOTAL</b>			<b>30.00</b>		
<b>1 - 3 Months</b>	Heleba Landesbank Hessen-Thüringen	12/11/2015	11/11/2016	5.00	1.04%	
	Principality Building Society	11/11/2015	11/11/2016	5.00	1.08%	
	Goldman Sachs International Bank	12/11/2015	14/11/2016	10.00	0.95%	
	Credit Suisse	20/11/2015	18/11/2016	10.00	1.03%	
	Credit Suisse	25/11/2015	25/11/2016	10.00	1.00%	
	Skandinaviska Enskilda Banken	07/12/2015	07/12/2016	5.00	0.85%	
	Development Bank of Singapore	08/06/2016	08/12/2016	5.00	0.62%	
	Bank of Montreal	15/03/2016	15/12/2016	10.00	0.72%	
	Commonwealth Bank of Australia	15/12/2015	15/12/2016	5.00	0.91%	
	Development Bank of Singapore	15/06/2016	15/12/2016	5.00	0.62%	
	Heleba Landesbank Hessen-Thüringen	12/11/2015	11/11/2016	5.00	1.04%	
		<b>SUB TOTAL</b>			<b>70.00</b>	
<b>3 - 6 Months</b>	Santander (95DN)		Call - 95N	20.00	1.10%	
	Bank of Montreal	06/04/2016	06/01/2017	10.00	0.75%	
	Royal Bank of Scotland	10/01/2014	09/01/2017	5.00	1.74%	
	National Australia Bank	12/04/2016	12/01/2017	10.00	0.74%	
	National Australia Bank	19/04/2016	19/01/2017	5.00	0.75%	
	Bank of Montreal	19/04/2016	19/01/2017	5.00	0.74%	
	Commonwealth Bank of Australia	23/02/2016	21/02/2017	5.00	0.90%	
	Heleba Landesbank Hessen-Thüringen	26/02/2016	27/02/2017	5.00	0.92%	
	Commonwealth Bank of Australia	14/03/2016	14/03/2017	10.00	0.92%	
	Skipton BS	23/03/2016	23/03/2017	5.00	1.02%	
		<b>SUB TOTAL</b>			<b>80.00</b>	
	<b>6 - 9 Months</b>	Nationwide	12/04/2016	12/04/2017	5.00	0.95%
Lloyds Banking Group		14/04/2016	13/04/2017	5.00	1.05%	
Lloyds Banking Group		15/04/2016	13/04/2017	5.00	1.05%	
Nationwide		15/04/2016	13/04/2017	10.00	0.97%	
Nationwide		22/04/2016	21/04/2017	5.00	0.95%	
Newcastle Building Society		28/04/2016	28/04/2017	5.00	1.15%	
Lloyds Banking Group		29/04/2016	28/04/2017	5.00	1.05%	
Royal Bank of Scotland		05/05/2015	05/05/2017	5.00	1.45%	
Royal Bank of Scotland		08/05/2015	08/05/2017	5.00	1.45%	
Nottingham Building Society		09/05/2016	09/05/2017	5.00	1.03%	
Commonwealth Bank of Australia		12/05/2016	12/05/2017	5.00	0.99%	
Heleba Landesbank Hessen-Thüringen		03/05/2016	03/06/2017	10.00	1.01%	
	<b>SUB TOTAL</b>			<b>70.00</b>		

<b>9 - 12 Months</b>	Toronto Dominion Bank	16/08/2016	15/08/2017	10.00	0.61%
	Royal Bank of Scotland	19/08/2016	19/08/2017	5.00	0.86%
	<b>SUB TOTAL</b>			<b>25.00</b>	
<b>Maturity</b>	<b>Counterparty</b>	<b>From</b>	<b>Maturity</b>	<b>Amount £m</b>	<b>Rate</b>
<b>&gt; 12 Months</b>	Royal Bank of Scotland	30/01/2015	30/01/2018	5.00	1.20%
	Royal Bank of Scotland	30/04/2015	30/04/2018	5.00	0.90%
	<b>SUB TOTAL</b>			<b>10.00</b>	
	<b>GRAND TOTAL</b>			<b>406.62</b>	



## 2016-17 Revised Prudential and Treasury Management Indicators

Prudential Indicators	2015/16	2016/17	2016/17	2017/18	2018/19
Extract from Estimate and rent setting reports	Actual	Original Estimate	Revised Estimate	Estimate	Estimate
	£m	£m	£m	£m	£m
<b>Capital Expenditure</b>					
Non – HRA	26.620	89.475	77.362	47.149	10.616
HRA	66.359	138.315	92.991	70.301	87.217
<b>TOTAL</b>	<b>92.979</b>	<b>227.790</b>	<b>170.353</b>	<b>117.450</b>	<b>97.833</b>
<b>Ratio of Financing Costs To Net Revenue Stream</b>					
Non – HRA	0.30%	0.33%	0.00%	0.00%	0.00%
HRA	3.70%	3.69%	4.42%	4.43%	8.16%
	£m	£m	£m	£m	£m
<b>Gross Debt and Capital Financing Requirement</b>					
Gross Debt	129.864	139.780	141.335	124.452	192.323
Capital Financing Requirement	262.588	267.344	268.381	259.644	321.946
Over/(Under) Borrowing	(132.724)	(127.564)	(127.046)	(135.192)	(129.624)
<b>In Year Capital Financing Requirement</b>					
Non – HRA	0.145	0.150	0.355	0.000	0.000
HRA	0.000	12.860	14.210	0.000	70.999
<b>TOTAL</b>	<b>0.145</b>	<b>13.010</b>	<b>14.565</b>	<b>0.000</b>	<b>70.999</b>
<b>Capital Financing Requirement as at 31 March</b>					
Non - HRA	192.913	187.096	186.813	180.394	174.011
HRA	69.675	80.248	81.567	79.250	147.935
<b>TOTAL</b>	<b>262.588</b>	<b>267.344</b>	<b>268.381</b>	<b>259.644</b>	<b>321.946</b>
<b>Incremental Impact of Financing Costs (£)</b>					
Increase in Council Tax (band D) per annum	67.317	101.444	73.130	80.534	84.610
Increase in average housing rent per week	5.176	5.261	6.452	6.550	12.102

Treasury Management Indicators	2014/15	2015/16	2015/16	2016/17	2017/18
	Actual	Original Estimate	Revised Estimate	Estimate	Estimate
	£m	£m	£m	£m	£m
<b>Authorised Limit For External Debt -</b>					
Borrowing & Other long term liabilities	245.720	323.828	292.349	326.700	327.089
Headroom	20.000	20.000	20.000	20.000	20.000
<b>TOTAL</b>	<b>265.720</b>	<b>343.828</b>	<b>312.349</b>	<b>346.700</b>	<b>347.089</b>
<b>Operational Boundary For External Debt -</b>					
Borrowing	206.310	285.356	253.877	289.192	290.786
Other long term liabilities	39.410	38.472	38.472	37.508	36.303
<b>TOTAL</b>	<b>245.720</b>	<b>323.828</b>	<b>292.349</b>	<b>326.700</b>	<b>327.089</b>
<b>Gross Borrowing</b>	<b>136.700</b>	<b>162.789</b>	<b>127.117</b>	<b>159.979</b>	<b>157.416</b>
<b>HRA Debt Limit*</b>	<b>184.381</b>	<b>192.000</b>	<b>192.000</b>	<b>192.000</b>	<b>192.000</b>
<b>Upper Limit For Fixed Interest Rate Exposure</b>					
Net principal re fixed rate borrowing / investments	<b>100%</b>	<b>100%</b>	<b>100%</b>	<b>100%</b>	<b>100%</b>
<b>Upper Limit For Variable Rate Exposure</b>					
Net interest payable on variable rate borrowing / investments	<b>20%</b>	<b>20%</b>	<b>20%</b>	<b>20%</b>	<b>20%</b>
<b>Upper limit for total principal sums invested for over 364 days (per maturity date)</b>	<b>£50m</b>	<b>£50m</b>	<b>£50m</b>	<b>£50m</b>	<b>£50m</b>

Maturity structure of new fixed rate borrowing during 2015/16	Upper Limit	Lower Limit
under 12 months	10%	0%
12 months and within 24 months	30%	0%
24 months and within 5 years	40%	0%
5 years and within 10 years	80%	0%
10 years and above	100%	0%

## List of Approved Counterparties for Lending for London Borough of Tower Hamlets.

Any values highlighted in yellow have undergone a change in the past 14 days.

Counterparty	Fitch Ratings			Moody's Ratings			S&P Ratings		
	Long Term	Short Term		Long Term	Short Term		Long Term	Short Term	
<b>Australia</b>	SB	AAA		SB	Aaa		NO	AAA	
<b>Banks</b>									
Australia and New Zealand Banking Group Ltd.	SB	AA-	F1+	NO	Aa2	P-1	NO	AA-	A-1+
Commonwealth Bank of Australia	SB	AA-	F1+	NO	Aa2	P-1	NO	AA-	A-1+
Macquarie Bank Ltd.	SB	A	F1	SB	A2	P-1	SB	A	A-1
National Australia Bank Ltd.	SB	AA-	F1+	NO	Aa2	P-1	NO	AA-	A-1+
Westpac Banking Corp.	SB	AA-	F1+	NO	Aa2	P-1	NO	AA-	A-1+
<b>Canada</b>	SB	AAA		SB	Aaa		SB	AAA	
<b>Banks</b>									
Bank of Montreal	SB	AA-	F1+	NO	Aa3	P-1	SB	A+	A-1
Bank of Nova Scotia	SB	AA-	F1+	NO	Aa3	P-1	SB	A+	A-1
Canadian Imperial Bank of Commerce	SB	AA-	F1+	NO	Aa3	P-1	SB	A+	A-1
National Bank of Canada	SB	A+	F1	NO	Aa3	P-1	SB	A	A-1
Royal Bank of Canada	NO	AA	F1+	NO	Aa3	P-1	NO	AA-	A-1+
Toronto-Dominion Bank	SB	AA-	F1+	NO	Aa1	P-1	SB	AA-	A-1+
<b>Denmark</b>	SB	AAA		SB	Aaa		SB	AAA	
<b>Banks</b>									
Danske A/S	SB	A	F1	PO	A1	P-1	SB	A	A-1
<b>Germany</b>	SB	AAA		SB	Aaa		SB	AAA	
<b>Banks</b>									
DZ BANK AG Deutsche Zentral-Genossenschaftsbank	SB	AA-	F1+	SB	Aa1	P-1	SB	AA-	A-1+

	Landesbank Berlin AG				PO	Aa3	P-1			
	Landesbank Hessen-Thuringen Girozentrale	SB	A+	F1+	SB	Aa3	P-1	SB	A	A-1
	Landwirtschaftliche Rentenbank	SB	AAA	F1+	SB	Aaa	P-1	SB	AAA	A-1+
	NRW.BANK	SB	AAA	F1+	SB	Aa1	P-1	SB	AA-	A-1+
<b>Netherlands</b>		SB	AAA		SB	Aaa		SB	AAA	
<b>Banks</b>	ABN AMRO Bank N.V.	SB	A+	F1	SB	A1	P-1	SB	A	A-1
	Bank Nederlandse Gemeenten N.V.	SB	AA+	F1+	SB	Aaa	P-1	SB	AAA	A-1+
	Cooperatieve Rabobank U.A.	SB	AA-	F1+	SB	Aa2	P-1	SB	A+	A-1
	ING Bank N.V.	SB	A+	F1	SB	A1	P-1	SB	A	A-1
	Nederlandse Waterschapsbank N.V.				SB	Aaa	P-1	SB	AAA	A-1+
<b>Singapore</b>		SB	AAA		SB	Aaa		SB	AAA	
<b>Banks</b>	DBS Bank Ltd.	SB	AA-	F1+	NO	Aa1	P-1	SB	AA-	A-1+
	Oversea-Chinese Banking Corp. Ltd.	SB	AA-	F1+	NO	Aa1	P-1	SB	AA-	A-1+
	United Overseas Bank Ltd.	SB	AA-	F1+	NO	Aa1	P-1	SB	AA-	A-1+
<b>Sweden</b>		SB	AAA		SB	Aaa		SB	AAA	
<b>Banks</b>	Nordea Bank AB	SB	AA-	F1+	SB	Aa3	P-1	NO	AA-	A-1+
	Skandinaviska Enskilda Banken AB	SB	AA-	F1+	SB	Aa3	P-1	SB	A+	A-1
	Svenska Handelsbanken AB	SB	AA	F1+	SB	Aa2	P-1	NO	AA-	A-1+
	Swedbank AB	SB	AA-	F1+	SB	Aa3	P-1	NO	AA-	A-1+
<b>Switzerland</b>		SB	AAA		SB	Aaa		SB	AAA	
<b>Banks</b>	Credit Suisse AG	SB	A	F1	SB	A1	P-1	SB	A	A-1
	UBS AG	SB	A+	F1	SB	Aa3	P-1	SB	A+	A-1
<b>United Kingdom</b>										

		N O	AA		N O	Aa1		NO	AA	
AAA rated and Government backed securities Banks	Debt Management Office									
	Bank of Scotland PLC	SB	A+	F1	SB	A1	P-1	NO	A	A-1
	Close Brothers Ltd	SB	A	F1	SB	Aa3	P-1			
	Co-operative Bank PLC (The)	SB	B	B	PO	Caa 2	NP			
	Goldman Sachs International Bank	PO	A	F1	SB	A1	P-1	P W	A	A-1
	HSBC Bank PLC	SB	AA-	F1 +	N O	Aa2	P-1	NO	AA-	A-1+
	Lloyds Bank Plc	SB	A+	F1	SB	A1	P-1	NO	A	A-1
	Santander UK PLC	PO	A	F1	N O	Aa3	P-1	NO	A	A-1
	Standard Chartered Bank	SB	A+	F1	N O	Aa3	P-1	PO	A	A-1
	Sumitomo Mitsui Banking Corporation Europe Ltd	N O	A	F1	SB	A1	P-1	SB	A	A-1
	UBS Ltd.	SB	A+	F1	SB	A1	P-1	SB	A+	A-1
Ulster Bank Ltd	SB	BBB +	F2	PO	A3	P-2	SB	BBB	A-2	
Building Society	Coventry Building Society	SB	A	F1	N O	A2	P-1			
	Cumberland Building Society									
	Leeds Building Society	SB	A-	F1	N O	A2	P-1			
	National Counties Building Society									
	Nationwide Building Society	PO	A	F1	N O	Aa3	P-1	NO	A	A-1
	Newcastle Building Society	SB	WD	WD						
	Nottingham Building Society				N O	Baa1	P-2			
	Principality Building Society	SB	BBB +	F2	SB	Baa3	P-3			
	Progressive Building Society									
	Skipton Building Society	SB	A-	F1	PO	Baa2	P-2			

	West Bromwich Building Society				SB	B1	NP			
	Yorkshire Building Society	SB	A-	F1	SB	A3	P-2			
Nationalised and Part Nationalised Banks	National Westminster Bank PLC	SB	BBB+	F2	PO	A3	P-2	SB	BBB+	A-2
	The Royal Bank of Scotland Plc	SB	BBB+	F2	PO	A3	P-2	SB	BBB+	A-2

**Advisory notes:**

**Local Authorities** - £20 Million per LA

**Money Market Funds**- £25 Million per Fund

**Standard Banks** up to 3 - 5 years - £25 Million or 1 year - £30 Million

**Part Nationalised Banks** 5 years - £50 Million or 1 year - £70 Million

## Glossary

Asset Life	How long an asset, e.g. a Council building is likely to last.
Borrowing Portfolio	A list of loans held by the Council.
Borrowing Requirements	The principal amount the Council requires borrowing to finance capital expenditure and loan redemptions.
Capitalisation direction or regulations	Approval from central government to fund certain specified types of revenue expenditure from capital resources.
CIPFA Code of Practice on Treasury Management	A professional code of Practice which regulates treasury management activities.
Capital Financing Requirement (CFR)	Capital Financing Requirement- a measure of the Council's underlying need to borrow to fund capital expenditure.
Certificates of Deposits	A certificate of deposit (CD) is a time deposit, a financial product. CDs are similar to savings accounts in that they are insured and thus virtually risk free; they are "money in the bank." They are different from savings accounts in that the CD has a specific, fixed term (often monthly, three months, six months, or one to five years) and, usually, a fixed interest rate. It is intended that the CD be held until maturity, at which time the money may be withdrawn together with the accrued interest.
Commercial paper	Commercial paper is a money-market security issued (sold) by large corporations to obtain funds to meet short-term debt obligations (for example, payroll), and is backed only by an issuing bank or corporation's promise to pay the face amount on the maturity date specified on the note. Since it is not backed by collateral, only firms with excellent credit ratings from a recognized credit rating agency will be able to sell their commercial paper at a reasonable price. Commercial paper is usually sold at a discount from face value, and carries higher interest repayment rates than bonds
Counterparties	Organisations or Institutions the Council lends money to e.g. Banks; Local Authorities and MMF.
Corporate bonds	A corporate bond is a bond issued by a corporation. It is a bond that a corporation issues to raise money effectively in order to expand its business. The term is usually applied to longer-term debt instruments, generally with a maturity date falling at least a year after their issue date.
Covered bonds	A covered bond is a corporate bond with one important enhancement: recourse to a pool of assets that secures or "covers" the bond if the originator (usually a financial institution) becomes insolvent. These assets act as additional credit cover; they do not have any bearing on the contractual cash flow to the investor, as is the case with Securitized assets.
Consumer Prices Index & Retail Prices Index (CPI & RPI)	The main inflation rate used in the UK is the CPI. The Chancellor of the Exchequer bases the UK inflation target on the CPI. The CPI inflation target is set at 2%. The CPI differs from the RPI in that CPI excludes housing costs. Also used

	is RPIX, which is a variation of RPI, one that removes mortgage interest payments.
Credit Default Swap (CDS)	A kind of protection that can be purchased by MMF companies from insurance companies (for their investment) in exchange for a payoff if the organisation they have invested in does not repay the loan i.e. they default.
Credit watch	Variety of special programs offered by credit rating agencies and financial institutions to monitor organisation/individual's (e.g. bank) credit report for any credit related changes. A credit watch allows the organisation/individuals to act on any red flags before they can have a detrimental effect on credit score/history.
Credit Arrangements	Methods of Financing such as finance leasing
Credit Ratings	A scoring system issued by credit rating agencies such as Fitch, Moody's and Standard & Poors that indicate the financial strength and other factors of a bank or similar institution.
Creditworthiness	How highly rated an institution is according to its credit rating.
Debt Management Office (DMO)	The DMO is an agency of the HM Treasury which is responsible for carrying out the Government's Debt Management Policy.
Debt Rescheduling	The refinancing of loans at different terms and rates to the original loan.
Depreciation Method	The spread of the cost of an asset over its useful life.
Gross domestic product (GDP)	Gross domestic product (GDP) is a measure of the size of an economy. It is defined as "an aggregate measure of production equal to the sum of the gross values added of all resident, institutional units engaged in production (plus any taxes, and minus any subsidies, on products not included in the value of their outputs)" by the OECD. GDP estimates are commonly used to measure the economic performance of a whole country or region, but can also measure the relative contribution of an industry sector.
Gilt	Gilt-edged securities are bonds issued by certain national governments. The term is of British origin, and originally referred to the debt securities issued by the Bank of England, which had a gilt (or gilded) edge. Hence, they are known as gilt-edged securities, or gilts for short. Today the term is used in the United Kingdom as well as some Commonwealth nations, such as South Africa and India. However, when reference is made to "gilts", what is generally meant is "UK gilts," unless otherwise specified.
Interest Rate exposures	A measure of the proportion of money invested and what impact movements in the financial markets would have on them.
The International Monetary Fund (IMF)	is an intergovernmental organisation which states its aims as to foster global monetary cooperation, secure financial stability, facilitate international trade, promote high employment and sustainable economic growth, and reduce



Impaired investment	poverty around the world. An investment that has had a reduction in value to reflect changes that could impact significantly on the benefits expected from it.
LIBID	The London Interbank Bid Rate – it is the interest rate at which major banks in London are willing to borrow (bid for) funds from each other.
Market Loans	Loans from banks available from the London Money Market including LOBOS (Lender Option, Borrowing Option) which enable the authority to take advantage of low fixed interest for a number of years before an agreed variable rate comes into force.
Money Market Fund (MMF)	A ‘pool’ of different types of investments managed by a fund manager that invests in lightly liquid short term financial instruments with high credit rating.
Monetary Policy Committee (MPC)	Committee designated by the Bank of England, whose main role is to regulate interest rates.
Minimum Revenue Provision (MRP)	This is the amount which must be set aside from the revenue budget each year to cover future repayment of loans.
Non Specified Investments The Organisation for Economic Co-operation and Development (OECD)	Investments deemed to have a greater element of risk such as investments for longer than one year The Organisation for Economic Co-operation and Development (OECD) is an international economic organisation of 34 countries, founded in 1961 to stimulate economic progress and world trade. It is a forum of countries describing themselves as committed to democracy and the market economy, providing a platform to compare policy experiences, seeking answers to common problems, identify good practices and coordinate domestic and international policies of its members.
Premium	Cost of early repayment of loan to PWLB to compensate for any losses that they may incur
Prudential Indicators	Set of rules providing local authorities borrowing for funding capital projects under a professional code of practice developed by CIPFA and providing measures of affordability and prudence reflecting the Council’s Capital Expenditure, Debt and Treasury Management.
PWLB	Public Works Loan Board, a statutory body whose function is to lend money to Local Authorities (LAs) and other prescribed bodies. The PWLB normally are the cheapest source of long term borrowing for LAs.
Specified Investments	Investments that meet the Council’s high credit quality criteria and repayable within 12 months.
Supranational bonds	Supranational bonds are issued by institutions that represent a number of countries, not just one. Thus, organisations that issue such bonds tend to be the World Bank or the European Investment Bank. The issuance of these bonds are for the purpose of promoting economic development
Treasury bills (or T-bills)	Treasury bills (or T-bills) mature in one year or less. Like

zero-coupon bonds, they do not pay interest prior to maturity; instead they are sold at a discount of the par value to create a positive yield to maturity. Many regard Treasury bills as the least risky investment available.

Unrated institution

An institution that does not possess a credit rating from one of the main credit rating agencies.

Unsupported Borrowing

Borrowing where costs are wholly financed by the Council.

Non-Executive Report of the: <b>Audit Committee</b> 8 <sup>th</sup> November 2016	 <b>TOWER HAMLETS</b>
<b>Report of:</b> Zena Cooke - Corporate Director - Resources	<b>Classification:</b> Unrestricted
<b>National Fraud Initiative Progress 2016/17</b>	

<b>Originating Officer(s)</b>	Sue Oakley
<b>Wards affected</b>	All wards

## **1. Summary**

1.1 This report provides details of the background and evolution of the National Fraud Initiative, and the National Fraud Initiative (NFI) 2014 exercise. This is a bi-annual data matching exercise whereby all Local Authorities and some other government agencies match their data to prevent and detect fraud and error in their systems.

## **2. Recommendations**

2.1 The Audit Committee is asked to note this report.

## **3. Background**

3.1 The NFI compares different sets of data, for example payroll and benefit records against other records held by the same or another organisation, bringing to light potentially fraudulent claims and payments. Where a match is found it may mean that further investigation is required.

3.2 The NFI has been running since 1994, and was originally managed by the Audit Commission. The Commission processed the NFI data under its statutory powers under part 2A of the Audit Commission Act (1998) these powers put the matching on a statutory footing for local government and NHS bodies

3.3 The Serious Crime Act 2007 (SCA) gave the Commission new powers to enable the benefit of NFI to be extended to Central Government and the private sector. The SCA inserted a new paragraph into the 1998 Audit Commission Act.

3.4 The SCA imposed a new regulatory regime alongside existing fair processing and other compliance requirements of the Data Protection Act 1998. Any person or body conducting or participating in the exercise must by law, have regard to a statutory Code of Data Matching Practice.

**3.5** Over time the exercise has evolved to extend its partners to all Local Authorities in England, Wales, Scotland and Northern Ireland, and now includes pension details from the Police, Health Service and Fire Service. To date over £1 billion has been identified in fraud and overpayments over the various exercises across the country.

**3.6** The 2014 exercise is now managed by the Cabinet Office following the dissolution of the Audit Commission.

#### **4. The 2014 (Current) Exercise**

**4.1** As mentioned previously, the main NFI matching exercise takes place bi-annually, with the current exercise commencing in October 2014 when the data was supplied. This exercise has run for a two year period and is now drawing to a close.

**4.2** Below is a list of the 16 data sets provided to NFI for the current matching exercise:

LBTH Pensions	Transport Passes /Residents Permits
LBTH Payroll	Blue Badge Holders
Housing Benefits	Right to Buy Applicants
Housing Tenants (THH)	Personal Budget Holders
Insurance Claimants	Private Supported Care Home Residents
Market Traders	Creditors Standing
Alcohol Licence Holders	Creditors Payments
Electoral Register	Council Tax Account Holders

**4.3** On 29<sup>th</sup> January 2015 the matches for the main exercise were released and for this Authority totalled 18,188 individual matches. These are presented in reports collated by type of match and subject matter.

**4.4** The matched data is contained on a secure website and access is granted to selected officers from each relevant service so that they can examine their own particular output and evaluate each match for the likelihood of fraud or error.

**4.5** The majority of the matches are erroneous, and arise because the data held is not completely up to date, has been inaccurately input, or simply that the matching criteria is not as well targeted as it might be. However, ideally, each one needs to be examined to eliminate the non-problem matches.

**4.6** Because of the sheer volume and spread of matched output there are invariably some reports that are not fully examined. The NFI system has its own inbuilt risk assessment system and this is used as a guideline to prioritise those matches which need attention as a priority. Also, experience and knowledge of previous years' exercises dictates which reports yield results, and which involve less accurate data and therefore contain largely inaccurate matches. This also helps us to prioritise the progress of the exercise.

**4.7** The Risk Management Section oversees the exercise, and aims to guide each service to completing its batch of NFI reports. Some reports are dealt with entirely by investigators within the Risk Management Section, since investigators specialising in these areas are based within the team.

**4.8** Where fraud or error is identified on a particular match the details are recorded on the NFI system, and in most cases recovery of the monies is sought. Where a system weakness is identified, the service in question should seek to resolve the issue by strengthening their controls to prevent recurrence. Similarly matches arising from data errors should prompt the service to improve the quality of its data.

## **5. Progress on the 2014 Exercise**

**5.1** To date 2,509 matches have been processed, and a further 177 are still in progress. One hundred and nine cases of fraud have been discovered and a further 122 cases of 'error' have been recorded. Matches cleared with no issue amount to 2,278.

**5.2** The total monetary value of the fraud and error identified to date amounts to £1,470,535.60

**5.3** A breakdown is shown below:

<b>Subject</b>	<b>Monetary value</b>	<b>Number of cases</b>	<b>Recovery action</b>
Housing Benefit related, including overpaid DWP benefits	£1,252,453.80	107 (fraud) 5 (error)	Yes, recovery ongoing
LBTH Pensions	£14,819.17	8	Yes, recovery ongoing
Blue Badge	Not valued	1 (fraud) 100 (error)	Yes, badges stopped or recovered
Housing Tenancy	1 Social Housing property recovered	1 (fraud)	Yes, 1 property recovered
Duplicate creditor payments	£122,297.49	7	Yes, recovery ongoing
Payroll	£80,965.33 (estimated value)	2	No

**5.4** The majority of the monetary value identified relates to Housing Benefit irregularities, where a specific value of benefit is identified as having been overpaid as a result of an investigation. Recovery is usually sought in addition to potential criminal prosecution action, or other sanction such as a Caution, or an Administration Penalty (a fine). However, in February 2016 the Housing Benefit Investigations Team transferred to the Department of Work

and Pensions, so action taken in terms of prosecutions or sanctions is no longer part of the Local Authorities remit.

**5.5** The LBTH Pensions value arose where the matches highlighted pensioners who had died, unknown to the authority. On these cases recovery is sought by the Pensions Section via their liaison with the deceased's family.

**5.6** One Social Housing Property has been recovered arising from this exercise.

**5.7** 101 Blue Badges have been recovered or stopped due to the recipient being deceased, unbeknown to the authority. At present no further action beyond recovery of the badge or preventing further issue has been taken on these. However one case in particular is being considered for prosecution after parking investigators identified the blue badge of a deceased person still in use after their death.

**5.8** A small number of duplicate creditor payments have been identified and are in the process of being recovered. The Finance Department have their own internal controls and have found that on many of the matches the error was already identified and rectified prior to the matches being received.

## **6. NFI 2016-18**

**6.1** A new exercise is about to commence with the Council's data being supplied to the Cabinet Office this month (October 2016). The resulting matches are due to be released in late January 2017.

**6.2** The Council Tax and Electoral Register data, which is designed to highlight discrepancies in Single Person Discounts awarded on Council Tax, will be matched at a slightly later time due to the Electoral Register's changes to compiling the register, because the completed register is not available until 1<sup>st</sup> December. These matches will also be available in January 2017.

## **7. Comments of the Chief Finance Officer**

**7.1** This report provides an update on progress with the National Fraud Initiative work as part of the 2014-16 Programme. To date the Council has identified notional and actual savings of £1,470,000 from its participation in the exercise and details are provided in 5.3 above.

**7.2** During this period there were approximately 15.5 staff directly deployed on fraud prevention activity at an estimated cost of approximately £930k per annum, 9 dealing with Housing Benefit Fraud, 5 dealing with Tenancy Fraud and 1.5 dealing with Parking related Fraud. Funding for these posts were through a combination of DWP admin subsidy grants, Parking income and HRA funding.

**7.3** 85% of the value of fraud detected related to Housing Benefit Fraud and during the period 2014-16 there was a dedicated team of 9 staff dealing with

Housing Benefit Fraud at a cost of £569k per annum, funded through Housing Benefit Admin Subsidy from the DWP. In 2016/17 these resources transferred to the DWP and future Housing Benefit Fraud investigation work needs to be referred to the DWP to investigate. The Council will need to give further consideration to what additional Council resources may be required to manage any future NFI work.

## **8. Legal Comments**

**8.1** The Serious Crime Act 2007 gave the Audit Commission new statutory powers to conduct data matching exercises by inserting a new Part IIA into the Audit Commission Act 1998 ('the 1998 Act'). Although Audit Commission was abolished by the Local Audit and Accountability Act 2014 ('the 2014 Act'), the National Fraud Initiative (NFI) was moved to the cabinet office in advance of its abolition.

**8.2** Statutory Guidance released pursuant to section 32(g) of the 1998 Act 'The Code of Data Matching Practice' was published in 2008 and most recently updated on 20/3/15. The statutory basis for this code is now set out in schedule 9 of the 2014 Act. The purpose of this code is to help ensure that the NFI and everyone involved in NFI data matching exercises comply with the law, especially regarding the provisions of the Data protection Act 1998. It also promotes good practice for the matching, such as

- The notification process for letting individuals know why their data is being matched
- The standards that apply
- Where to find further information

**8.3** Additionally, unless certain exemptions within the Data Protection Act 1998 apply, the Council is required to provide Fair Processing information which complies with the Fair Processing Statutory Guidance released on 20/3/15.

**8.4** Under regulation 3 of the Accounts and Audit Regulations 2015, the Council is required to ensure that it has a sound system of internal control that facilitates the effective exercise of the Council's functions. The consideration of this report is consistent with the Council's obligations and is within the Committee's functions.

## **9. One Tower Hamlets**

**9.1** There are no specific one Tower Hamlets considerations.

**9.2** There are no specific Anti-Poverty issues arising from this report

## **10. Best Value Implications**

**10.1.** This report highlights areas where internal control, governance and risk management can be improved to meet the Best Value Duty of the Council.

## **11. Risk Management Implications**

**11.1.** This report highlights risks arising from weaknesses in controls that may expose the Council to unnecessary risk. The risks highlighted in this report require management responsible for the systems of control to take steps so that effective governance can be put in place to manage the authority's exposure to risk.

## **12. Sustainable Action for a Greener Environment (SAGE)**

**12.1.** There are no specific SAGE implications.

## **13. Crime and Disorder Reduction Implications**

**13.1.** By having sound systems of controls, the Council can safeguard against the risk of fraud and abuse of financial resources and assets.



Non-Executive Report of the: <b>Audit Committee</b> 8 <sup>th</sup> November 2016	 <b>TOWER HAMLETS</b>
<b>Report of:</b> Zena Cooke - Corporate Director - Resources	<b>Classification:</b> Unrestricted
<b>Revised Audit Plan 2016/17</b>	

<b>Originating Officer(s)</b>	Minesh Jani and Bharat Mehta
<b>Wards affected</b>	All wards

## 1. SUMMARY

- 1.1. This report provides an update of audit activity planned for this financial year and reflects changes made to the original internal audit plan as a result of changing priorities of the authority within the resources available to perform audit work.

## 2. RECOMMENDATIONS

- 2.1 The Audit Committee is asked to note the changes proposed and to endorse the revised 2016/17 internal audit plan attached at Appendix 2.
- 2.2 The Audit Committee is asked to note the resourcing of the audit plan, as detailed at para. 4.1 of this report.

## 3. BACKGROUND

- 3.1 The original internal audit plan was prepared at the start of the current financial year and was presented to CMT and the Audit Committee for endorsement in March 2016. The internal audit plan was formulated using the governance model whereby four key areas were assessed for all operations of the Council and prioritised.
- 3.2 In line with the internal audit strategy, the plan has been refreshed and some changes made to the original annual audit plan. The reasons for this are as follows:
- Requests from officers to perform audits that were not originally planned;

- Requests from officers to increase the scope of audits which has resulted in higher allocation of audit days;
- Requests from Chief Officers to defer audits due to service restructuring, other external inspections and changes made to existing systems and the need to allow a period of bedding in;
- Make use of days provided in the original plan that had not been allocated to specific audits.
- To avoid duplication of work with either the external auditor or other assurance provider; and
- Additional commitment to unplanned work.

#### **4. UPDATED INTERNAL AUDIT PLAN FOR 2016/17**

4.1 Appendix 1 summarises audits that have been added to or deferred from the original internal audit plan. Audits listed in Appendix 1 which are proposed to be carried forward to 2017/18, could still be scheduled for 2016/17 if resources permit. The summary below shows how the plan has changed from that approved in March 2016.

Number of days originally planned	1,521
Add: Additional audits added to the plan (Please refer to Appendix 1)	147
Less: Audits to be considered as part of 2017/18 Audit Plan (Please refer to Appendix 1)	85
Less: Use of previously unallocated days to specific audits	37
Less: Use of reactive fraud allocation	25
Number of days per the Revised plan	1,521

#### **5. COMMENTS OF THE CHIEF FINANCE OFFICERS**

5.1 The 2016/17 audit plan will be delivered within the existing resources taking account of changes to the original scope and making use of the unallocated 'contingency days' in the original plan. To the extent that additional urgent audits arise they will either be accommodated by re-prioritising proposed audit work or through the identification of additional resources.

## **6. LEGAL COMMENTS**

- 6.1 The Council has a duty to make arrangements to secure continuous improvement in the way in which its functions are exercised, having regard to a combination of economy, efficiency and effectiveness by virtue of section 3 of the Local Government Act 1999. This is known as its Best Value Duty.
- 6.2 Under Regulation 3 of the Accounts and Audit Regulations 2015 (**‘the 2015 Regulations’**), the Council is required to ensure that it has a sound system of internal control that facilitates effective exercise of the Council’s functions and includes arrangements for the management of risk. The Council is also required by Regulation 5 to maintain an effective system of internal audit to evaluate the effectiveness of its risk management, control and governance processes, taking into account public sector internal auditing standards and guidance.
- 6.3 The Audit Plan assists with compliance with the Council’s Best Value Duty and regulations 3 and 5 of the 2015 Regulations.

## **7. ONE TOWER HAMLETS**

- 7.1. There are no specific one Tower Hamlets considerations.
- 7.2. There are no specific Anti-Poverty issues arising from this report

## **8. BEST VALUE IMPLICATIONS**

- 8.1. The revised plan includes areas where internal control, governance and risk management can be improved to meet the Best Value Duty of the Council.

## **9. RISK MANAGEMENT IMPLICATIONS**

- 9.1. In compiling the original and the revised audit plans, the Council’s Corporate and Directorate level risks have been considered. These risks have been programmed for review within the scope of individual audits listed in the plan.

## **10. SUSTAINABLE ACTION FOR A GREENER ENVIRONMENT (SAGE)**

- 10.1. There are no specific SAGE implications.

## **11. CRIME AND DISORDER REDUCTION IMPLICATIONS**

- 11.1. By having a sound planning system for a systematic and independent review of the Council’s internal controls, governance and risk management, the Council can safeguard against the risk of fraud and abuse of financial resources and

	Directorate	No. of days	No. of days
<b>Original 2016/17 Audit Plan</b>			<b>1,521</b>
<b><i>Audits Added to the Original Plan</i></b>			
Waiver of Procurement Rules for ATOS	RES	10	
Grant Claim Certification for Rogue Landlords	CLC	7	
Tendering for Ice Cream Pitches	CLC	15	
Withey House TMO	THH	15	
Corporate Purchase cards	CORP	25	
Youth Service Review	CS	20	
Ben Jonson School - Investigation	CS	10	
Lettings – further testing	D&R	15	
PFI Contract Review	RES	15	
Pensions Testing	RES	15	
<b><i>Sub Total</i></b>			<b>147</b>
			<b>1,668</b>
<b>Less</b>			
<b>Audits amended and carried forward to 2017/18</b>			
Control of Executive Decisions	CORP	15	
Management of Information Security Breaches	LPG	10	
Member-Officer Protocol	LPG	10	
Members' Hospitality and Gifts	LPG	5	
Procurement of Legal Advice	LPG	15	
Mulberry Place - Dilapidations	D&R	10	
Monitoring of MSG Grants Programme	RES	20	
<b><i>Sub Total</i></b>			<b>85</b>
Use of Management Request contingency		37	
Use of Reactive Fraud provision		25	
<b><i>Sub Total</i></b>			<b>62</b>
<b>Total Revised Plan</b>			<b>1,521</b>



# London Borough of Tower Hamlets

Risk, Internal Audit and Control – Revised Audit Plan 2016/17



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# Foreword

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The role of internal audit is important in supporting the Council achieve its goals and outcomes. For internal audit to contribute towards the overall goals of the organisation, effective planning of audit activity is essential, whether planned or unplanned. The annual audit plan for 2016/17 is devised using a risk based methodology, and focuses on areas where Tower Hamlets needs to be sure its risks are being properly managed. The plan also recognises the wider role audit has in supporting management, who strive to deliver excellent public services to residents living in, and people working in the borough, by including for example, consultancy audits, corporate reviews, value for money, contract and ICT audits. A large part of the annual plan rightly focuses on providing independent assurance over the systems of control for managing risks across the authority. There is also some flexibility within the plan for risks that will arise over the next financial year.

In preparing the plan, it is important to recognise the contributions made by officers at the Departmental and Corporate Management Teams, the S151 Officer, and the Chair of the Audit Committee for which I am grateful.

Minesh Jani  
Head of Risk Management and Audit

# Context

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Risk taking is vital to the success of any business; it is inherent in everything we do. All too often, however, risks are regarded only as hazards despite the fact they can present significant opportunities for organisations to innovate and gain short and long-term competitive advantages. Risk and opportunity are, in essence, a duality – like two sides of the same coin.

The Good Governance Standard for Public Services identifies that ‘Good governance means “taking informed, transparent decisions and managing risk”. This implies creating a framework of enterprise-wide risk management that is embedded in the ‘business as usual’ operations and viewed as an integral component of how the organisation is governed.

Risk management is not about avoiding or eliminating risk. It is about understanding what risks are and the potential impact upon the organisation should the risks materialise and also about controlling risks when they arise.

Embedding good, enterprise-wide risk management systems will facilitate the achievement of our strategic objectives.

Internal Audit and their evaluation of controls provide an important part of the tool kit that the Corporate Management Team and the Audit Committee have in evaluating the risks being faced by the organisation, and the controls that are in place to mitigate these risks.



# Key Risks

The Audit Plan is based on three principal sources of information – Risk Registers (Strategic Risks and Directorate based service risks), our own risk analysis and management request. In formulating the Audit Plan, the key corporate risks and Directorate based risks have been considered. There are **11 corporate risks** currently facing the Council which are being monitored by the CMT and the Audit Committee and are summarised below. These risks have been referenced within the Audit Plan, where applicable.

Risk Ref..	Risk
ASD0015	Death or serious harm to a vulnerable adult that was or should have been in receipt of services, either from the council or a partner agency.
DRA0016	Failure to meet the borough's housing targets.
CSDR0002	Council's inability to meet demand for school places
CSD0016	Death or serious harm to a child that was or should have been in receipt of services, either from the council or a partner agency.
LPGCOM0003	Failure to effectively manage the reputation of the Council.

No.	Risk
PPM0016	Failure of the Council's supply chain.
LPGSE0001	Failure to achieve community cohesion, Radicalisation of young people and gangs.
DR0029	Council is unable to identify a viable exit route from Mulberry Place that ensures staff are decanted by September 2019.
LPGLS0001	Non-compliance with corporate governance procedures.
CLSCEI0008	There is a risk that, should a major incident take place affecting Council services, there may be a failure to implement an effective response.

# The Role of Internal Audit

The role of Internal Audit is to provide an independent 'assurance' to the organisation that its systems of internal control are sound and adequate, and are being complied with by staff and management.

Internal Audit is a review function, which independently reviews and reports upon the organisation's internal control, governance and risk management arrangements. It critically evaluates the entire internal control framework and where necessary, makes recommendations for improvement and the introduction of best practice.

**The public sector internal audit standards defines internal audit as:**

***“an independent, objective assurance and consulting activity designed to add value and improve an organisation's operations. It helps an organisation accomplish its objectives by bringing a systematic, disciplined approach to evaluate and improve the effectiveness of risk management, control and governance processes.”***

The findings emerging from internal audit reviews provide a basis for an Annual Audit Opinion in the Statement of Internal Control within the Annual Governance Statement.

# London Borough of Tower Hamlets 2016/17 Internal Audit Plan

	<b>Audit Days</b>	<b>Pages</b>
Corporate systems and Council-wide reviews	195	8-10
Adults Services	85	11-12
Children's Services	260	13-14
Communities, Localities & Culture	172	15-17
Development & Renewal	120	18-19
Resources & core financial systems	256	20-22
Tower Hamlets Homes	145	23-25
Information technology audits	100	26
Follow up, management and reactive fraud provision	188	26
<b>Total Provision</b>	<b>1,521</b>	-

## Internal Audit Plan 2016/17

### Corporate Audits

	<b>Broad Scope</b>	<b>Audit Days</b>	<b>Audit Source</b>	<b>Link with Corporate Priorities</b>
Best Value Action Plans	The objective of this audit would be to test and determine the extent to which the five Best Value Improvement Plans around Procurement, Property, Communications, Grants and Organisational Culture have been embedded into the business processes.	50	CMT and Commissioners	<b>One Tower Hamlets</b> Working efficiently and effectively as One Council
Control and Monitoring of DBS checks	This audit will review the effectiveness of systems and procedures in place for controlling, monitoring and reviewing DBS checks for employees working in the relevant professions which require basic and enhanced DBS clearance.	15	Audit Needs Analysis	<b>One Tower Hamlets</b> Working efficiently and effectively as One Council
Business Continuity Planning and Disaster Recovery	This audit will examine systems for ensuring that should a major incident takes place which affects Council's services, the Council is resilient to plan, co-ordinate and manage an effective response to such events.	15	Audit Needs Analysis  Corporate Risk Ref. CLSCEI0008	<b>One Tower Hamlets</b> Working efficiently and effectively as One Council
Fees and Charges	This audit will examine the Council's arrangements for reviewing fees and charges to ensure compliance with its fees and charges policy and to maximise the potential for generating income. A sample of fees and charges across all Directorates will be selected for testing.	15	Management Request	<b>One Tower Hamlets</b> Working efficiently and effectively as One Council

	<b>Broad Scope</b>	<b>Audit Days</b>	<b>Audit Source</b>	<b>Link with Corporate Priorities</b>
Staff Hospitality	The objective of this audit will be to review the systems and procedures for controlling and monitoring staff hospitality and gifts across all Directorates to ensure that the Council's ethical standards are complied with.	15	Audit Needs Analysis  Corporate Risk LPGLS0001	<b>One Tower Hamlets</b> Working efficiently and effectively as One Council
Control and Monitoring of Corporate Purchase Cards	This audit will examine the Council's systems and procedures for using, controlling and monitoring of Purchase Cards.	25	Management Request	<b>One Tower Hamlets</b> Working efficiently and effectively as One Council
Staff Declaration of Interests	To provide assurance that the systems for declaration of interests by staff across Directors are sound and secure to ensure that the Council's ethical standards are complied with.	15	Audit Needs Analysis  Corporate Risk LPGLS0001	<b>One Tower Hamlets</b> Working efficiently and effectively as One Council
Programme and Project Management	This audit will review the Council's Corporate arrangements for ensuring that there are sound procedures and tools for managing and monitoring major change programmes and projects.	10	Audit Needs Analysis  Corporate Risk LPGCOM0003 and RSB0019	<b>One Tower Hamlets</b> Working efficiently and effectively as One Council
Acting up and Honoraria Payments	The objective of this audit will be ensure that current acting up and honoraria payments across all Directorates are in accordance with Council's policy and that such payments are approved, controlled, monitored and reviewed.	15	Audit Needs Analysis  Corporate Risk LPGCOM0003	<b>One Tower Hamlets</b> Working efficiently and effectively as One Council
Local Code of Corporate Governance	To ensure that the best practice principles of CIPFA Good Governance Framework 2016 are incorporated in the	10	Audit Needs Analysis and Corporate Risk	<b>One Tower Hamlets</b> Working efficiently and effectively as One Council

	<b>Broad Scope</b>	<b>Audit Days</b>	<b>Audit Source</b>	<b>Link with Corporate Priorities</b>
	LBTH Local Code of Corporate Governance and to test compliance with the best practice.		LPGLS0001	
Whistle blowing procedures	The review will review the Council's whistle blowing arrangements once planned changes have been implemented and provide assurance over their operations.	10	Audit Needs Analysis Corporate Risk LPGLS0001	<b>One Tower Hamlets</b> Working efficiently and effectively as One Council
<b>Total</b>		<b>195</b>		

**Adult Services**

	<b>Broad Scope</b>	<b>Audit Days</b>	<b>Audit Source</b>	<b>Link with Corporate Priorities</b>
Financial Assessments	This audit will review the systems for carrying out financial assessments of service users to ensure that assessments are undertaken and charged for in accordance with policy, procedures and regulations.	15	Audit Needs Analysis  Corporate Risk ASD0015	<b>A Safe and Supportive Community</b> Empower Older and Vulnerable People
Electronic Home Care Monitoring System	To provide assurance that the newly implemented electronic system is operating effectively to ensure that the service users receive the required service and payments are made only for the service/hours provided.	20	Audit Needs Analysis  Corporate Risk ASD0015	<b>A Safe and Supportive Community</b> Empower Older and Vulnerable People. Focus on Early Intervention
Contract Monitoring of Commissioned Services	This audit will examine systems and procedures for monitoring a sample of commissioned services to ensure that providers effectively deliver the services to vulnerable service users and that payments are made in line with the rates set out in the contract.	20	Audit Needs Analysis  Corporate Risk ASD0015	<b>A Safe and Supportive Community</b> Empower Older and Vulnerable People. Focus on Early Intervention

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	<b>Broad Scope</b>	<b>Audit Days</b>	<b>Audit Source</b>	<b>Link with Corporate Priorities</b>
Procurement of Domiciliary Home Care Contracts	This audit will review the tendering arrangements for domiciliary care contracts to ensure that Council's procurement procedures and financial regulations are complied with in the procurement process.	15	Audit Needs Analysis	<b>A Safe and Supportive Community</b> Empower Older and Vulnerable People. Focus on Early Intervention
Reviews of Care Plans	The objective of this audit is to provide assurance that controls are in place to ensure that Care Plans for vulnerable adults are reviewed within the statutory time period and that the plans are properly costed and budgeted for.	15	Audit Needs Analysis  Corporate Risk ASD0015	<b>A Safe and Supportive Community</b> Focus on Early Intervention
<b>Total</b>		<b>85</b>		

## Children's Services

	<b>Broad Scope</b>	<b>Audit Days</b>	<b>Audit Source</b>	<b>Link with Corporate Priorities</b>
Quality Assurance Systems for Child Protection	This audit will provide assurance that the quality assurance and review systems over child protection cases are sound and secure.	15	Audit Needs Analysis Corporate Risk CS0016	<b>A Safe and Supportive Community</b> Focus on Early Intervention
Prevent Strategy and Action Plan	This audit will review the arrangements put in place to discharge the requirements of the Council's Prevent Duty and the effectiveness of the delivery and monitoring of the action plan.	15	Management Request Corporate Risk LPGSE0001	<b>A Safe and Supportive Community</b> Focus on Early Intervention
Contract Audit	We will select a sample of building works in progress and test the effectiveness of contract management and monitoring to ensure that building works are delivered on time and to the agreed budget.	10	Audit Needs Analysis Corporate Risk CSDR0002	<b>One Tower Hamlets</b> Working efficiently and effectively as One Council
Schools Probity Audit	The school visits will cover areas of Leadership and Governance; Budget Management; Procurement; Income and Expenditure controls; Payroll and Personnel; Asset Management; and other key areas of schools' business.	160	Annual Programme of Audit	<b>A Prosperous Community</b> Support lifelong learning opportunities for all.
Youth Offending Service	This audit will review the arrangements for planning, controlling and governing the operation of the Youth Offending service to ensure that Council objectives are achieved.	15	Audit Needs Analysis and Management Request	<b>A Safe and Supportive Community</b> Focus on Early Intervention

	<b>Broad Scope</b>	<b>Audit Days</b>	<b>Audit Source</b>	<b>Link with Corporate Priorities</b>
Commissioning of Special Education Placements	This audit will review the effectiveness of procuring and monitoring placements for SEN pupils to ensure that the placements provide good value for money and that Council's procedures are complied.	15	Audit Needs Analysis and Management Request	<b>A Prosperous Community</b> Support lifelong learning opportunities for all.
Youth Service Review	This review will examine management controls and monitoring systems to provide assurance that the current service meets the Council's key objectives and priorities for youth service.	20	Management Request	<b>A Prosperous Community</b> Support lifelong learning opportunities for all.
Ben Jonson School Investigation	Providing assistance and support in the continuing investigation.	10		
		<b>260</b>		

## Communities, Locality and Culture

	<b>Broad Scope</b>	<b>Audit Days</b>	<b>Audit Source</b>	<b>Link with Corporate Priorities</b>
Street Lighting	This audit will review the monitoring arrangements for street lighting to ensure that works are identified, ordered, carried out, monitored and paid for in accordance with the contract.	15	Audit Needs Analysis	<b>One Tower Hamlets</b> Working efficiently and effectively as One Council
Penalty Charge Notices	To review the systems and controls for processing and management of PCNs, including the effectiveness of debt recovery through the bailiff contract.	15	Management Request	<b>One Tower Hamlets</b> Working efficiently and effectively as One Council
Parking Permits	The objective of this audit is to review the systems for processing new and renewal applications for parking permits, ensuring that permits are issued to those who meet the eligibility requirements and that there are sound controls in place.	20	Audit Needs Analysis	<b>One Tower Hamlets</b> Working efficiently and effectively as One Council
Tendering for Waste Contracts	To review compliance with Council's procurement procedures and to provide necessary advice.	5	Management Request	<b>One Tower Hamlets</b> Working efficiently and effectively as One Council
On the Spot Fine Collection	This audit will review the systems and controls for on the spot fine collection by officers in accordance with their delegated function to charge, collect and arrange for the safe custody, transfer and banking of the collected income.	10	Audit Needs Analysis	<b>One Tower Hamlets</b> Working efficiently and effectively as One Council

	<b>Broad Scope</b>	<b>Audit Days</b>	<b>Audit Source</b>	<b>Link with Corporate Priorities</b>
Boishakhi Mela	To be determined.	10	Management Request	<b>One Tower Hamlets</b> Working efficiently and effectively as One Council
Contract Procurement and Monitoring	This audit will review the systems and controls in place for procuring and monitoring contracts to ensure that Council procedures are complied with and that payments to contractors and income received from providers of concessionary services are in accordance with agreed rates and contract conditions.	25	Audit Needs Analysis  Management Request	<b>One Tower Hamlets</b> Working efficiently and effectively as One Council
Watney Market Idea Store	This will be a regularity visit to ensure that procedures for petty cash, income collection and banking, stock control, security, ordering of goods and services, staffing control, inventory control, health and safety etc. are being complied with.	10	Audit Needs Analysis	<b>One Tower Hamlets</b> Working efficiently and effectively as One Council
Brady Arts Centre and Kobi Nazrul Centre	This will be a regularity visit to ensure that procedures for petty cash, income collection and banking, security, ordering of goods and services, staffing control, inventory control, health and safety etc. are being complied with.	10	Audit Needs Analysis	<b>One Tower Hamlets</b> Working efficiently and effectively as One Council
CCTV Control Room	To review the controls over the effective operation of the control room and to provide assurance that any surveillance carried out is in accordance with the	10	Management Request	<b>One Tower Hamlets</b> Working efficiently and effectively as One Council

	<b>Broad Scope</b>	<b>Audit Days</b>	<b>Audit Source</b>	<b>Link with Corporate Priorities</b>
	RIPA regulations.			
Bancroft Library Archiving	To provide assurance that the controls over archiving, valuation, security and insurance of literature, arts and other pieces of heritage and history are sound and secure.	10	Management request	<b>One Tower Hamlets</b> Working efficiently and effectively as One Council
King George's Trust – Mile End Park	To review the governance and financial probity and management of the Trust accounts to provide assurance to stakeholders that arrangements are sound and secure and protects Council's interests.	10	Management Request	<b>One Tower Hamlets</b> Working efficiently and effectively as One Council
Tendering for Ice Cream Pitches	This audit reviewed the tendering procedures followed in letting concession contracts for Ice Cream Pitches in the Council's parks.	15	Management Request	<b>One Tower Hamlets</b> Working efficiently and effectively as One Council
Grant Certification for Rogue Landlords	This was grant certification work required by Management.	7	Management Request	<b>One Tower Hamlets</b> Working efficiently and effectively as One Council.
<b>Total</b>		<b>172</b>		

	<b>Broad Scope</b>	<b>Audit Days</b>	<b>Audit Source</b>	<b>Link with Corporate Priorities</b>
<b>Development and Renewal</b>				
Asset Disposals	This will be compliance testing of procedures developed by Management for managing the disposal of Council assets.	15	Audit Needs Analysis	<b>One Tower Hamlets</b> Working efficiently and effectively as One Council
Procurement of Temporary Accommodation	This audit will review the arrangements for procuring temporary accommodation for homeless families to ensure that the Council's procedures are complied with and that payments made are in accordance with the agreed rates.	15	Audit Needs Analysis	<b>One Tower Hamlets</b> Working efficiently and effectively as One Council
Control and Monitoring of RTB Valuations	The objective of this audit is to provide assurance over the robustness of systems for procuring, ordering, controlling and monitoring the valuations for RTB properties to ensure that Council's objectives are achieved.	15	Audit Needs Analysis and Management Request.  Corporate Risk DRA0016	<b>One Tower Hamlets</b> Working efficiently and effectively as One Council
Property Buy Back Programme	To review the effectiveness of the Council's buy back programme to ensure that properties bought back meet the set criteria, are valued appropriately and the programme is managed effectively to achieve Council's objectives and value for money principles.	15	Audit Needs Analysis  Corporate Risk DRA0016	<b>One Tower Hamlets</b> Working efficiently and effectively as One Council

	<b>Broad Scope</b>	<b>Audit Days</b>	<b>Audit Source</b>	<b>Link with Corporate Priorities</b>
Economic Benefits	This review will provide assurance that the Council has effective systems and controls in place for managing and monitoring the various Economic Benefits to the community designed in various agreements and contracts.	15	Audit Needs Analysis	<b>One Tower Hamlets</b> Working efficiently and effectively as One Council
Planning Permissions and Approvals	This audit will provide assurance that the Council's arrangements for granting and approving planning permissions are in accordance with rules and regulations.	15	Audit Needs Analysis and Management Request.	<b>One Tower Hamlets</b> Working efficiently and effectively as One Council
New Town Hall Building Project	To provide assurance that there are sound and secure project management arrangements in place to manage and monitor various contractual agreements for commissioning and building of the new town hall.	15	Audit Needs Analysis  Corporate Risk DR0029	<b>One Tower Hamlets</b> Working efficiently and effectively as One Council
Lettings	This audit reviewed systems for control and management of the Lettings process to ensure that Council policy and procedures are complied.	15	Management Request	<b>One Tower Hamlets</b> Working efficiently and effectively as One Council
<b>Total</b>		<b>120</b>		



## Resources

	<b>Broad Scope</b>	<b>Audit days</b>	<b>Audit Source</b>	<b>Link with Corporate Priorities</b>
Staff Recruitment	To ensure that recruitment to established posts are in compliance with the Council's recruitment policy and procedures.	20	Audit Needs Analysis	<b>One Tower Hamlets</b> Working efficiently and effectively as One Council
Waiving of Procurement Rules	This audit reviewed the compliance with the Council procedures on waiving of procurement rules for a supplier.	10	Management Request	<b>One Tower Hamlets</b> Working efficiently and effectively as One Council
Procurement Procedures	To review the Council's Procurement Procedures to provide assurance that they are fit for purpose and meet Council's priorities and objectives.	15	Audit Needs Analysis	<b>One Tower Hamlets</b> Working efficiently and effectively as One Council
Category Management	To test the effectiveness of the category management function to ensure that the operational procedures for category management are complied with.	15	Audit Needs Analysis	<b>One Tower Hamlets</b> Working efficiently and effectively as One Council
Client Monitoring of ICT Contract	This audit will examine the procedures for monitoring the contract with Agilisys by the client team to ensure that the systems for performance monitoring are effective and that payments and deductions are made in accordance with the contract.	15	Audit Needs Analysis	<b>One Tower Hamlets</b> Working efficiently and effectively as One Council

	<b>Broad Scope</b>	<b>Audit days</b>	<b>Audit Source</b>	<b>Link with Corporate Priorities</b>
Treasury Management	Annual Review of key financial system	10	Part of Managed Audit approach	<b>One Tower Hamlets</b> Working efficiently and effectively as One Council
HR/payroll	Annual Review of key financial system	15	Part of Managed Audit approach	<b>One Tower Hamlets</b> Working efficiently and effectively as One Council
General Ledger	Annual Review of key financial system	10	Part of Managed Audit approach	<b>One Tower Hamlets</b> Working efficiently and effectively as One Council
Creditors	Annual Review of key financial system	15	Part of Managed Audit approach	<b>One Tower Hamlets</b> Working efficiently and effectively as One Council
Debtors	Annual Review of key financial system	15	Part of Managed Audit approach	<b>One Tower Hamlets</b> Working efficiently and effectively as One Council
INNDR	Annual Review of key financial system	10	Part of Managed Audit approach	<b>One Tower Hamlets</b> Working efficiently and effectively as One Council
Council Tax	Annual Review of key financial system	15	Part of Managed Audit approach	<b>One Tower Hamlets</b> Working efficiently and effectively as One Council
Revenue and Capital Budgetary Control	Annual Review of key financial system	15	Part of Managed Audit approach	<b>One Tower Hamlets</b> Working efficiently and effectively as One Council
Control and Monitoring of cash income C&D	Annual Review of key financial system	10	Part of Managed Audit approach	<b>One Tower Hamlets</b> Working efficiently and effectively as One Council

	<b>Broad Scope</b>	<b>Audit days</b>	<b>Audit Source</b>	<b>Link with Corporate Priorities</b>
Pensions	Annual Review of key financial system	8	Part of Managed Audit approach	<b>One Tower Hamlets</b> Working efficiently and effectively as One Council
Housing and Council Tax Benefit	Annual Review of key financial system	15	Part of Managed Audit approach	<b>One Tower Hamlets</b> Working efficiently and effectively as One Council
Housing Rents	Annual Review of key financial system	8	Part of Managed Audit approach	<b>One Tower Hamlets</b> Working efficiently and effectively as One Council
Back Office Revenue Collection and Processing	This audit will review and test the effectiveness of the back office revenue collection, processing, payment and support functions provided by the ex-Cashier's office at Albert Jacob House.	10	Audit Needs Analysis	<b>One Tower Hamlets</b> Working efficiently and effectively as One Council
Contract Review	This was provision of consultancy support and assistance in a review of contract for schools.	15	Management Request	<b>One Tower Hamlets</b> Working efficiently and effectively as One Council.
Pensions Review	This was a review of the administration and control over statutory pension statements.	15	Management Request	<b>One Tower Hamlets</b> Working efficiently and effectively as One Council
<b>Total</b>		<b>256</b>		

<b>Tower Hamlets Homes</b>	<b>Broad Scope</b>	<b>Audit Days</b>	<b>Audit Source</b>	<b>Link with Corporate Priorities</b>
Right to Buy	This audit will examine systems of control for managing Right to Buy applications and compliance with appropriate legislation, regulations and authorisations from LBTH.	15	Audit Needs Analysis	<b>One Tower Hamlets</b> Working efficiently and effectively as One Council
Programme and Project Management	We will review the company's arrangements for programme and project management to ensure that the required standards and procedures are sound and secure to achieve strategic aims and priorities.	10	Audit Needs Analysis	<b>One Tower Hamlets</b> Working efficiently and effectively as One Council
Management and Control of Voids	We will review the effectiveness of the systems and controls for managing void Council dwellings to ensure that these are re-let efficiently and effectively and the required policy, procedures and standards are followed.	15	Audit Needs Analysis Carried forward from 2015/16	<b>One Tower Hamlets</b> Working efficiently and effectively as One Council
Estate and caretaking management	We will review the effectiveness of Estate and Caretaking management to ensure that the required policy, procedures and standards are followed.	10	Audit Needs Analysis Carried forward from 2015/16	<b>One Tower Hamlets</b> Working efficiently and effectively as One Council

Tower Hamlets Homes	Broad Scope	Audit Days	Audit Source	Link with Corporate Priorities
Financial Systems	This audit will review the robustness of key financial systems such as income and expenditure systems, cash flow forecasting, Treasury Management, VAT and reconciliation processes, as part of the annual assurance on the soundness of financial control across THH.	10	Audit Needs Analysis	<b>One Tower Hamlets</b> Working efficiently and effectively as One Council
Follow Up Audits	We will undertake follow up audits to ensure that the agreed internal audit recommendations have been implemented and that the control environment has improved.	15	Audit Needs Analysis	<b>One Tower Hamlets</b> Working efficiently and effectively as One Council
Withy House TMO	This audit examined systems and controls for management of the TMO to ensure that it complies with the management agreement.	15	Management Request	<b>One Tower Hamlets</b> Working efficiently and effectively as One Council

<b>Tower Hamlets Homes</b>	<b>Broad Scope</b>	<b>Audit Days</b>	<b>Audit Source</b>	<b>Link with Corporate Priorities</b>
Contract Audits and Final Account Audits	We will review the effectiveness of systems and controls for managing and monitoring various building contracts delivered by the company under the Delegated powers from LBTH.	20	Audit Needs Analysis  Corporate Risk Ref. DRA0016	<b>One Tower Hamlets</b> Working efficiently and effectively as One Council
Estate Parking, Sheds and Garages	This audit will examine systems for managing and controlling estate parking, sheds and garages to ensure that the assets are managed efficiently and effectively.	15	Management Request	<b>One Tower Hamlets</b> Working efficiently and effectively as One Council
Management of ASB	We will review systems and procedures for managing and reporting anti-social behaviour to ensure that the key objectives and priorities are achieved.	10	Management Request	<b>One Tower Hamlets</b> Working efficiently and effectively as One Council
Sickness Management	To review systems and controls for effective management of sickness to ensure that procedures are complied with and that the company's objectives are achieved.	10	Management Request	<b>One Tower Hamlets</b> Working efficiently and effectively as One Council
<b>Total</b>		<b>145</b>		

	<b>Broad Scope</b>	<b>Audit Days</b>	<b>Audit Source</b>	<b>Link with Corporate Priorities</b>
<b>Information Technology</b>		<b>100</b>		
<b>Other</b>				
Follow up Audits	We will undertake follow up audits to ensure that the agreed internal audit recommendations have been implemented and that the control environment has improved.	100		<b>One Tower Hamlets</b> Working efficiently and effectively as One Council
Management Requests	Contingency set aside to service Management requests during the year.	13		<b>One Tower Hamlets</b> Working efficiently and effectively as One Council
Reactive Fraud	Earmarked resource to support the investigation of cases of potential fraud, irregularities, waste of public money and whistle blow inquiries directed to the team.	25		<b>One Tower Hamlets</b> Working efficiently and effectively as One Council
Management Time	Provision for management time to direct, control and monitor the work of the team.	50		<b>One Tower Hamlets</b> Working efficiently and effectively as One Council
<b>Grand Plan Total</b>		<b>1,521</b>		

## Governance-based Audit Assessment Methodology

### Assessment Categories

The Risk Assessment model takes account four assessment categories to produce a risk index for each auditable area. The auditable area is scored in each category using assessment criteria to gauge the degree of risk or materiality associated with the particular area. The table below summarises the proposed four assessment categories and what each is intended to measure.

Assessment Category		Measure
A	Corporate Importance – Objectives/Priorities	Corporate materiality
B	Corporate Sensitivity – Impact	Reputational materiality
C	Inherent Risk	Inherent vulnerability
D	Control Risk	Control effectiveness

The full definition for each category and the scoring criteria are described below.

### Assessment Process

Assessment was based on professional judgement after careful consideration of the key risks to the authority with the Executive Directors and other key officers, a review of current and previous audit plans and strategic issues facing the authority. The following steps were followed in performing the risk assessment:

Step	Action
1	Select the System and Corporate Controls to be risk assessed, to ensure a clear and unambiguous understanding of the area under review. This is normally called the Auditable Area
2	Select the most appropriate assessment criterion and therefore the score in each assessment category
3	Record the scores.
4	Compute the risk index by reference to the following section

### Calculation of the Audit Risk Index

Internal Audit risk is the product of risk and materiality. In valuing materiality it is appropriate to add the constituent assessments of Corporate Importance and Corporate Sensitivity to generate a Materiality Factor on a scale of 100.



Total Risk is the product of inherent and control risk. For the purposes of simplicity in this model Inherent Risk is assessed on a scale of 5-10 and Control Risk on a scale of 2-10. The minimum Risk Factor is produced by multiplying these components is therefore 10% (2 x 5).

The Audit Risk Index for each auditable area is, therefore, the Materiality Factor multiplied by the Risk Factor.

### Results of the Audit Risk Assessment

The structured list of auditable areas with illustrative assessment scores is recorded and the summarised scores used to give the Risk Factor and Materiality Factor and the resultant Audit Risk Index.

The list of auditable areas is then ranked by reference to the Audit Risk Index and grouped as high, medium or low priority. The top third are considered to be high priority, the next medium priority, and the bottom third low priority.

## Internal Audit Risk Assessment Matrices

A CORPORATE IMPORTANCE This aspect considers the effect on an organisation of any inability to achieve management defined service objectives should the system or process fail. This aspect also takes into account the financial exposure or materiality of the area. The consequential impact, either directly or indirectly, on other systems and processes is also relevant to the assessment. Overall it is a measure of the extent to which the organisation depends on the correct running of the system to achieve its strategic objectives.					
Score	Risk to Department, Corporate and/or Service Objectives		Operational Risk Exposure		Financial Risk Exposure
10	Negligible impact on achievement of service objectives. This would still be achieved with minimum extra cost or inconvenience.	or	Minor inconvenience	or	Under 2% of total operating income or net assets.
20	Service objectives only partially achievable without compensating action being taken or reallocation of resources.	or	Difficult to recover	or	Between 2% and 10% of operating income or net assets.
30	Unable to achieve service objectives without substantial additional costs or time delays or adverse effect on achievement of national targets / performance indicators.	or	Permanent loss of data	or	Between 10% and 30% of operating income or net assets.
40	Unable to achieve service objectives resulting in significant visible impact on service provision such as closure of facilities.	or	Unable to restore system	or	Between 30% and 50% of operating income or net assets.
50	Unable to achieve service objectives, resulting in inability to fulfil corporate obligations.	or	Organisation unable to function	or	Over 50% of total operating income or net assets

## Internal Audit Risk Assessment Matrices

B Corporate Sensitivity This aspect takes into account the sensitivity / confidentiality of the information processed, or service delivered by the system, or decisions influenced by the output. It also assesses any legal and regulatory compliance requirements. The measure should also reflect any management concerns and sensitivities.

Score	Risk to Public Image		Risk of Adverse Publicity		Risk to Accountability		Risk of non-legal Compliance
10	Negligible consequences					or	No regulatory requirements
20	Some public embarrassment but no damage to reputation or standing in the community	or	Information would be of interest to local press			or	Minimal regulatory requirements and limited sensitivity to non-compliance
30	Some public embarrassment leading to limited damage	or	Information would be of interest to local MPs			or	Modest legal and regulatory requirements
40	Loss of credibility and public confidence in the service concerned	or	Incident of interest to National Press	O r	Incident potentially leading to the dismissal or resignation of the responsible functional manager	or	Extensive legal and regulatory requirements with sanctions for non-compliance
50	Highly damaging with immediate impact on public confidence	or	Incident of interest to the Audit Commission, government agencies	O r	Incident potentially leading to the resignation or dismissal of a Chief Officer	or	Possible court enforcement order for non-compliance

## Internal Audit Risk Assessment Matrices

C Inherent Risk This aspect considers the inherent risk of the system, service, process or related assets to error, loss, irregularity, inefficiency, illegality or failure. The particular service sector, nature of operations and the pace of change will also affect the level of inherent risk. Similarly the relative complexity of the system will influence the inherent risk or error. The inherent vulnerability of a system, service or process cannot be altered, only mitigated by the quality of controls considered in section D.

Score	Inherent Risk – Vulnerability		Risk of Error due to System Complexity		Risk resulting from Pace of Change		Risk to Asset Security
5	Low vulnerability		Simple system with low risk of error	or	No changes planned	or	Undesirable low value assets not at risk of fraud or loss
6	Medium or low inherent risk	or		or	Limited changes planned with reasonable timescale		
7	Medium vulnerability	or	Moderately complex system with medium risk of error	or	Moderate level of change over medium term		
8	Medium to high inherent risk	or		or	Significant level of change with restricted timescale		
10	Highly vulnerable	or	Complex system with high risk of error	or	Extensive changes planned with short timescale	or	Highly desirable assets exposed to high risk of fraud or loss

## Internal Audit Risk Assessment Matrices

<p>D Control Risk This aspect assesses the level of control risk based upon the results of past audits of the control environment under review. This aspect also takes into account of the operating history and condition of systems and processes and knowledge of management controls to minimise exposure to risk. CRSA and extensive Control Risk Workshops under the leadership of the Council's Risk Manager could support evaluation.</p>					
Score	History of Risk Management Success		Management Risk and Control Environment		Condition of Risk Management Controls
2	No history of control weakness	or	There is effective risk management in place and adequate controls operated by risk-aware management	or	Effective controls and robust attitude to the management of all material risks. Embedded risk management culture
4	No history of significant weakness	or	Good management risk and control environment	or	Stable system with history of reliability and controls. Risk management issued considered regularly.
6	No high risk issues outstanding from the previous audit/investigation/best value/external review	or	No knowledge of management risk and control environment	or	Risk management and system controls not validated.
8	Some significant problems were identified and are known to be outstanding from the previous audit/review	or	Some significant concerns have been expressed by management (through Controls Risk Workshops)	or	Technical health of system of risk management and controls in doubt.
10	Major weaknesses in risk management and controls were identified and are known to be outstanding	or	Major concerns have been expressed by management (through Controls Risk workshops)	or	Obsolete system with history of problems and ineffective control. Little or no work undertaken on risk management.

# Internal Audit Charter

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**This Charter sets out the purpose, authority and responsibility of the Council’s Internal Audit function, in accordance with the UK Public Sector Internal Audit Standards.**

**The Charter will be reviewed annually and presented to the Audit Committee and to Corporate Management Team for final approval.**

## **Purpose**

Internal Audit is defined by the Institute of Internal Auditors’ International Professional Practices Framework as “an independent, objective assurance and consulting activity designed to add value and improve an organisation’s operations. It helps an organisation accomplish its objectives by bringing a systematic, disciplined approach to evaluate and improve the effectiveness of risk management, control and governance processes.”

Internal audit provides independent and objective assurance to the organisation, its Members, the Corporate Management Team (CMT) and in particular to the Chief Financial Officer to help discharge responsibilities under S151 of the Local Government Act 1972, relating to the proper administration of the Council’s financial affairs.

In addition, the Accounts and Audit Regulations (2011) specifically require the provision of an internal audit service. In line with regulations, Internal Audit provides independent assurance on the adequacy of the Council’s governance, risk management and internal control systems. Further information around the purpose of Audit is set out in the Council’s Financial Regulations (D3) and Financial Procedures (CR4).

## **Authority**

The Internal Audit function has unrestricted access to all Council records and information, both manual and computerised, cash, stores and other Council property or assets it considers necessary to fulfil its responsibilities. Audit may enter Council property and has unrestricted access to all locations and officers where necessary on demand and without prior notice. Right of access to other bodies funded by the Council should be set out in the conditions of funding.

The Internal Audit function will consider all requests from the external auditors for access to any information, files or working papers obtained or prepared during audit work that has been finalised, which External Audit would need to discharge their responsibilities.

## **Responsibility**

The Council's Head of Internal Audit (The Head of Audit and Risk Management) is required to provide an annual opinion to the Council and to the Chief Financial Officer, through the Audit Committee, on the adequacy and the effectiveness of the internal control system for the whole Council. In order to achieve this, the Internal Audit function has the following objectives:

- To provide a quality, independent and objective audit service that effectively meets the Council's needs, adds value, improves operations and helps protect public resources
- To provide assurance to management that the Council's operations are being conducted in accordance with external regulations, legislation, internal policies and procedures.
- To provide a systematic, disciplined approach to evaluate and improve the effectiveness of risk management, internal control and governance processes
- To provide assurance that significant risks to the Council's objectives are being managed. This is achieved by annually assessing the adequacy and effectiveness of the risk management process.
- To provide advice and support to management to enable an effective control environment to be maintained
- To promote an anti-fraud, anti-bribery and anti-corruption culture within the Council to aid the prevention and detection of fraud
- To investigate allegations of fraud, bribery and corruption

Even sound systems of internal control can only provide reasonable and not absolute assurance and may not be proof against collusive fraud. Internal audit procedures are designed to focus on areas identified by the organisation as being of greatest risk

and significance and rely on management to provide full access to accounting records and transactions for the purposes of audit work and to ensure the authenticity of these documents.

Where appropriate, Internal Audit will undertake audit or consulting work for the benefit of the Council in organisations wholly owned by the Council, such as Tower Hamlets Homes. Internal Audit may also provide assurance to the Council on third party operations (such as contractors and partners) where this has been provided for as part of the contract.

## Reporting

The UK Public Sector Internal Audit Standards require the Head of Internal Audit to report at the top of the organisation and this is done in the following ways:

- The Internal Audit Strategy and Charter and any amendments to them are reported to the Corporate Management Team (CMT) and the Audit Committee (AC). Both documents must then be presented to these bodies annually.
- The annual Internal Audit Plan is compiled by the Head of Internal Audit taking account of the Council's risk framework and after input from members of CMT. It is then presented to CMT and AC annually for noting and endorsement.
- The internal audit budget is reported to Cabinet and Full Council for approval annually as part of the overall Council budget.
- The adequacy, or otherwise, of the level of internal audit resources (as determined by the Head of Internal Audit) and the independence of internal audit will be reported annually to the AC. The approach to providing resource is set out in the Internal Audit Strategy.
- Performance against the Internal Audit Plan and any significant risk exposures and control issues arising from audit work are reported to CMT and AC on a quarterly basis.
- Any significant consulting activity not already included in the audit plan and which might affect the level of assurance work undertaken will be reported to the AC.
- Results from internal audit's Quality Assurance and Improvement Programme will be reported to both CMT and the AC.
- Any instances of non-conformance with the Public Sector Internal Audit Standards must be reported to CMT and the AC and will be included in the annual Head of Internal Audit report. If there is significant non-conformance this may be included in the Council's Annual Governance Statement.



**Independence**

The Head of Internal Audit (the Head of Audit and Risk Management) has free and unfettered access to the following:

- Chief Financial Officer (Corporate Director, Resources)
- Head of Paid Service
- Chair of the Audit Committee (AC)
- Monitoring Officer
- Any other member of the Corporate Management Team

The independence of the Head of Internal Audit is further safeguarded by ensuring that his annual appraisal is not inappropriately influenced by those subject to audit. This is achieved by ensuring that both the Chief Executive and the Chair of the AC contribute to, and/or review the appraisal of the Head of Internal Audit.

All Council and contractor staff in the Governance Service are required to make an annual declaration of interest to ensure that auditors' objectivity is not impaired and that any potential conflicts of interest are appropriately managed.

Internal Audit may also provide consultancy services, such as providing advice on implementing new systems and controls. However, any significant consulting activity not already included in the audit plan and which might affect the level of assurance work undertaken will be reported to the AC. To maintain independence, any audit staff involved in significant consulting activity will not be involved in the audit of that area for at least 12 months.

**Due Professional Care**

The Internal Audit function is bound by the following standards:

- Institute of Internal Auditor's International Code of Ethics
- Seven Principles of Public Life (Nolan Principles)

- UK Public Sector Internal Audit Standards.
- All Council Policies and Procedures
- All relevant legislation

Internal Audit is subject to a Quality Assurance and Improvement Programme that covers all aspects of internal audit activity. This consists of an annual self-assessment of the service and its compliance with the UK Public Sector Internal Audit Standards, ongoing performance monitoring and an external assessment at least once every five years by a suitably qualified, independent assessor.

A programme of Continuous Professional Development (CPD) is maintained for all staff working on audit engagements to ensure that auditors maintain and enhance their knowledge, skills and audit competencies. Both the Head of Audit and Risk Management and the Audit Manager are required to hold a professional qualification (CCAB or CMIIA) and be suitably experienced.

# The Internal Strategy

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**This Strategy sets out how the Council's Internal Audit service will be delivered in accordance with the Internal Audit Charter.**

**The Strategy will be reviewed annually and presented to the Audit Committee and to Corporate Management Team for final approval.**

## **Internal Audit Objectives**

Internal Audit will provide independent and objective assurance to the organisation, its Members, the Corporate Management Team (CMT) and in particular to the Corporate Director, Resources to support him in discharging his responsibilities under S151 of the Local Government Act 1972, relating to the proper administration of the Council's financial affairs.

It is the Council's intention to provide a best practice, cost efficient internal audit service.

## **Internal Audit's Remit**

The internal audit service is an assurance function that primarily provides an independent and objective opinion on the degree to which the internal control environment supports and promotes the achievement of the council's objectives.

Under the direction of a suitably qualified and experienced Head of Internal Audit (the Head of Audit and Risk Management), Internal Audit will:

- Provide management and members with an independent, objective assurance and consulting activity designed to add value

and improve the Council's operations.

- Assist the Audit Committee to reinforce the importance of effective corporate governance and ensure internal control improvements are delivered;
- Drive organisational change to improve processes and service performance;
- Work with other internal stakeholders and customers to review and recommend improvements to internal control and governance arrangements in accordance with regulatory and statutory requirements;
- Work closely with other assurance providers to share information and provide a value for money assurance service; and
- Participate in local and national bodies and working groups to influence agendas and developments within the profession.

Internal Audit must ensure that it is not responsible for the agreed design, installation and operation of controls so as to compromise its independence and objectivity. Internal Audit will however offer advice on the design of new internal controls in accordance with best practice.

### **Service Delivery**

The Service will be delivered by the Council's internal audit team and the Council's strategic internal audit partner (currently Mazars) under the direction of the Council's Head of Internal Audit and Risk Management and supported by the Audit Manager.

To ensure that the benefits of the Internal Audit service are maximised and shared as best practice, Tower Hamlets will participate in the London Audit & Anti-Fraud Partnership to work with other local authorities on a shared service basis. This includes appropriate: resource provision, joint working, audit management & strategy and a range of value added services.

### **Internal Audit Planning**

Audit planning will be undertaken on an annual basis and audit coverage will be based on the following:

- Discussions with the Council's Management Team (CMT) and management
- The Council's Risk Register
- Outputs from other assurance providers
- Requirements as agreed in the joint working protocol with External Audit

The Head of Internal Audit and Risk Management or his deputy will attend all Departmental Management Team meetings as part of the annual planning process to ensure that management views and suggestions are taken into account when producing the audit plan.

The Internal Audit Plan 2014-15 is composed of the following:

- **Risk Based Systems Audit:** Audits of systems, processes or tasks where the internal controls are identified, evaluated and confirmed through risk assessment process. The internal controls depending on the risk assessment are tested to confirm that they operating correctly. The selection of work in this category is driven by Departments' own risk processes and will increasingly include work in areas where the Council services are delivered with other organisations.

Internal Audit planning is already significantly based on the Council's risk register. Internal audit will continue to have a significant role in risk management with audit planning being focused by risk and the results of audit work feeding back into the risk management process.

- **Key Financial Systems:** Audits of the Council's key financial systems where External Audit require annual assurance as part of their external audit work programme.
- **Probity Audit (schools & other establishments):** Audit of a discrete unit. Compliance with legislation, regulation, policies, procedures or best practice are confirmed. For schools this includes assessment against the Schools Financial Value Standard.
- **Computer Audit:** The review of ICT infrastructure and associated systems, software and hardware.
- **Contract Audit:** Audits of the Council's procedures and processes for the letting and monitoring of contracts, including reviews of completed and current contracts.
- **Fraud and Ad Hoc Work:** A contingency of audit days are set aside to cover any fraud and irregularity investigations arising during the year and additional work due to changes or issues arising in-year.
- **Knowledge and Insight:** The Head of Audit and Risk Management, in conjunction with the Internal Audit and the Corporate Fraud teams, will use the knowledge and insight gained of the organisation and carry out reviews in specific areas.

### **Follow-up**

Internal Audit will evaluate the Council's progress in implementing audit recommendations against set targets for implementation. Progress will be reported to management and to the Audit Committee on a quarterly basis.

Where progress is unsatisfactory or management fail to provide a satisfactory response to follow up requests, Internal Audit will implement the escalation procedure as agreed with management.

### **Reporting**

Internal audit reports the findings of its work in detail to local management at the conclusion of each piece of audit work and in summary to departmental and corporate management on a quarterly basis. Summary reports are also provided to the Audit Committee four times per year. This includes the Head of Internal Audit's annual report which contributes to the assurances underpinning the Annual Governance Statement of the Council.

# The Internal Audit Process

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## **The Pre-Audit Stage**

Based on the audit timetable, which has previously been agreed, Internal Audit Team will give two weeks' notice to the appropriate Corporate Director and Service Head (the Audit Owner) of an impending audit review and issue an Audit Brief. The Audit Brief will also detail how the audit relates to the agreed audit plan. The Audit Owner has an opportunity to comment on the Audit Brief and raise any areas of concern.

The Audit Owner will ensure that Internal Audit is provided with a written agreement or otherwise to the Audit Brief within two weeks following the receipt of the draft by the Audit Owner.

## **During the Audit**

At this stage Internal Audit will keep the Auditee informed of key findings found during the course of the audit. Where an officer has not been able to provide information requested, Internal Audit will refer matters to the Audit Owner.

The Auditee will ensure that the auditor is provided with all the resources and facilities, including information requested, to facilitate the smooth progress of the audit, including responding to any auditor enquiries promptly.

## **Post Audit Stage**

Upon conclusion of the audit field work Internal Audit will present a Draft Audit Report to be discussed at the audit exit meeting with the Audit Owner. At the audit exit meeting, the findings will be discussed, along with any recommendations for improvement.

Following the audit exit meeting, LB Tower Hamlets Internal Audit will issue a formal Draft of the Audit Report which includes a Management Action Plan of Recommendations to the Audit Owner within three weeks following the completion of the audit exit meeting.

The Audit Owner has three weeks to respond to the Draft Audit Report by completing the Management Action Plan of Recommendations, including listing responsible officers and proposed completion dates. Upon receipt of the agreed Action Plan, a Final Report will be issued to all parties concerned.

The Audit Owner will then enter the agreed management actions and target dates into the Audit Tracker System, and monitor the progress in implementing the recommendations.

The LB Tower Hamlets Internal Audit will present a Summary of Findings from recently issued Final Audit Reports to the Audit Committee. The Audit Owner will have the opportunity to add a response to the Summary of Findings before this report is presented to the Audit Committee.



# The Monitoring Process

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**Follow-up audits** will be conducted six months after the issue of the Final Report, and a follow up audit report will be issued showing the progress on implementing the agreed recommendations.

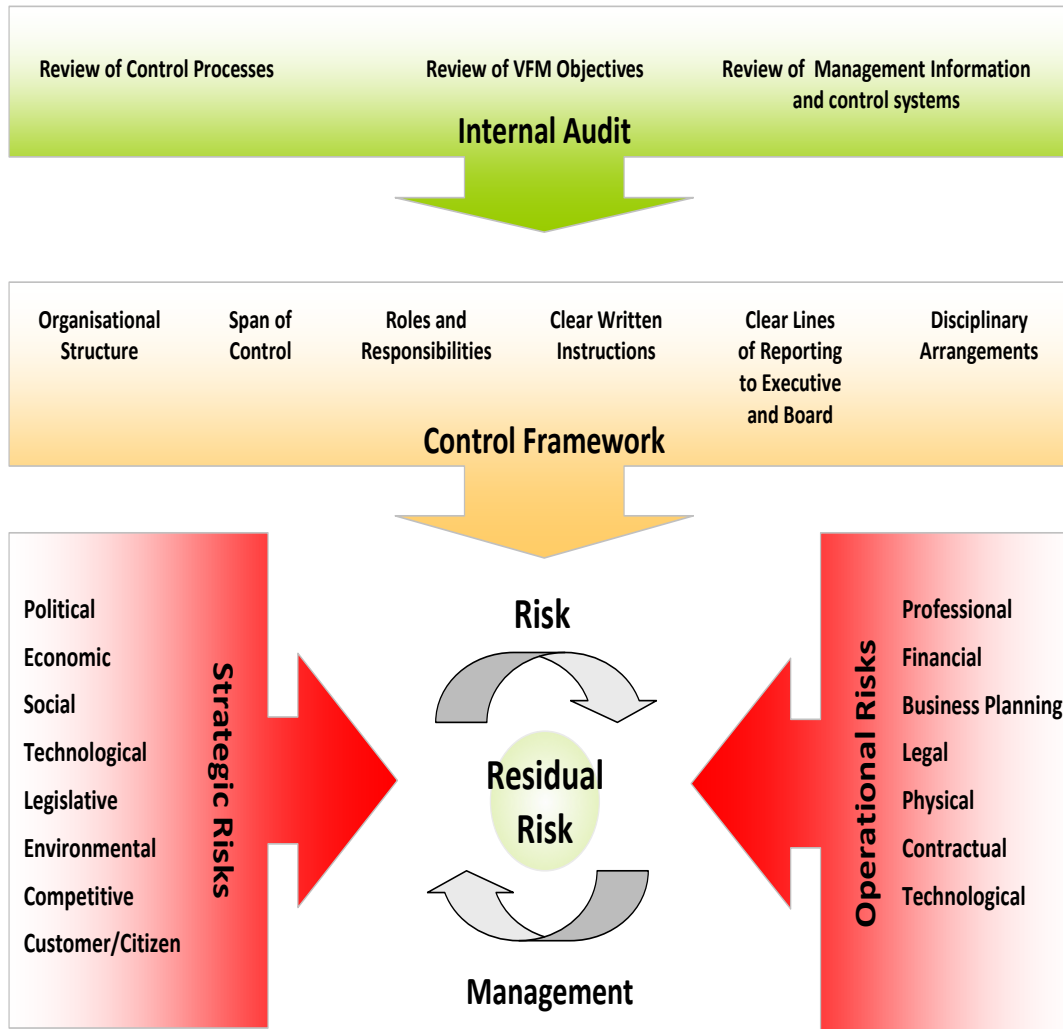
Internal Audit recommendations are classified as follows:

Category 1 – High Priority - 100% of recommendations to be implemented within six months

Category 2 – Medium Priority – 95% of recommendations to be implemented within six months

# Summary

## Appendix 6



**Internal Audit:** Will provide assurance that risk management processes and internal controls are operating effectively, ensure major business risks are being managed effectively, and that governance arrangements are operating effectively.

**Control Framework:** A matrix of control mechanisms will be developed to ensure that every member of staff is aware of their responsibility in managing risk, and a reporting framework will ensure that the Senior Management Team and the Board have a clear view of the effectiveness of the controls in place.

**Risk Management:** The Risk Register will be reviewed on a periodic basis to reassess the residual level of risk for the strategic risks identified in the first year of operation; new risks added as they become evident.

## Definitions

**Risk** “Any issue which could impact on an organisation’s ability to meet its objectives”

**Risk Management** Risk management is a planned and systematic approach to the identification, analysis and control of risks that challenge and threaten the achievement of the objectives of the organisation. Risk management makes it possible to determine whether the risks pose a large enough threat and the innovations a big enough opportunity, to implement mitigation techniques.

**Objective** Is to implement an effective risk management framework that ensures that risks are identified and managed to an acceptable level and that opportunities are fully exploited, whilst minimising, financial loss, service disruption, bad publicity, reputation loss, claims for compensation and threats to the public and staff.

**Our Policy:** We believe that by managing risks effectively, we at LB of Tower Hamlets will be in a stronger position to deliver our strategic and operational objectives. By taking advantage of opportunities and managing them well, we will be in a better position to improve services and give our stakeholders better value for money.



## **Objectives of Risk Management:**

- Ensure that systems are in place to identify, track and report upon existing and emerging risks that could damage the interest of our business and our stakeholders.
- Ensure that risk management is embedded throughout the organisation, creating an environment where all staff assumes responsibility for managing risk.

## **These Objectives will be Achieved by:**

- Establishing clear roles, responsibilities and reporting lines within the organisation for risk management;
- Providing opportunities for shared learning on risk management across the organisation;
- Developing and maintaining systems for identifying and evaluating all significant risks;
- Developing and maintaining a framework for allocating resources to identified priority risk areas;
- Reinforcing the importance of effective risk management as part of the everyday work of employees by offering training;
- Incorporating risk management considerations into Best Value and service reviews and business planning;
- Put in place review and monitoring arrangements to assess the effectiveness of our mechanisms and arrangements.

**To Emphasise the Organisation’s Working Commitment to Risk Management, the Risk Management Mission Statement is as Follows:**

“London Borough of Tower Hamlets recognises that it has a responsibility to manage opportunities and risks in a structured manner in order that LB Tower Hamlets will better achieve its corporate objectives and enhance the value of services it provides to the Community”.

The Audit Committee, Corporate Management Team (CMT) and the Directorate Management Team (DMT) will have overall responsibility for risk management and will be consulted and kept informed as to the progress of the implementation of the strategy on at least an annual basis.

## Roles and Responsibilities

<b>Audit Committee</b>	<p>The Committee's primary role is to review and conclude upon the adequacy and effectiveness of the Council's overall internal control system. In performing this role the Committee's work predominantly focuses upon the framework of risks, controls and related assurances that underpin the delivery of the Council's objectives.</p>
<b>Corporate Management Team</b>	<p>One of the roles of the CMT is to work on a cross-directorate basis to ensure that the Council has an effective risk management arrangement in place to achieve its objectives and to consider quarterly reports on the key strategic risks faced by the Council and how these risks are being managed and mitigated.</p>
<b>Corporate Director of Resources</b>	<p>As S.151 officer, the Corporate Director of Resources is responsible for the proper administration of the financial affairs of the Council. The requirement to have an Internal Audit function derives from S.151 of the Local Government Act 1972. As such the Corporate Director of Resources supports the Council and its departments in ensuring that the arrangements made for financial management, risk management and internal control systems are sound and secure.</p>
<b>Corporate Directors</b>	<p>The Corporate Directors have the operational responsibility for ensuring that there are sound procedures in place at Directorate level for effective financial management, risk management and internal control systems.</p>

## **Risk Management Action Plans**

One of the key risk management objectives is the effective management of the organisation's risks, both strategic and operational. This has been achieved by the sessions to identify and profile the organisation's significant strategic risks.

Once this task has been compiled, SMT and the Audit Committee will be asked to comment on these risks and the risk assessment process. In relation to the operational risks, each Director has facilitated and co-ordinated a similar risk assessment exercise in order that the significant operational risks have been accurately identified profiled and managed. The aim of such a process is that it will eventually form part of each Division's annual business planning process.

Coming out of this process, will be risk management action plans relating to the most serious significant risks, i.e. those where the existing levels of internal control are seen as inadequate. The above assessments (both strategic and operational) will be a yearly process with tracking and monitoring of risks on an annual basis.

The Director of Resources will receive copies of each Division's operational risk management action plans in order that any cross-departmental risks can be picked up and managed accordingly. The Director of Resources will also monitor the risk improvement strategy to ensure that progress is made against the key significant risks.

Similarly, the same risk assessment programme can be adopted when services are going through the Best Value programme. A risk management pack can be included in the Best Value documentation. It is generally accepted that each Directorate must be seen to be managing its risks in order to demonstrate Best Value.

## Classification of Risk

Strategic Risks		Operational Risks	
<p><b>Political</b></p> <p>Wrong strategic priorities Not meeting Government agendas Too slow to innovate/modernise Decisions based on incomplete information Unfulfilled promises to Council Failure to recruit a suitable CEO</p>	<p><b>Economic</b></p> <p>General economic problems Regional economic problems Treasury risk Missed business or service opportunities</p>	<p><b>Professional</b></p> <p>Failure to recruit/retain staff Lack of training Over-reliance on key officers Inefficient management processes Inability to implement change Lack of employee motivation Bad management of partners</p>	<p><b>Financial and business planning</b></p> <p>Failure of major project(s) Failure to prioritise, allocate appropriate budgets and monitor Failure to implement effective partnering contracts for property and estate services</p>
<p><b>Social</b></p> <p>Failing to meet the needs of disadvantaged Impact of demographic changes Employment challenges Lack of development of staff Failures in partnership working</p>	<p><b>Technological</b></p> <p>Obsolescence of technology Security policies Breach of confidentiality Failure in communications</p>	<p><b>Legal</b></p> <p>Not meeting statutory duties Breach of confidentiality/DPA Failure to comply with European Directives on procurement of works, supplies, and services Failure to implement new legislation</p>	<p><b>Physical</b></p> <p>Attacks on personnel Loss of tangible assets Non-compliance with health &amp; safety law Loss of physical assets Local and national emergencies</p>
<p><b>Legislative</b></p> <p>Judicial review Human Rights Act breaches Intervention by regulatory bodies Inadequate response to new legislation Poor response to Audit Commission</p>	<p><b>Environmental</b></p> <p>Impact of sustainability policies Noise, contamination and pollution</p>	<p><b>Contractual</b></p> <p>Over-reliance on key suppliers/contractors Failure of outsource provider Quality issues Non-compliance with procurement policies</p>	<p><b>Technological</b></p> <p>Failure of big technology project IT system crashes affect services Breaches of security of network and data Bad management of intranets and websites</p>



**Competitive**

Failure to show best value  
Failure of bids for government funds

**Customer/Citizen**

Lack of appropriate consultation  
Bad public and media relations

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Non-Executive Report of the: <b>Audit Committee</b> 8 <sup>th</sup> November 2016	 <b>TOWER HAMLETS</b>
<b>Report of:</b> Zena Cooke - Corporate Director - Resources	<b>Classification:</b> Unrestricted
<b>Changes to Arrangements for the Appointment of External Auditors</b>	

<b>Originating Officer(s)</b>	Minesh Jani
<b>Wards affected</b>	All wards

## 1. SUMMARY

- 1.1. This report summarises the changes to the arrangements for appointing External Auditors following the closure of the Audit Commission and the end of the transitional arrangements at the conclusion of the 2017/18 audits.
- 1.2. The Council will need to consider the options available and put in place new arrangements in time to make a first appointment by 31 December 2017. In practical terms, this means that one of the options outlined in this report will need to be in place by spring 2017.

## 2. RECOMMENDATION

- 2.1. The Audit Committee members should note the following three available options:-
  1. Establishing a stand-alone independent Auditor Panel to make the appointment on behalf of the Council;
  2. Commencing work on exploring the establishment of local joint procurement arrangements with one or more other authorities.
  3. Join the Sector Led Body, Public Sector Audit Appointment (PSAA) that has been set up by the Local Government Association (LGA).
- 2.2. Note that option 2.1.3 is at this stage the preferred option, but this does not commit the Council at this point.
- 2.3. Note that further decisions will be required by the Council to either (a) set up an auditor panel should the recommendation be to carry out a procurement exercise or (b) approve any Sector Led Body recommendation.

### **3. BACKGROUND**

- 3.1. The Local Audit and Accountability Act 2014 abolished the Audit Commission and established transitional arrangements for the appointment of external auditors and the setting of audit fees for all local government and NHS bodies in England. On 5<sup>th</sup> October 2015 the Secretary of State Communities and Local Government (CLG) determined that the transitional arrangements for local government bodies would be extended by one year to also include the audit of the accounts for 2017/18.
- 3.2. The Council's current external auditor is KPMG. This appointment was made under a contract negotiated by the Audit Commission. Following the abolition of the Audit Commission the contract is currently managed by Public Sector Audit Appointments Limited (PSAA), the transitional body set up by the LGA with delegated authority from the Secretary of State, DCLG. Over recent years we have benefited from a reduction in fees in the order of 50% compared with historical levels. This has been the result of a combination of factors including new contracts negotiated nationally with the firms of accountants and savings from the abolition of the Audit Commission. The Council's current external audit fees are £0.2 million per annum.
- 3.3. When the current transitional arrangements come to an end on 31 March 2018, the Council will be able to move to a local appointment of the auditor. There are a number of routes by which this can be achieved, each with varying degree of risks and opportunities. Current fees are based on discounted rates offered by the firms in return for substantial market share. When the contracts were last negotiated nationally by the Audit Commission they covered NHS and local government bodies and offered maximum economies of scale.
- 3.4. The scope of the audit will still be specified nationally and the National Audit Office (NAO) is responsible for writing the Code of Audit Practice which all firms appointed to carry out Council's audits must follow. Not all accounting firms will be eligible to compete for the work; they will need to demonstrate that they have the required skills and experience and be registered with a Registered Supervising Body approved by the Financial Reporting Council. The registration process has not yet commenced and so the number of firms is not known but it is reasonable to expect that the list of eligible firms may include the top 10 or 12 firms in the country, including our current auditor. It is thought unlikely that small local independent firms will meet the eligibility criteria.

### **4. OPTIONS FOR LOCAL APPOINTMENT OF EXTERNAL AUDITORS**

- 4.1. There are three broad options open to the Council under the Local Audit and Accountability Act 2014 (the Act):

#### **Option 1 – To make a standalone appointment**

- 4.2. In order to make a stand-alone appointment the Council will need to set up an Auditor Panel. The members of the panel must be wholly or a majority independent members as defined by the Act and must be chaired by an independent member.

Independent members for this purpose are independent appointees, this excludes current and former elected members (or officers) within the last five years and their close families and friends. This means that elected members will not have a majority input in assessing bids and advising which firm of accountants to award the contract for the Council's external audit. A new independent auditor appointment panel established by the Council will be responsible for selecting the auditor.

***Advantages/benefit***

- 4.3. The Council has full ownership of the process, a bespoke contract with the auditors and tendering process that reflects local circumstances (within EU procurement rules).

***Disadvantages/risks***

- 4.4. Recruitment and servicing of the Auditor Panel, running the bidding exercise and negotiating the contracts is estimated by the LGA to cost in the region of £15,000 plus ongoing expenses and allowances. It is also unclear whether the Council will be able to attract sufficient individuals with the requisite skills and experiences to undertake the role on the board or as chair.
- 4.5. The Council will not be able to take advantage of reduced fees that may be available through joint or national procurement contracts.
- 4.6. There is a more fundamental issue. Selecting one's own external auditor may seem superficially attractive, but many would argue that it creates a risk of conflict of interest and does not promote best governance. Independent appointment of the auditor provides a separation which strengthens any audit findings especially if they are positive. Whilst the establishing of an independent auditor appointment panel is intended to create this separation, it is unclear the extent to which it would in practice achieve this.

**Option 2 – Set up a joint auditor panel / local joint procurement arrangements**

- 4.7 The Act enables the Council to join with other authorities to establish a joint auditor panel. Again this will need to be constituted of wholly or a majority of independent appointees (members). Further legal advice will be required on the exact constitution of such a panel having regard to the obligations of each Council under the Act and the Council will need to liaise with other local authorities to assess the appetite for such an arrangement.

***Advantages/benefits***

- 4.8. The costs of setting up the panel, running the bidding exercise and negotiating the contract will be shared across a number of authorities.
- 4.9. There is greater opportunity for negotiating some economies of scale by being able to offer a larger combined contract value to the firms.

### ***Disadvantages/risks***

- 4.10. The decision making body will be further removed from local input, with potentially no input from elected members where a wholly independent auditor panel is used or possible only one elected member representing each Council, depending on the constitution agreed with the other bodies involved.
- 4.11. Although this creates more separation and independence and hence reduces the risk of conflict of interests set out in paragraph 4.6 it does not wholly remove the issue.
- 4.12. The Council may not end up with first choice of auditor, compared to an individual auditor panel. If a large group of authorities work together and decide to appoint one joint audit contract across all the authorities, a joint panel may be more likely to advise appointment of an auditor it considers suitable for all authorities taken together.
- 4.13. An alternative solution to a joint auditor panel or joint procurement arrangement could be using another authority's panel. This option was not considered due to it being difficult to find an authority willing to enter into such arrangement and have adequate liaison with the Council's own Audit Committee. Also another local authority's would not understand the specific needs of the authority.

### **Option 3 – Opt-in to a Sector Led Body**

- 4.14. In response to the consultation on the new arrangement, the LGA successfully lobbied for Councils to be able to 'opt-in' to a Sector Led Body (SLB) appointed by the Secretary of State under the Act. An SLB would have the ability to purchase on behalf of many authorities at once, thereby maximising the economic advantages created by high volume purchases when they approach the market place. In turn this will increase the opportunities for the most economic and efficient approach to procurement of external audit on behalf of the whole sector.
- 4.15. PSAA is an independent, not-for-profit company limited by guarantee and established by the LGA. It already carries out a number of functions in relation to auditor appointments under powers delegated by the Secretary of State for CLG. In July 2016, the Secretary of State for DCLG specified PSAA as an appointing person under regulation 3 of the Local Audit (Appointing Person) Regulations 2015. They are currently working on the details of the scheme, including a timetable, and will provide further information as soon as possible.
- 4.16. It is anticipated that invitations to opt in will be issued before December 2016 and authorities will have a minimum period of eight weeks to respond to the invitation. In accordance with regulation 19 of the Local Audit (appointing Person) Regulations 2015, the Council would need to make the decision to opt in by the Audit Committee.

### ***Advantages/benefits***

- 4.17. The costs of setting up the appointment arrangements and negotiating fees would be shared across all opt-in authorities.
- 4.18. By offering large contract values the firms would be able to offer better rates and lower fees than are likely to result from local negotiation.
- 4.19. Any conflicts at individual authorities would be managed by the SLB who would have a number of contracted firms to call upon.
- 4.20. The appointment process would not be in the remit of locally appointed independent members. Instead the PSAA would act in the collective interests of the 'opt-in' authorities. This therefore resolves the point about conflict and governance that arises from local appointment.

### ***Disadvantages/risks***

- 4.21. Individual elected members will have little or no opportunity for direct involvement in the appointment process other than through the SLB and/or stakeholder representative groups.
- 4.22. In order for the SLB to be viable and to be placed in the strongest possible negotiating position the SLB will need Councils to indicate their intention to opt-in before final contract prices are known.
- 4.23. Rates may be set at a national level, which could arguably involve a degree of cross-subsidy from larger authorities to smaller ones. It is difficult at this stage to estimate what, if any, would be the impact of this for Tower Hamlets.

## **5. Comments of the Chief Finance Officer**

- 5.1 This report seeks a view from the Committee on their preferred option for the selection of an external audit firm to carry out the statutory audit of the Council's Statement of Accounts after the 2017/18 audit process has concluded; as such there are no direct financial implications arising from the report although there are clearly uncertainties about the cost of providing external audit services after 2017/18 which will be dependent on the approach taken and fees negotiated.

## **6. Legal Comments**

- 6.1. The Audit Commission was established under the Audit Commission Act 1998 ('the 1998 Act'), which was abolished by the Local Audit and Accountability Act 2014 ('the 2014 Act'). The 2014 Act established transitional arrangements for the appointment of external auditors and the setting of audit fees for all local government and NHS bodies in England, which have now been extended by one year to include the audit of the accounts for 2017/18.
- 6.2. Under Regulation 3 of the Accounts and Audit Regulations 2015 ('**the 2015 Regulations**'), the Council is required to ensure that it has a sound system of

internal control that facilitates effective exercise of the Council's functions and includes arrangements for the management of risk. The Council is also required by Regulation 5 to maintain an effective system of internal audit to evaluate the effectiveness of its risk management, control and governance processes, taking into account public sector internal auditing standards and guidance. The option selected must enable the Council to comply with these duties.

- 6.3. In determining which of the three options to select in respect of the arrangements for appointing External Auditors, the Council has a duty to make arrangements to secure continuous improvement in the way in which its functions are exercised, having regard to a combination of economy, efficiency and effectiveness by virtue of section 3 of the Local Government Act 1999. This is known as its Best Value Duty.
- 6.4. The principal way that the Council demonstrates compliance with its Best Value Duty is by subjecting the purchases it makes to a competitive tendering exercise. Also, services of this nature are ordinary services for the purposes of the Public Contracts Regulations 2015. This means that where the estimated value of the contract is greater than £164,176.00 then the full regime will apply to any such purchase, meaning that regardless of the option selected by the Council the identity of the final contractor should be found by running some form of full European Procurement.
- 6.5. With regard to Option 1 (a local procurement) it would be a straight forward task and one which would be entirely under the Council's control to comply with the 2015 regulations. In essence the Council would have to comply directly with the methods of advertising and evaluation and also the timescales prescribed by the Regulations with the winning contractor being determine on a Most Economically Advantageous basis given an appropriate blend of price and quality of the evaluation.
- 6.6. With options 2 and 3 the Council would be relying on a third party to satisfy the Council's procurement obligations under the Regulations. This is possible although the Council should not commit itself to a given path unless it is certain that the Council's own procurement obligations have been properly satisfied.
- 6.7. With regard to Option 2 the appointment of the final contractor would be down to the joint Audit Panel. However, the contractual relationship would be a direct one between LBTH and the winning bidder for the provision of the audit services. Therefore, the relevant procurement exercise would be that of a joint procurement between the participating boroughs and the European Advert would have to specifically state the identities of the parties who will ultimately purchase through the procured route. The role of the joint panel would be to operate the procurement evaluation and recommend to each borough the identity of the winning bidder. Each borough would then be responsible for following its own constitutional requirements and enter into the relevant contract.
- 6.8. The difficulty is one of control as the Council may not be able to influence the shape of the procurement and where the Council fundamentally believes that its own procurement obligations have not been satisfied then the Council should not and would not be able to enter into the contract.



- 6.9. It is notable that the execution of such a contract should also be subject to its own delegated decision making process beyond that included in this report.
- 6.10. As regard Option 3 the nature of the contract would be a purchase of services between LBTH and the Sector Led Body (SLB). However, on the face of it this is a purchase that would not have been subject to competition and would not satisfy the Council's legal obligation to tender in accordance with the 2015 regulations.
- 6.11. However, Regulation 12 of the Public Contracts Regulations 2015 provides an exception. This is where the Council purchases services from an organisation where:
- a. the Council exercises over that organisation a control which is similar to that which it exercises over its own departments; and
  - b. more than 80% of the activities of that organisation are carried out in the performance of tasks entrusted to it by the Council; and
  - c. there is no direct private capital participation in the organisation
- 6.12. However, this will not be the case here as such. However, Regulation 12 goes further to say that where the other public body is jointly owned by a number of public authorities then each one will be deemed to have the necessary control where:
- 6.12.1. the Council exercises jointly with the other members a control over the set up organisation which is similar to that which they exercise over their own departments
  - 6.12.2. more than 80% of the activities of the set up organisation are carried out in the performance of tasks entrusted to it by the group members
  - 6.12.3. there is no direct private capital participation in the set up organisation
- 6.13 Also the Council will be said to be exercising joint control where:
- 6.13.1 the decision-making bodies of the set up organisation are composed of representatives of all participating member authorities
  - 6.13.2 those member authorities are able to jointly exert decisive influence over the strategic objectives and significant decisions of the set up company and
  - 6.13.3 the set up company does not pursue any interests which are contrary to those of the member authorities
- 6.14 Therefore, the constitution of the SLB would be vital to the success of option 3. It should be possible to set up an SLB which is jointly owned by all the authorities who wish to purchase services from it, who together are able to exert a sufficient level of control over it.
- 6.15 The key feature would be though that the level of control is over the company, rather than the subsequent contractor auditor consultancy, who would need to

maintain their specific independence in order to satisfy the requirements of the 2015 Audit Regulations

- 6.16 Any changes in provision or services brought about by the move to a pan-London model should be considered in accordance with the public sector equalities duty under the Equalities Act 2010, which requires the Council when exercising its functions to have 'due regard' to the need to eliminate discrimination (both direct and indirect discrimination), harassment and victimisation and other conduct prohibited under the Act, and to advance equality of opportunity and foster good relations between those who share a 'protected characteristic' and those who do not share that protected characteristic. The Council should perform a proportionate equality analysis before determining its preferred procurement option and prior to any changes being made.

**7. One Tower Hamlets**

- a. There are no specific one Tower Hamlets considerations.
- b. There are no specific Anti-Poverty issues arising from this report

**8. Best Value Implications**

- 8.1. The preferred option would provide good value for money to the Council. By offering large contract values, the firms would be able to offer better rates and lower fees than are likely to result from local negotiation. This will meet the Council's Best Value duty.

**9. Risk Management Implications**

- 9.1. Whilst there is no immediate risk to the Council, early consideration by the Council of its preferred approach will enable detailed planning to take place so as to achieve Successful transition to the new arrangement in a timely and efficient manner

**10. Sustainable Action for a Greener Environment (SAGE)**

- 10.1. There are no specific SAGE implications.

**11. Crime and Disorder Reduction Implications**

- 11.1. There are no specific Crime and Disorder implications.