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Havering
LONDON BOROUGH

AUDIT COMMITTEE
AGENDA

7.00 pm	**Tuesday 27 November 2018**	**Committee Room 3b, Town Hall, Main Road, Romford**

Members 6: Quorum 3

COUNCILLORS:

Conservative Group (3)	**Residents' Group (1)**	**Upminster & Cranham Residents' Group (1)**	**North Havering Residents Group (1)**
Matt Sutton (Vice-Chair) Viddy Persaud Roger Ramsey	Gerry O'Sullivan	Clarence Barrett	Martin Goode (Chairman)

For information about the meeting please contact:
Victoria Freeman 01708 433862
victoria.freeman@OneSource.co.uk

Protocol for members of the public wishing to report on meetings of the London Borough of Havering

Members of the public are entitled to report on meetings of Council, Committees and Cabinet, except in circumstances where the public have been excluded as permitted by law.

Reporting means:-

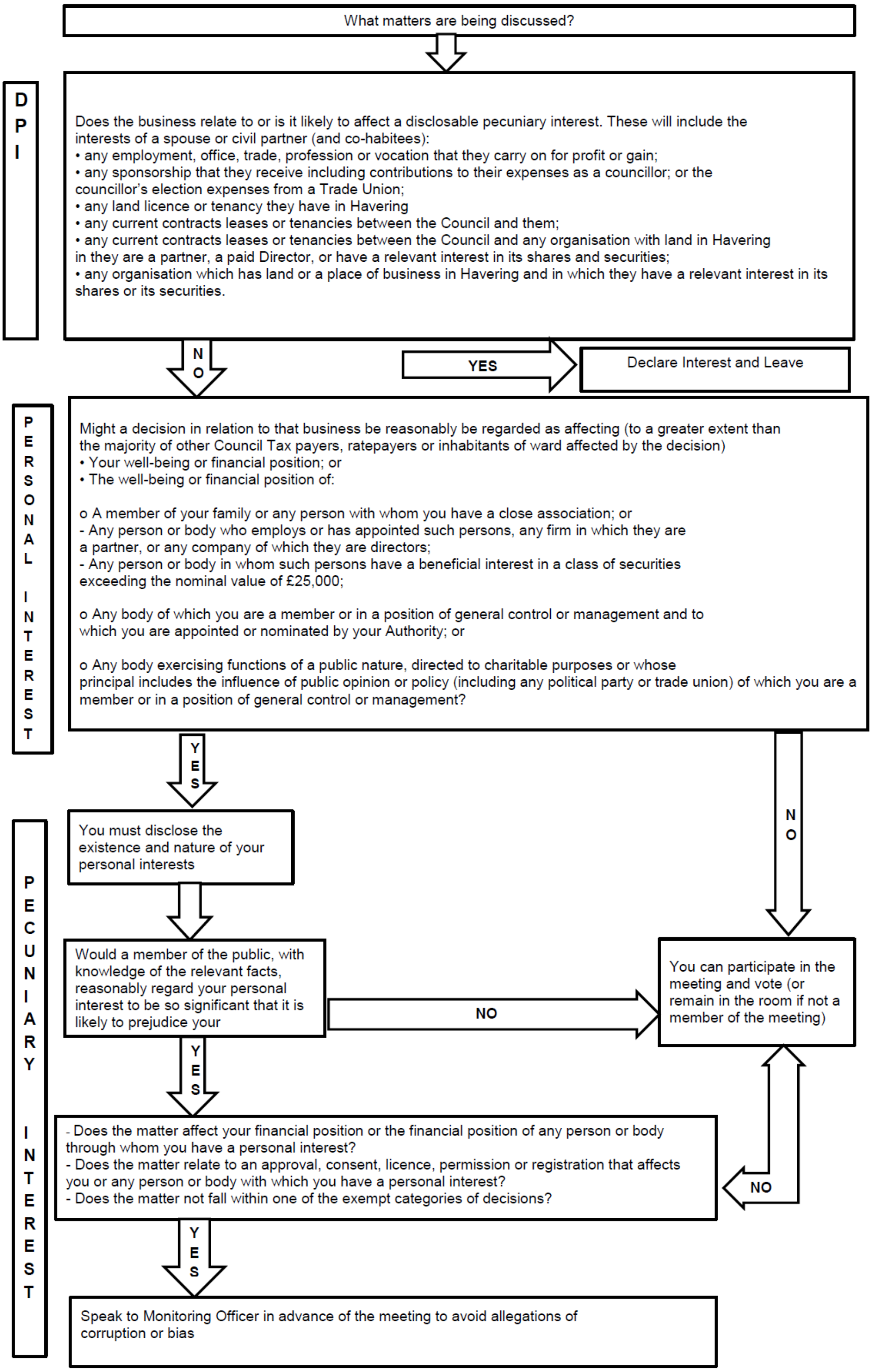
- filming, photographing or making an audio recording of the proceedings of the meeting;
- using any other means for enabling persons not present to see or hear proceedings at a meeting as it takes place or later; or
- reporting or providing commentary on proceedings at a meeting, orally or in writing, so that the report or commentary is available as the meeting takes place or later if the person is not present.

Anyone present at a meeting as it takes place is not permitted to carry out an oral commentary or report. This is to prevent the business of the meeting being disrupted.

Anyone attending a meeting is asked to advise Democratic Services staff on 01708 433076 that they wish to report on the meeting and how they wish to do so. This is to enable employees to guide anyone choosing to report on proceedings to an appropriate place from which to be able to report effectively.

Members of the public are asked to remain seated throughout the meeting as standing up and walking around could distract from the business in hand.

DECLARING INTERESTS FLOWCHART – QUESTIONS TO ASK YOURSELF



AGENDA ITEMS

1 CHAIRMAN'S ANNOUNCEMENTS

The Chairman will announce details of the arrangements in case of fire or other events that might require the meeting room or building's evacuation.

2 APOLOGIES FOR ABSENCE AND ANNOUNCEMENT OF SUBSTITUTE MEMBERS

(if any) – received.

3 DISCLOSURE OF INTERESTS

Members are invited to declare any interest in any of the items on the agenda at this point of the meeting.

Members may still disclose any interest in any item at any time prior to the consideration of the matter.

4 MINUTES OF THE MEETING (Pages 1 - 6)

To approve as correct the minutes of the meeting held on 30 July 2018 and authorise the Chairman to sign them.

5 HEAD OF ASSURANCE - PROGRESS REPORT 2018/19 (Pages 7 - 16)

6 TREASURY MANAGEMENT MID YEAR UPDATE 2018/19 (Pages 17 - 36)

7 2017-18 ANNUAL AUDIT LETTER (Pages 37 - 66)

8 FORWARD PLAN 2018/19 (Pages 67 - 68)

Andrew Beesley
Head of Democratic Services

MINUTES OF A MEETING OF THE
AUDIT COMMITTEE
Committee Room 1-Town Hall - Town Hall
30 July 2018 (7.00 - 9.00 pm)

Present:

COUNCILLORS:

Conservative Group	Matt Sutton (Vice-Chair), Viddy Persaud and Roger Ramsey
Residents' Group	Gerry O'Sullivan
Upminster & Cranham Residents' Group	Clarence Barrett
North Havering Residents Group	Martin Goode (in the Chair)

Through the Chairman, announcements were made regarding emergency evacuation arrangements and the decision making process followed by the Committee.

1 **MINUTES OF THE MEETING**

The minutes of the meeting of the Committee held on the 14 March 2018 were agreed as a correct record and signed by the Chairman with an amendment to reflect that Councillor Clarence Barrett had been in attendance at the meeting.

2 **ANNUAL GOVERNANCE STATEMENT 2017/18**

Officers advised that the 2016/17 Annual Governance Statement had identified five significant governance issues; these were Scheme of Delegation (L B Havering); Commissioning and Contracts (including compliance with procurement rules); Mercury Land Holdings (MLH); Projects and Programme Governance; and Information Technology and Information Governance. These significant issues had been closed, since the Governance and Assurance Board concluded that sufficient action to address the issues had been taken during the year.

Four new issues had been raised during 2017/18 and would be addressed during 2018/19:

- Corporate Project Management Office (PMO) and Economic Development Programme;
- Financial Regulations;
- Delivery of balanced budget; and
- Information Governance – GDPR.

Resolved:

That the contents of the 2017-18 Annual Governance Statement, be noted.

3 **ANNUAL STATEMENT OF ACCOUNTS 2017/18 & ISA 260 REPORT TO THOSE CHARGED WITH GOVERNANCE**

The Accounts and Audit Regulations 2015 required that from the 2017/18 financial year, that each local authority prepare and publish its approved draft and audited accounts by the 31 May and 31 July respectively. This change had a significant impact on both Havering and its auditors to ensure the accounts were completed within the required timescales. It was explained that the Council had prepared well for these changes, preparing a good set of draft accounts and supporting working papers in advance of the deadline of 31 May. Council staff had promptly responded to the queries raised by the Auditors during the course of the audit.

The auditor had prepared two ISA 260 reports, one relating to the audit of the Council, and the other the Pension Fund. The two reports detailed the auditor's findings from their review of the 2017/18 financial accounts. External audit confirmed that they intended, subject to completion of the outstanding work listed in their report, to give an unqualified opinion on the financial statement for the Council and Pension Fund, and an unqualified Value for Money conclusion for the Council.

Within their ISA 260 report for the Council, the auditors highlighted two adjusted audit difference, and one unadjusted audit difference.

The unadjusted audit amendment was in relation to difference in valuation of one of the council's Leisure centres between Wilks Head and Eve and the auditors own valuers. This difference was identified as part of the auditor's work on the Council's 2016/17 financial statements, but in the absence of any change to the value of this asset, the auditor felt the difference identified in the prior year remained. Members confirmed that as the difference was not material, they were satisfied that the accounts were not amended to correct this.

The adjusted audit differences related to a change in the value of the pension fund liability arising from a change in the value of net assets between 31 December 2017 and 31 March 2018, and a reduction in the payables balance. An amendment was also to be made to reflect Councillor Gillian Ford and Councillor Damian White's membership of the Havering Theatre Trust for the period 2017-18.

The auditor's also noted that during 2017/18 the Council's external valuer had revised their approach to the valuation of land. This had led to a significant increase in the value of the land associated with all assets valued on a DRC (Depreciated Replacement Cost) basis, particularly Schools. The auditors noted that they had engaged valuation experts from within their firm to support their work in the valuation of these assets, and had considered whether the change arose from a change in the basis of the estimate, or as a result of an error in the prior year valuation. The auditor's noted that they were satisfied this was a change in accounting estimate, and as such no restatement of the prior year financial statements was required.

Members discussed the valuation of land and buildings, in particular specialist assets such as schools who are able to convert to academy status and transfer the asset for nil value. Members sought clarification on the relevance of their inclusion in the financial statements as the land and buildings were not readily marketable. It was explained that the inclusion was in accordance with the Code of Practice on Local Authority Accounting in the United Kingdom. Members requested that their concerns be raised with the Chartered Institute of Public Finance & Accountancy (CIPFA).

Members sought clarification in regards to the wording of the letter or representation as it was thought too much reliance was placed on the audit chair to give assurance. It was discussed that the letter stated was to "the best of their knowledge" One member expressed concern over the wording and advised the Chair not to sign the letter.

Members requested that trend data for Revenue Outturn be provided in the Statement of Accounts for 2018/19, to ensure transparency.

Clarification was sought on the reason for the deficit from Romford Market, this was due to a 40% short fall in Romford Market rent against budget, which was usually off set by other commercial income.

Resolved: That

a) **The contents of the report and the Statement of Accounts, alongside the Report to those charged with governance and the verbal updates by the External Auditor, following their examination of the Council's accounts, were considered.**
b) **The deadline for publication of the audited accounts by the 31 July 2018, be noted.**
c) **The amendments to the accounting policies arising from the audit of the accounts set out at paragraph set out at paragraph 2 of the Report.**
d) **The Statement of Accounts for the financial year ended 31 March 2018, be approved.**
e) **Any subsequent amendments to the Statement of Accounts that may be necessary as a result of audit completion procedures, be delegated to the Chair of the Committee, in consultation with the Chief Operating Officer and Statutory Chief Finance Officer.**
f) **The Letter of Representation be signed, subject to an acknowledgement in the minutes that the letter is correct to the best of the committees knowledge given the information that has been provided.**

4 **ANNUAL TREASURY MANAGEMENT REPORT 2017/18**

Officers provided details of the final 2017/18 Treasury Position. Investment income for the year was £1.51m compared to a budget of £1.35m. The Authority's average interest return was 0.74% outperforming the budgeted rate of return by 0.14%, and was also better than the average of 0.64% across the London Peer Group and 0.63% across the Local Authority Group with Arlingclose's benchmarking club. The Authority complied with all set treasury and prudential Indicator limits. The Authority successfully opted up to MiFD II professional status with the relevant counter parties in January 2018, enabling the Authority to deliver the Treasury Management strategy.

Members raised concern regarding the Danske Bank Lenders Option Borrowers Option (LOBO) Loan to the Authority following media reports that 14 Local Authorities have started legal action against Barclays bank. It was explained that this legal action was in response to an earlier Barclays LiBOR settlement and that the basis of their claim was based on the fact that these 14 Authorities held Barclays LOBO loans where the interest paid is linked to the LIBOR rate. In contrast this Authority's Danske Bank LOBO was a standard fixed rate or 'Vanilla' type LOBO which is not linked to the LIBOR rate and therefore falls outside the scope of this legal action.

Resolved:

That the treasury management activities for the financial year 2017-18, as detailed in the report, be noted.

5 **HEAD OF ASSURANCE ANNUAL REPORT 2017/18**

The Committee received a report detailing the work undertaken to review the system of internal control and provided Members with assurance that an adequate system of internal control was in place within the London Borough of Havering.

During 2017/18, the Project and Programme Governance Review and No Recourse to Public Funds (NRPF) were given an audit opinion of Limited Assurance. It was requested that, in future, action plans be presented to committee for those areas with limited assurance. Furthermore, it was requested that feedback on the progress of the No Recourse to Public Funds audit be provided at the next meeting.

The Internal Audit Team tracked the completion of all audit recommendations and the Audit Committee received a full list of all outstanding high risk recommendations.

Resolved:

That the contents of the report be noted.

6 **HEAD OF ASSURANCE - QUARTER FOUR PROGRESS REPORT 2017/18**

The Committee were provided with details of the work undertaken by the Internal Audit and Counter Fraud teams during quarter 4.

All recommendations that became due in quarter four had been followed up and had been implemented.

The Committee requested that future reports indicate clearly what audits had been added and deleted to the Audit Plan and the number of audit days used and carried forward.

Resolved:

That the report be noted.

7 **PROPOSED WORK PROGRAMME FOR THE AUDIT COMMITTEE FOR THE 2018/19 MUNICIPAL YEAR**

At the request of officers, the Committee agreed that the meeting scheduled to be held on the 27 September 2018, be cancelled. The next meeting would be held on the 27 November 2018.

It was requested that an action log and evidence of completion be provided at future meetings.

Resolved:

That the proposed work programme be agreed, subject to the October 2018 meeting being replaced with November 2018.

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Chairman

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Havering
LONDON BOROUGH

AUDIT COMMITTEE

Subject Heading:	Head of Assurance – Progress Report 2018/19
SLT Lead:	Sean Harriss Interim Chief Executive, oneSource
Report Author and contact details:	Jeremy Welburn, Head of Assurance Tel: 01708 433307 / 07976539248 Email: Jeremy.welburn@onesource.co.uk
Policy context:	To inform the Committee of progress on the assurance work during the first half of 2018/19.
Financial summary:	There are none arising directly from this report which is for noting and/or providing an opportunity for questions to be raised

The subject matter of this report deals with the following Council Objectives

Communities making Havering	[X]
Places making Havering	[X]
Opportunities making Havering	[X]
Connections making Havering	[X]

SUMMARY

This report advises the Committee on the work undertaken by the Assurance Service (internal audit & counter fraud) during the first half of 2018/19. The report is presented in three sections:

Section 1: Introduction, Issues and Assurance Opinion

Section 2: Executive Summary - A summary of the key messages.

Section 3: Appendices: Provide supporting detail for Members' information
Appendix A: Detail of Internal Audit work to date
Appendix B: Detail Counter Fraud work
Appendix C: Current status of 2018/19 audit plan

RECOMMENDATIONS

1. To note the contents of the report.

2. To raise any issues of concern and ask specific questions of officers where required.

REPORT DETAIL

Section 1: Introduction, Issues and Assurance Opinion

1.1 Introduction

1.1.1 The Accounts and Audit Regulations require the Council to undertake an effective internal audit to evaluate the effectiveness of its risk management, control and governance processes, taking into account the Public Sector Internal Auditing Standards (PSIAS) and other guidance.

1.1.2 Internal audit is a key component of corporate governance within the Council. The three lines of defence model, as detailed below, provides a framework for understanding the role of internal audit in the overall risk management and internal control processes of an organisation:

- First line – operational management controls
- Second line – monitoring controls, e.g. the policy or system owner/sponsor
- Third line – independent assurance.

The Council's third line of defence includes Internal Audit, which should provide independent assurance to senior management and the Audit Committee on how effectively the first and second lines of defence have been operating.

1.1.3 An independent internal audit function will, through its risk-based approach to work, provide assurance to the Council's Audit Committee and senior management on the higher risk and more complex areas of the Council's business, allowing management to focus on providing coverage of routine operations.

1.1.4 The work of internal audit is critical to the evaluation of the Council's overall assessment of its governance, risk management and internal control systems, and forms the basis of the annual opinion provided by the Head of Assurance which contributes to the Annual Governance Statement. It can also perform a consultancy role to assist in identifying improvements to the organisation's practices.

1.1.5 This report brings together all aspects of internal audit and counter fraud work undertaken in during the first half of 2018/19, in support of the Audit Committee's role.

1.1.6 The report supports the Head of Assurance's ongoing assurance opinion on the internal control environment and highlights key outcomes from internal audit and counter fraud work and provides information on wider issues of interest to the Council's Audit Committee. The Appendices provide specific detail of outputs for the Committee's information.

1.2 Level of Assurance

1.2.1 At the July 2018 Audit Committee meeting, Members received the Head of Assurance opinion based upon the work undertaken 2017/18, which concluded that reasonable assurance could be given that the internal control environment is operating adequately.

1.2.2 There can be some qualifications to this conclusion where audit work has resulted in limited assurance opinions. One limited assurance report was issued in the first half of 2018/19. However, it is considered that this does not have a material impact on the overall opinion of reasonable assurance.

Section 2. Executive Summary of work undertaken to date in 2018/19

2.1 Internal Audit

2.1.1 There have been eight final reports issued in the first half of 2018/19. Of these reports two were given an audit opinion of substantial assurance, five moderate assurance and one limited assurance. Appendix C shows the current position of the 2018/19 audit plan.

2.1.2 A total of 60 recommendations were raised from these reports, of which ten have been categorised as high risk. Further detail is provided in Appendix A.

2.2 Pro-Active and Counter Fraud

2.2.1 Investigation into the referral brought forward from the previous year identified there was no case to answer.

2.2.2 Four referrals were received during the first half of the year of which one resulted in disciplinary action. Three referrals are currently being investigated.

IMPLICATIONS AND RISKS

Financial implications and risks:

There are none arising directly from this report which is for noting and/or providing an opportunity for questions to be raised.

By maintaining an adequate internal audit service, management are supported in the effective identification and efficient management of risks and ultimately good governance. Failure to maximise the performance of the service may lead to losses caused by insufficient or ineffective controls or even failure to achieve objectives where risks are not mitigated. In addition recommendations may arise from any audit work undertaken and managers have the opportunity of commenting on these before they are finalised. In accepting audit recommendations, the managers are obliged to consider financial risks and costs associated with the implications of the recommendations. Managers are also required to identify implementation dates and then put in place appropriate actions to ensure these are achieved. Failure to either implement at all or meet the target date may have control implications, although these would be highlighted by any subsequent audit work. Such failures may result in financial losses for the Council.

Legal implications and risks:

None arising directly from this report.

Human Resources implications and risks:

None arising directly from this report.

Equalities implications and risks:

None arising directly from this report.

Appendix A

3. Progress Report - Internal Audit Work

3.1 Audit Progress

3.1.1 The Annual Audit Plan, approved by the Audit Committee in February 2018, comprised 47 audit reviews. Members will be aware that the plan is subject to revision and amendment at any time should higher priority risks or tasks be identified. Adjustments have been made since the plan was approved (see table below) and the current number of audit reviews is 48.

3.1.2 Current, cumulative progress toward delivery of the 2018/19 audit plan (including audits carried forward from 2017/18, but excluding School Health Checks) is summarised in the table below, with further detail provided in Appendix C. It should be noted that some of the work undertaken by internal audit does not result in an opinion being provided, such as advisory reviews and grant claims.

Audit Plan Status	Number of Audits / Tasks
Approved Audit Plan 2018/19	47
2017/18 Audit tasks brought forward to 2018/19	1
Audit tasks added to the Plan	4
Audit tasks cancelled	(3)
Audit tasks postponed/deferred to 2019/20	(1)
Total	48
Audits completed	**13**
Final reports issued / completed	8
Draft reports issued	5
In Progress	12
To be Completed	22

3.2 Risk Based Systems and School Audits

3.2.1 The table below details the results of the final reports issued in the first half of 2018/19.

Report	Assurance	Recommendations			
		High	Med	Low	Total
System Audits					
Children with Disabilities	Substantial	0	2	0	2
One Oracle Interfaces (2017/18)	Substantial	0	2	0	2
System Audits Total		**0**	**4**	**0**	**4**
School Audits					
St Patrick's Catholic Primary	Moderate	0	5	2	7
Brady Primary	Moderate	3	1	3	7
Hylands Primary	Moderate	1	6	4	11
Nelmes Primary	Moderate	0	6	3	9
St Ursula's Catholic Primary	Moderate	0	6	6	12
The Learning Federation (Mead & Broadford)	Limited	6	3	1	10
Schools Total		**10**	**27**	**19**	**56**
Q1 & Q2 Audits Total		**10**	**31**	**19**	**60**

Key to Assurance Levels	
Substantial Assurance	There is a robust framework of controls and appropriate actions are being taken to manage risks within the areas reviewed. Controls are applied consistently or with minor lapses that do not result in significant risks to the achievement of system objectives.
Moderate Assurance	Whilst there is basically a sound system of control within the areas reviewed, weaknesses were identified and therefore there is a need to enhance controls and/or their application and to improve the arrangements for managing risks.
Limited Assurance	There are fundamental weaknesses in the internal control environment within the areas reviewed, and further action is required to manage risks to an acceptable level.

3.2.2 During the first half of 2018/19, one school health check was completed.

3.3 Outstanding Audit Recommendations Update

3.3.1 Internal Audit follows up all audit recommendations with management when the deadlines for implementation are due. There is a rolling programme of follow up work, with each auditor taking responsibility for tracking the implementation of recommendations made in their audit reports. The implementation of audit recommendations, in systems where limited assurance was provided, is verified through a follow up audit review.

3.3.2 This work is of high importance given that the Council's risk exposure remains unchanged if management fail to implement the recommendations raised in respect of areas of control weakness. A key element of the Audit Committee's role is to monitor the extent to which recommendations are implemented as agreed and within a reasonable timescale, with particular focus applied to any high risk recommendations.

3.3.3 Recommendations are classified into three potential categories according to the significance of the risk arising from the control weakness identified. The three categories comprise:

High:	Fundamental control requirement needing implementation as soon as possible.
Medium:	Important control that should be implemented
Low:	Pertaining to best practice.

3.3.4 The table below summarises the number of recommendations arising from reports issued in the first half of 2018/19. This table does not include schools, as these are set out below in section 3.4.

System Audit recommendations	High	Med	Low	Total
No. of Recs raised in Q1 & Q2	0	4	0	4
Outstanding Recs brought forward from 2017/18	11	22	8	41
Total	**11**	**26**	**8**	**45**

3.3.5 All of the 11 high risk recommendations were due to be implemented by 30th September 2018 but are currently in the process of being reviewed as part of two follow up audits since the original reviews were given a limited assurance rating. The two audits are: No Recourse to Public Funds and Project and Programme Governance. The outcomes of these follow up reviews will be reported in the next progress report.

3.4 Outstanding School Audit Recommendations Update

3.4.1 The table below summarises the recommendations raised for school audits during the first half of 2018/19:

School Audit Recommendations	High	Medium	Low	Total
No. of Recs raised in Q1 & Q2	10	27	19	56
Outstanding Recs brought forward from 2017/18	2	59	16	77
TOTAL	**12**	**86**	**35**	**133**

3.4.2 Of the 12 high risk recommendations detailed above, three were due to be implemented by 30th September 2019. All three have been implemented.

Appendix B

4. Quarter Four - Counter Fraud Audit Work

4.1 Proactive Counter Fraud Investigations

4.1.1 Proactive work undertaken during the first half of the year is shown below:

Description	Risks	Quarter 4 Status
Advice to Directorates	General advice and support to Directors and Heads of Service including short ad-hoc investigations, audits and compliance. Eleven requests for advice were received.	Ongoing
Advice to Other Local Authorities	All Data Protection Act requests via Local Authorities, Police etc. Two requests for advice were received.	Ongoing
Fraud Hotline	To take all telephone calls and emails relating to the 'Fraud Hotline' and refer appropriately. Nine referrals were received.	Ongoing
FOI Requests	To undertake all freedom of Information Requests. Five FOI requests were received.	Ongoing

4.2 Reactive Investigation Cases

4.2.1 One referral was brought forward from the previous year. The investigation proved there was no case to answer.

4.2.2 During the first half of the year four referrals were received:
- One case has resulted in disciplinary action; and
- Three cases are still being investigated.

Appendix C: Current status of 2018/19 Audit Plan

	AUDIT TITLE	STATUS	OPINION
LBH SYSTEM AUDITS	Children with Disabilities	COMPLETED	SUBSTANTIAL
	Reablement Services	DRAFT REPORT	
	Care Packages	DRAFT REPORT	
	Financial Monitoring of CAD Placements	DRAFT REPORT	
	SEN Transport	DRAFT REPORT	
	Direct Payments	UNDERWAY	
	Homelessness – Homelessness Reduction Act	UNDERWAY	
	IR35	UNDERWAY	
	No Recourse to Public Funds (NRPF) Follow Up (Additional Task)	UNDERWAY	
	Project and Programme Governance Follow Up (Additional Task)	UNDERWAY	
	Right to Buy	UNDERWAY	
ONESOURCE	One Oracle Interfaces (2017/18)	COMPLETED	SUBSTANTIAL
	Financial Controls Phase 1 (forms part of the Key Financial Systems audit allocation)	DRAFT REPORT	
	Financial Controls Assurance Phase 2 (forms part of the Key Financial Systems audit allocation) (Additional Task)	UNDERWAY	
	Pension Fund Governance	UNDERWAY	
	Pension Fund Administration	UNDERWAY	
	Treasury Management	UNDERWAY	
	Cloud Computing (forms part of the ICT audit allocation)	UNDERWAY	
	Virus Protection (forms part of the ICT audit allocation) (Additional Task)	UNDERWAY	
SCHOOLS	St Patrick's Catholic Primary	COMPLETED	MODERATE
	Brady Primary	COMPLETED	MODERATE
	Hylands Primary	COMPLETED	MODERATE
	Nelmes Primary	COMPLETED	MODERATE
	St Ursula's Catholic Primary	COMPLETED	MODERATE
	The Learning Federation (Mead & Broadford)	COMPLETED	LIMITED
	Health Checks (21)	UNDERWAY	1 FINAL REPORT ISSUED

Status of 2018/19 Audit Plan – Audits to be scheduled

	AUDIT TITLE	STATUS
LBH SYSTEM AUDITS	Adoption and Permanency Prescription	Q3
	Housing – Fixed term tenancy agreements	Q3
	Economic Development Programme Review	Q4
	GDPR	Q3
	Social Care Transitions	Q3
	Replacement for SWIFT	Q3
	Private Sector leasing – new payments system	TBC
	Homelessness/Housing – new system	TBC
	General Project Assurance Work	Q4
	Joint Commissioning Unit	TBC
	PMO / Project Management Arrangements	Q4
	Corporate Health and Safety	TBC
	Contract Management	TBC
	Emergency Planning and Business Continuity	TBC
	School Expansion Programme	Move to 2019/20
	Housing and Planning Act 2016	Cancelled
SCHOOLS	James Oglethorpe Primary	Q4
	Parsonage Farm Primary	Q4
	R.J. Mitchell Primary	Q3
	Suttons Primary	Q4
	Scotts Primary	Q4
	Gaynes Language College	Cancelled – Converted to Academy
	Sanders Drapers	Cancelled – Converted to Academy
	Health Checks (20)	Q3/Q4
ONESOURCE	NNDR – Debt Recovery and Write Offs	Q3
	Transactional Services	Q3
	Procurement	Q3/4

Agenda Item 6

Havering
LONDON BOROUGH

AUDIT COMMITTEE

Subject Heading:	**TREASURY MANAGEMENT MID YEAR UPDATE 2018/19**
SLT Lead:	**Jane West** **Chief Operating Officer**
Report Author and contact details:	**Reena Patel / Stephen Wild** **Treasury Manager / Head of Pensions and Treasury** **01708432485** **Reena.Patel@onesource.co.uk**
Policy context:	**The Code of Practice on Treasury Management (Revised 2017) requires that Council be provided with a mid-year report on treasury activities.**
Financial summary:	**There are no direct financial implications from the report.**

The subject matter of this report deals with the following Council Objectives

Communities making Havering	[x]
Places making Havering	[x]
Places making Havering	[x]
Connections making Havering	[x]

Summary

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The Chartered Institute of Public Finance and Accountancy's Treasury Management Code (CIPFA's TM Code) requires that authorities report on the performance of the treasury management function to Full Council at least twice per year (mid-year and at year end).

The Authority's treasury management strategy for 2018/19 was approved at a meeting of the Authority in February 2018.

The Authority has borrowed and invested substantial sums of money and is therefore exposed to financial risks including the loss of invested funds and the revenue effect of changing interest rates. This report covers activity on treasury managed investments and borrowings and the associated monitoring and control of risk.

The key highlights of the Mid-Year report are as follows:

- Investment portfolio average quarterly return was 0.85% as at 30/9/18 compared against the average quarterly 3 month LIBOR benchmark of 0.73%.
- The Treasury Advisor's benchmarking club of 15 London Boroughs had an average return of 0.84% in Q2 on comparable internally managed investments.
- No breach of the Authority's prudential indicators and treasury indicators.

RECOMMENDATIONS

- To note the treasury management activities for the half year detailed in the report.
- To note Section 7 on the separation of structures of larger UK Banks into retail (ring fenced) and investment (non ring-fenced) banks.

REPORT DETAIL

1. Background

1.1 Treasury management

The Council operates a balanced budget, which broadly means cash raised during the year will meet its cash expenditure. Part of the treasury management operations ensure this cash flow is adequately planned, with surplus monies being invested in low risk counterparties, providing adequate liquidity initially before considering optimising investment return.

The second main function of the treasury management service is the funding of the Council's capital plans. These capital plans provide a guide to the borrowing need of the Council, essentially the longer term cash flow planning to ensure the Council can meet its capital spending operations. This management of longer term cash may involve arranging long or short term loans, or using longer term cash flow surpluses, and on occasion any debt previously drawn may be restructured to meet Council risk or cost objectives.

1.2 Capital Strategy

In December 2017, the Chartered Institute of Public Finance and Accountancy, (CIPFA), issued revised Prudential and Treasury Management Codes. As from 2019/20, all local authorities will be required to prepare a Capital Strategy which is intended to provide the following: -

- a high-level overview of how capital expenditure, capital financing and treasury management activity contribute to the provision of services
- an overview of how the associated risk is managed
- the implications for future financial sustainability

A report setting out our Capital Strategy will be taken to the full council, (or cabinet, with responsibility retained by the full council), before 31st March 2019.

2. Introduction

This report has been written in accordance with the requirements of the Chartered Institute of Public Finance and Accountancy's (CIPFA) Code of Practice on Treasury Management (revised 2017).

This is the Mid-Year Review Report required by the Code and covers the following:

- An economic update for the first part of the 2018/19 financial year;
- Treasury Management Summary for the half year;
- A review of the Council's borrowing strategy for 2018/19;
- A review of the Council's investment portfolio for 2018/19;
- A review of compliance with Treasury and Prudential Limits for 2018/19.

3. Economics and interest rates

3.1 Economics update – UK

The Council's Treasury Advisor, Link Asset Services, has provided the following commentary as at 30 September 2018:

The first half of 2018/19 has seen UK economic growth post a modest performance, but sufficiently robust for the Monetary Policy Committee, (MPC), to unanimously (9-0) vote to increase Bank Rate on 2nd August from 0.5% to 0.75%.

In mid-September, the Bank of England's MPC chose to hold the bank rate at 0.75% following the August hike. Bank Governor Mark Carney reiterated that the Committee is in no rush to raise rates back to more "normal" levels, and with Brexit *uncertainty coming to the fore; markets are showing little to no expectation of a further rate hike until Q2/Q3 2019.*

Some MPC members have expressed concerns about a build-up of inflationary pressures, particularly with the pound falling in value again against both the US dollar and the Euro. The Consumer Price Index (CPI) measure of inflation rose unexpectedly from 2.4% in June to 2.7% in August due to increases in volatile components. It was back to 2.4% in September and is expected to fall back to the 2% inflation target over the next two years given a scenario of minimal increases in Bank Rate.

3.2 Interest rate forecasts

Link Asset Services, has provided the following forecast:

	Link Asset Services Interest Rate View										
	Now	Dec-18	Mar-19	Jun-19	Sep-19	Dec-19	Mar-20	Jun-20	Sep-20	Dec-20	Mar-21
Bank Rate	0.75%	0.75%	0.75%	0.75%	1.00%	1.00%	1.00%	1.25%	1.25%	1.50%	1.50%
3 month LIBID	0.68%	0.80%	0.80%	0.90%	1.10%	1.10%	1.20%	1.40%	1.50%	1.60%	1.60%
6 month LIBID	0.78%	0.90%	0.90%	1.00%	1.20%	1.20%	1.30%	1.50%	1.60%	1.70%	1.70%
12 month LIBID	0.95%	1.00%	1.00%	1.10%	1.30%	1.30%	1.40%	1.60%	1.70%	1.80%	1.80%
5yr PWLB Rate	1.79%	2.00%	2.10%	2.20%	2.20%	2.30%	2.30%	2.40%	2.50%	2.50%	2.60%
10yr PWLB Rate	2.20%	2.50%	2.50%	2.60%	2.70%	2.70%	2.80%	2.90%	2.90%	3.00%	3.10%
25yr PWLB Rate	2.69%	2.90%	3.00%	3.10%	3.10%	3.20%	3.30%	3.30%	3.40%	3.50%	3.50%
50yr PWLB Rate	2.59%	2.40%	2.80%	2.90%	2.90%	3.00%	3.10%	3.10%	3.20%	3.30%	3.30%

Link have the view that the MPC is more likely to wait until August 2019, than May 2019, before the next increase, to be followed by further increases of 0.25% in May and November 2020 to reach 1.5%. However, the cautious pace of even these limited increases is dependent on a reasonably orderly Brexit.

The 50 year PWLB rate is expected to be around 2.80% in March 2019, gradually rising to 3.30% by March 2021. Also, as seen in the table above the 50 year PWLB rate is slightly cheaper than the 25 year PWLB rate, and whilst this is an important factor to take into consideration when undertaking new borrowing, the profile of capital spend would have overriding influence on the borrowing term.
PWLB is priced off the Gilt so reflects the current yield curve – PWLB certainty rate is 80bps above this.

The market dictates the Gilt curve, but in general terms demand from Pension Funds for longer dated Gilts (to match their liabilities) means that prices have increased and therefore yields have fallen below the earlier periods such as 25 years.

The results from 'Brexit' negotiations, low economic growth and inflation will have an impact on these interest projections.

4. Treasury Management Summary

The treasury management position as at 30th September 2018 and the change over the period is shown in Table 1 below.

Table 1: Treasury Management Summary as at 30th September 2018

	31.3.18 Balance £m	Movement £m	30.9.18 Balance £m	30.9.18 Rate %
Long-term borrowing	210.234		210.234	3.60
Short-term borrowing	30.252	-30.100	0.152	0.38
Total borrowing	**240.486**	**-30.100**	**210.386**	**3.59**
Long-term investments	33.000	5.000	38.000	1.61
Short-term investments	150.850	-9.100	141.750	0.77
Cash and cash equivalents	44.739	-10.102	34.637	0.83
Total investments	**228.589**	**-14.202**	**214.387**	**0.93**
Net borrowing	**11.897**	**-15.898**	**-4.001**	**2.66**

Temporary borrowing was undertaken at year end to cover higher than normal BACS runs towards the year end. At the same time LBH received grants (e.g. schools capital improvement grant 18/19 of £4.6m which was paid early) and other miscellaneous receipts at year end not factored in the cash flow plan. The surplus temporary borrowing was invested in money market funds and repaid in the first two weeks of April. Investments at 30.09.17 on a comparable basis were £205m.

5. Borrowing Strategy

5.1 Borrowing Position

The 30th September 2018 borrowing position is show in Table 2 below.

Table 2: Borrowing Position

	Balance at 31.03.18 £m	Raised £m	Repaid £m	Balance at 30.09.18 £m	Weighted Average Rate %
Loans					
PWLB	203.234	-	-	203.234	**3.60**
Banks (LOBO)	7.000	-	-	7.000	**3.60**
Local Authorities and Other (Short Term Borrowing)	30.252	15.000	-45.100	0.152	**0.38**
Total Loans	**240.486**	**15.000**	**-45.100**	**210.386**	**3.59**

The Council's capital financing requirement (CFR) for 2018/19 was forecasted at £292.3m. At period 6, the CFR forecasts have been revised down to £283m per forecasted capital spend received from service departments.

The CFR denotes the Council's underlying need to borrow for capital purposes. If the CFR is positive the Council may borrow from the PWLB or the market (external borrowing) or from internal balances on a temporary basis (internal borrowing). The balance of external and internal borrowing is generally driven by market conditions.

5.2 New borrowing

Affordability and the "cost of carry" remained important influences on the Authority's borrowing strategy alongside the consideration that, for any borrowing undertaken ahead of need, the proceeds would have to be invested in the money markets at rates of interest significantly lower than the cost of borrowing.

As a result no long term borrowing was undertaken during the half year but this will be kept under continuous review as capital investment plans are developed and spending is monitored.

The graph and table in Appendix A show the movement in PWLB certainty rates for the first six months of the year to date:

5.3 Debt Rescheduling

Debt rescheduling opportunities have been very limited in the current economic climate given the consequent structure of interest rates, and following the increase in the margin added to gilt yields which has impacted PWLB new borrowing rates since October 2010. No debt rescheduling has therefore been undertaken to date in the current financial year.

5.4 LOBO's

The Authority holds a £7m LOBO loan, where the lender has the option to propose an increase in the interest rate at set dates, following which the Authority has the option to either accept the new rate or to repay the loan at no additional cost. The LOBO loan has options during 2018/19, and although the Authority understands that lenders are unlikely to exercise their options in the current low interest rate environment, there remains an element of refinancing risk. The Authority will consider repaying the LOBO loan at no break cost if the opportunity arises.

6. Investment Portfolio 2018/19

6.1 Investment Activity

The Authority holds significant invested funds, representing income received in advance of expenditure plus balances and reserves held. The investment position during the half year is shown in Table 3 below.

Table 3: Investment Activity

	31.3.18 Balance	Movement	30.09.18 Balance	Weighted Average Rate %
Investments				
Banks & Building Societies (Fixed Unsecured)	49.000	18.000	67.000	0.75
Banks & Building Societies (Call & Notice Accounts Unsecured)	23.202	6.898	30.100	0.90
Banks & Building Societies (Fixed Secured)	8.800	-7.800	1.000	1.03
Government (incl. Local Authorities)	131.850	-27.100	104.750	0.98
Money Market Funds	12.737	-4.200	8.537	0.68
Corporate Bonds and Loans	3.000	0.000	3.0000	4.00
Total investments	**228.589**	**14.202**	**214.387**	**0.93**

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. As shown by forecasts in section 3.2, it is a very difficult investment market in terms of earning the level of interest rates commonly seen in previous decades as rates are very low and in line with the current 0.75% Bank Rate. The continuing potential for a re-emergence of a Eurozone sovereign debt crisis, and its impact on banks, prompts a low risk and short term strategy. Given this risk environment and the fact that increases in Bank Rate are likely to be gradual and unlikely to return to the levels seen in previous decades, investment returns are likely to remain low.

A full list of investments held as at 30th September 2018 is in **Appendix B**.

6.2 Budgeted Income and Return

The Authority measures the financial performance of its treasury management activities both in terms of its impact on the revenue budget and its relationship to benchmark interest rates, as shown in table 4 below:

Table 4: 2018/19 Treasury Investment Performance to 30.09.18

	Benchmark Return 3 month LIBOR (Average Quarterly Rate) %	Budgeted Rate of Return %	Budgeted Interest (Full Year) £m	Actual Rate of Return %	Actual Interest to end of Quarter £m
Quarter 1	0.68	0.60	1.105	0.81	0.449
Quarter 2	0.78	0.60	1.105	0.88	0.496
Average / Total	0.73	0.60	1.105	0.85	0.945

6.3 Budgeted Capital Financing Costs (Interest and MRP Costs)

Table 5: 2018/19 Budgeted Capital Financing Costs

Capital Financing Costs		Revised Budget £m	FY Forecast £m
Interest Payable	Existing Long Term Loans	£7,787	£7,787
Interest Payable	Regenerations Projects	£0.877	0.00
Minimum Revenue Provision		£2.084	£2.084

The interest earned to date and the forecast capital financing costs take into account a forecast reduction in capital expenditure during the year from £185m to £118m.

7. Other

7.1 UK banks – ring fencing

The largest UK banks, (those with more than £25bn of retail / Small and Medium-sized Enterprise (SME) deposits), are required, by UK law, to separate core retail banking services from their investment and international banking activities by 1st January 2019. This is known as "ring-fencing". Whilst smaller banks with less than £25bn in deposits are exempt, they can choose to opt up. Several banks are very close to the threshold already and so may come into scope in the future regardless.

Ring-fencing is a regulatory initiative created in response to the global financial crisis. It mandates the separation of retail and SME deposits from investment banking, in order to improve the resilience and resolvability of banks by changing their structure. In general, simpler, activities offered from within a ring-fenced bank, (RFB), will be focused on lower risk, day-to-day core transactions, whilst more complex and "riskier" activities are required to be housed in a separate entity, a non-ring-fenced bank, (NRFB). This is intended to ensure that an entity's core activities are not adversely affected by the acts or omissions of other members of its group.

While the structure of the banks included within this process may have changed, the fundamentals of credit assessment have not.

The Authority will continue to assess the new-formed entities in the same way that it does others and will review the position in the Treasury Management Strategy Statement for 2019/20.

7.2 IFRS9 accounting standard

This accounting standard came into effect from 1st April 2018. It means that the category of investments valued under the available for sale category will be removed and any potential fluctuations in market valuations may impact onto the Surplus or Deficit on the Provision of Services, rather than being held on the balance sheet. This change is unlikely to materially affect the commonly used types of treasury management investments but more specialist types of investments, (e.g. pooled funds, third party loans, commercial investments), are likely to be impacted. Based on the current investment portfolio the impact on this authority is not likely to be significant.

The Ministry of Housing, Communities and Local Government (MHCLG), are currently conducting a consultation for an override to the requirements of the standard. There is also a proposal to time limit the override if it was granted to allow English local authorities time to adjust their portfolio of investments. Members will be updated when the result of this consultation is known.

7.3 Money Market Fund Regulation (MMF)

The new EU regulations for Money Market Funds (MMFs) were approved and published in July and existing funds will have to be compliant by no later than 21st January 2019. The MMF sector is now in the last stages of introducing these new regulations. These will see existing non-government Constant Net Asset Value (CNAV) funds convert to Low Volatility Net Asset Value (LVNAV) pricing. Note that government-type funds will remain as “CNAV” funds under the new regulations.

This change is expected to occur in the very early stages of 2019. The 2018/19 Treasury Management Strategy Statement as approved by Council in February allows the use of LVNAV money market funds for Treasury Management purposes.

7.4 Local Authority Lending

Over the last few years inter Local Authority lending and borrowing activity has gradually been increasing within the money markets. Whilst Local Authorities cannot provide a formal guarantee nor have the power to offer security they are required by statute to repay debt first out of revenues, before any spend, which is usually sufficient to give quasi UK Government ratings.

However over the last decade Local Authorities have faced significant financial pressures due to constant cuts in government funding on one hand and increasing demographic pressures on the other.

The Authority's treasury advisors central view is that all local authorities I have the same credit risk as the mechanisms that exist within the local authority legislative framework effectively prevent a local authority from going bankrupt.

This is reinforced by a statement from the National Audit Office, entitled Financial Sustainability of Local Authorities, dated November 2014, which states that:

"A legal framework at the core of the local government accountability system effectively prevents local authorities becoming insolvent. Local authorities cannot borrow to finance revenue expenditure or run deficits."

7.5 Changes in risk appetite

The 2018 CIPFA Codes and guidance notes have placed enhanced importance on risk management. Where an authority changes its risk appetite e.g. for moving surplus cash into or out of certain types of investment funds or other types of investment instruments, this change in risk appetite and policy will be brought to members' attention in treasury management update reports.

8. Compliance with Prudential and Treasury Indicators

It is a statutory duty for the Authority to determine and keep under review the affordable borrowing limits. The Authority's approved 2018/19 Treasury and Prudential Indicators (affordability limits) were included and approved by Full Council as part of the Treasury Management Strategy Statement (TMSS) in February 2018.

During the half year, the Authority has operated within the treasury limits and Prudential Indicators set out in the authority Treasury Management Strategy Statement and in compliance with the authority's Treasury Management Practices. An update on indicators and limits are reported in **Appendix C** of this report.

IMPLICATIONS AND RISKS

Financial implications and risks:

There are no direct financial implications arising from this report.

Legal implications and risks:

There are no apparent legal implications or risks from noting this report.

Human Resources implications and risks:

There are no HR implications from this report.

Equalities implications and risks:

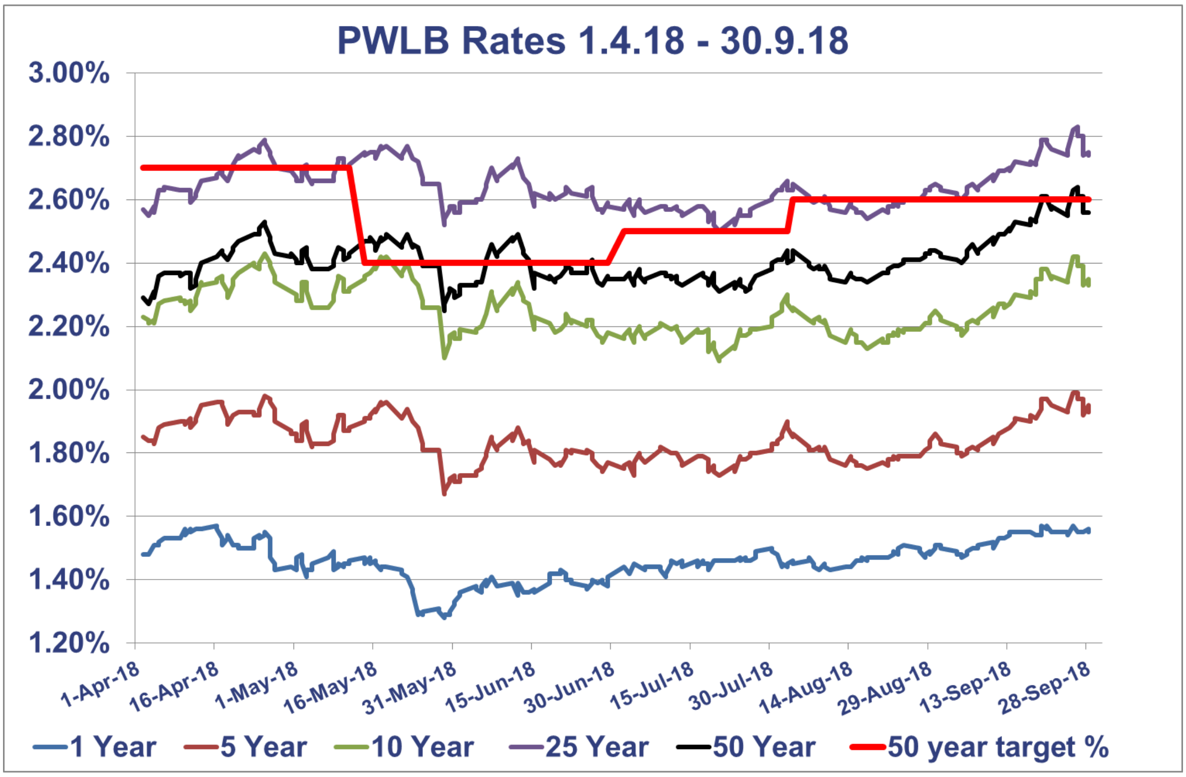
There are no Equalities implications arising from this report.

BACKGROUND PAPERS

None.

Appendix A

Movement in PWLB certainty rates for the first six months of 2018/19



	1 Year	5 Year	10 Year	25 Year	50 Year
3.4.18	1.48%	1.84%	2.22%	2.55%	2.27%
30.9.18	1.55%	1.93%	2.33%	2.74%	2.56%
Low	1.28%	1.67%	2.09%	2.50%	2.25%
Date	01/06/2018	29/05/2018	20/07/2018	20/07/2018	29/05/2018
High	1.57%	1.99%	2.43%	2.83%	2.64%
Date	17/04/2018	25/09/2018	25/04/2018	25/09/2018	25/09/2018
Average	1.46%	1.84%	2.25%	2.64%	2.41%

Appendix B

Table 1 breakdown of Deposits at 30th September 2018

Institution Type	Counterparty	Start Date	Maturity Date	Principal O/S
UK Bank	Close Brothers	20/04/2018	22/10/2018	5.000
UK Bank	Close Brothers	27/07/2018	28/01/2019	5.000
UK Bank	Lloyds Bank plc	15/05/2018	15/11/2018	5.000
UK Bank	Lloyds Bank plc	01/06/2018	30/11/2018	5.000
UK Bank	Lloyds Bank plc	03/08/2018	04/02/2019	10.000
UK Bank	Santander UK plc (Covered Bond)	31/08/2016	08/07/2019	1.000
UK Bank - Call Account	National Westminster Bank plc	28/03/2013	(blank)	0.100
UK Bank - Notice Account	Goldman Sachs Int Bank (95 Days)	06/07/2018	(blank)	5.500
UK Bank - Notice Account	Goldman Sachs Int Bank (95 Days)	16/07/2018	(blank)	4.500
UK Bank - Notice Account	Lloyds Bank plc	15/05/2018	(blank)	5.000
UK Bank - Notice Account	Santander UK plc	01/06/2018	(blank)	15.000
Government	Ards and North Down Borough Council	02/05/2018	02/11/2018	5.000
Government	Cambridge Count~~it~~y Council	08/05/2018	09/11/2020	5.000
Government	Dorset County Council	08/01/2018	07/01/2019	5.000
Government	Dundee City Council	20/10/2017	17/10/2018	5.000
Government	Falkirk Council	15/02/2018	15/11/2018	5.000
Government	Gateshead Metropolitan Borough Council	16/10/2017	15/10/2018	5.000
Government	Lancashire County Council	04/11/2015	05/11/2018	5.000
Government	Lancashire County Council	15/11/2016	15/11/2018	5.000
Government	Lancashire County Council	17/04/2018	17/04/2019	5.000
Government	Lincoln City Council	31/01/2018	30/01/2019	1.750
Government	London Borough of Croydon	20/09/2018	12/09/2019	5.000
Government	London Borough of Haringey	10/09/2018	09/05/2019	4.000
Government	London Borough of Islington	26/04/2016	26/04/2021	5.000
Government	Mid Suffolk District Council	06/07/2018	06/07/2020	5.000
Government	Newcastle upon Tyne City Council	29/02/2016	26/02/2021	5.000
Government	Newcastle upon Tyne City Council	03/04/2017	03/04/2019	5.000

Institution Type	Counterparty	Start Date	Maturity Date	Principal O/S
Government	Newcastle upon Tyne City Council	02/02/2018	01/02/2019	5.000
Government	Northumberland County Council	01/11/2016	01/11/2018	5.000
Government	Northumberland County Council	16/11/2016	16/11/2020	5.000
Government	Northumberland County Council	16/11/2016	16/11/2021	5.000
Government	Powys County Council	22/02/2018	22/02/2021	5.000
Government	Uttlesford District Council	19/02/2018	19/10/2018	4.000
Non UK Bank	Australia and New Zealand Banking Group	05/06/2018	05/12/2018	5.000
Non UK Bank	Australia and New Zealand Banking Group	15/06/2018	13/12/2018	5.000
Non UK Bank	Commonwealth Bank of Australia	06/04/2018	05/10/2018	5.000
Non UK Bank	DBS Bank Ltd	03/08/2018	04/02/2019	5.000
Non UK Bank	Rabobank Nederland	13/10/2017	12/10/2018	5.000
Non UK Bank	Rabobank Nederland	16/10/2017	15/10/2018	5.000
Non UK Bank	Rabobank Nederland	17/10/2017	16/10/2018	5.000
Non UK Bank	United Overseas Bank Limited	13/10/2017	12/10/2018	2.000
Money Market Funds	BNP Paribas InstiCash GBP I Dis GBP	21/01/2017	(blank)	4.387
Money Market Funds	Insight Liquidity Sterling C3	16/01/2017	(blank)	4.150
Corporate Bond	Rockfire Capital Ltd	15/02/2018	21/04/2022	3.000
Grand Total				**214.387**

Appendix C

Compliance Report

All treasury management activities undertaken during the half year complied fully with the CIPFA Code of Practice and the authority's approved Treasury Management Strategy. Compliance with specific treasury limits is demonstrated in tables below.

1.1 Interest Rate Exposures

1.1.1 This indicator is set to control the Authority's exposure to interest rate risk on its debt portfolio. The upper limits on fixed and variable rate interest rate exposures, expressed as the proportion of gross principal borrowed will be:

Table1: Interest rate exposure activity

	2018/19 Limit %	2018/19 Q2 Actual %	2019/20 Limit %	2021/22 Limit %
Upper limit on fixed interest rate exposure	100	96.60	100	100
Upper limit on variable interest rate exposure	25	3.40	30	35

Fixed rate borrowings are those borrowings where the rate of interest is fixed for the whole financial year. Instruments that mature during the financial year are classed as variable rate.

1.1.2 Having larger amounts of fixed interest rate borrowing gives the Authority greater stability with regards to its interest payments and reduces the risk of higher interest costs should interest rates rise. Traditionally local authorities have taken advantage of fixing interest rates long term to reduce interest rate exposure. The table excludes Salix Finance loans as these are held at zero interest hence no interest rate exposure.

1.2 Maturity Structure of Borrowing

1.2.1 This indicator is set to control the Authority's exposure to refinancing risk. The upper and lower limits on the maturity structure of fixed rate borrowing will be:

Table 2: Loan maturity structure

	Upper %	Lower %	Actual %
Under 12 months	40	0	0.00
12 months and within 24 months	40	0	3.33
24 months and within 5 years	60	0	0.53
5 years and within 10 years	75	0	26.89
10 years and above	100	0	69.25

Time periods start on the first day of each financial year. The maturity date of borrowing is the earliest date on which the lender can demand repayment.

1.3 Principal Sums Invested for Periods Longer than 365 days

1.3.1 The purpose of this indicator is to control the authority's exposure to the risk of incurring losses by seeking early repayment of its investments.

1.3.2 The limits set in the 2018/19 treasury management strategy in comparison to the half year are set below. It is the authority's policy to classify available for sale investments with maturities exceeding one year as short term investments.

Table 3: Investments for periods longer than 365 days

	2017/18 Limit £m	2018/19 Actual at 30.09.18 £m	2018/19 Limit £m
Limit on principal invested beyond year end	75	38	75

1.4 Gross Debt and the Capital Financing Requirement (CFR)

1.4.1 In order to ensure that over the medium term debt will only be for a capital purpose, the Authority should ensure that debt does not, except in the short term, exceed the total of CFR in the preceding year plus the estimates of any additional CFR for the current and next two financial years. This is a key indicator of prudence.

Table 4: Gross debt and the CFR

	31.03.18 Actual £m	31.03.19 Original Estimate £m	31.03.19 Revised Estimate £m	31.03.20 Estimate £m	31.03.21 Estimate £m
Long Term External Debt*	210.234	210.234	210.234	230.234	260.234
CFR	264.469	292.252	283.134	339.253	360.140
Internal Borrowing	54.235	82.018	72.900	109.019	99.906

**Excluding service loans (e.g. Salix)*

1.4.2 Total debt is expected to remain below the CFR during the year. The actual debt levels are monitored against the Operational Boundary and authorised Limit for External Debt, below.

1.5 Operational Boundary for External Debt

1.5.1 The operational boundary is based on the authority's estimate of most likely, i.e. prudent, but not worst case scenario for external debt.

Table 5: Operational Boundary

Operational Boundary	**2018/19 £m**	**2019/20 £m**	**2020/21 £m**
Borrowing	360.100	369.100	367.500
Other long-term liabilities	10.000	10.000	10.000
Total	370.100	379.100	377.500

1.6 Authorised Limit for External Debt

1.6.1 The authorised limit is the affordable borrowing limit determined in compliance with the Local Government Act 2003. It is the maximum amount of debt that the authority can legally owe. The authorised limit provides headroom over and above the operational boundary for unusual cash movements.

Table 6: Authorised limit for external debt

Authorised Limit	**2018/19 £m**	**2019/20 £m**	**2020/21 £m**
Borrowing	448.200	458.600	457.900
Other long-term liabilities	10.000	10.000	10.000
Total Debt	458.200	468.600	467.900
Long Term Debt	210.200	210.200	230.200
Headroom	**248.000**	**258.400**	**237.700**

Glossary of Terms **Appendix D**

A bond is a debt instrument in which an investor lends money for a specified period of time at a fixed rate of interest. The issuing entity could be corporate, financial or government.

A floating rate note (FRN) is a money market instrument with a Floating/variable rate of interest, which re-fixes over a reference rate, for example 3 month LIBOR.

Bail in is rescuing a financial institution on the brink of failure by making its creditors and depositors take a loss on their holdings. A **bail**-in is the opposite of a **bail**-out, which involves the rescue of a financial institution by external parties, typically governments using taxpayer's money.

Certificates of deposit (CDs) are a negotiable form of fixed deposit, ranked pari passu with fixed deposits. The difference is that you are not obligated to hold the CD to maturity, you can realise the cash by selling in the secondary market.

Coupon is the total amount of interest a security will pay. The coupon period depends on the security. A CD will often pay interest at maturity, while a bond may pay semi annually or annually and an FRN will most likely pay every 3 months.

Covered bond Covered bonds are conventional bonds (fixed or floating) issued by financial institutions, that are backed by a separate group of loans, usually prime residential mortgages. This lowers the creditor's exposure to default risk, enhancing the credit. This is why the issue is usually rated AAA, higher than the rating given to the issuer reduces exposure to bail-in risk.

Credit rating A measure of the credit worthiness of a borrower. A credit rating can be assigned to country, organisation or specific debt issue/ financial obligation. There are a number of credit ratings agencies but the main 3 are Standard & Poor's, Fitch or Moody's.

MIFID is the Markets in Financial Instruments Directive. A European Union Directive.

Principal is the total amount being borrowed or lent.

Spread is the difference between the buy and sell price of a security. It can also be the gap, usually in basis points, between the yield of a security and the benchmark security.

Treasury bills (T-bills) are UK government rated, short-dated form of Government debt, issued by the Debt Management Office (DMO) via a weekly tender. T-bills are normally issued for one, three or six month duration.

Havering
LONDON BOROUGH

AUDIT COMMITTEE

Subject Heading:	Annual Audit Letter
SLT Lead:	Jane West
Report Author and contact details:	Contact: Radwan Ahmed Designation: Head of Finance –Financial Control & Corporate Business Systems Telephone: 0203 373 0934 E-mail address: Radwan.Ahmed@onesource.co.uk
Policy context:	Audit Committee responsible for approving accounts.
Financial summary:	The audit letter highlights the area of work which was covered within the audit as well as their findings.

The subject matter of this report deals with the following Council Objectives

Communities making Havering	[x]
Places making Havering	[x]
Opportunities making Havering	[x]
Connections making Havering	[x]

SUMMARY

Our external auditors, Ernst & Young, have issued their annual audit letter to the Committee summarising the results of their 2017/18 audit.

RECOMMENDATIONS

The Committee is asked to note the contents of the letter and consider any issues raised by the external auditor.

REPORT DETAIL

1. The purpose of the letter is to communicate to Members and external stakeholders, including members of the public, the key issues arising from the auditors' work which they consider needing to be brought to the attention of the Council. The letter is included at appendix A.

2. The letter includes the following issues:

2.1 Ernst & Young issued unqualified opinions on both the Council's Main accounts including the group position, and the Pension Fund financial statements. The Audit Results report was issued on 31 July 2018 and their certificate was issued on 29 August 2018 upon completion of their Whole of Government Accounts work.

2.2 The auditors are required to consider whether the Council has put in place 'proper arrangements' to secure economy, efficiency and effectiveness on its use of resources. Page 16 of their report identifies one significant risk in relation to *"the establishment of Joint Venture"*. In their assessment, they highlight the importance of decisions to the Council's strategic, operational and financial priorities, the effectiveness of the governance and risk management arrangements linked these key decisions. In addition it lists some of the key issues that need to be addressed as part of these arrangements

2.3 The other area to highlight is control themes and observations from the auditors which are identified from page 19 of their letter. In 2016/17, 3 control issues were identified and a plan of action to resolve these concerns was undertaken. As part of the 2017/18, the auditors did not identify any significant deficiencies in the design or operation of Havering's internal controls that might result in a material misstatement in the Council's financial statements.

IMPLICATIONS AND RISKS

Financial Implications and Risks:

There are no financial implications or risks arising directly from this report. There are no financial consequences arising from the outcome of the audit of accounts.

Legal Implications and risks:

There are no apparent legal implications in noting the content of the audit letter. The matters highlighted by the letter clearly identify some areas of legal and financial risk but the letter does not indicate any issues which are not already being addressed appropriately by management.

Human Resources Implications and risks:

None arising directly

Equalities and Social Inclusion Implications and risks:

None arising directly

BACKGROUND PAPERS

Annual Statement of Accounts 2017/18 & To Those Charged with Governance.
Audit Committee (30 July 2018)

Appendix A

London Borough of Havering

Annual Audit Letter 2017/18

London Borough of Havering and Pension Fund

Annual Audit Letter for the year ended 31 March 2018

August 2018

EY

Building a better working world

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Public Sector Audit Appointments Ltd (PSAA) have issued a 'Statement of responsibilities of auditors and audited bodies'. It is available from the Chief Executive of each audited body and via the PSAA website (www.psaa.co.uk)

The Statement of responsibilities serves as the formal terms of engagement between appointed auditors and audited bodies. It summarises where the different responsibilities of auditors and audited bodies begin and end, and what is to be expected of the audited body in certain areas.

The 'Terms of Appointment (updated 23 February 2017)' issued by PSAA sets out additional requirements that auditors must comply with, over and above those set out in the National Audit Office Code of Audit Practice (the Code) and statute, and covers matters of practice and procedure which are of a recurring nature.

This Annual Audit Letter is prepared in the context of the Statement of responsibilities. It is addressed to the Members of the audited body, and is prepared for their sole use. We, as appointed auditor, take no responsibility to any third party.

Our Complaints Procedure – If at any time you would like to discuss with us how our service to you could be improved, or if you are dissatisfied with the service you are receiving, you may take the issue up with your usual partner or director contact. If you prefer an alternative route, please contact Steve Varley, our Managing Partner, 1 More London Place, London SE1 2AF. We undertake to look into any complaint carefully and promptly and to do all we can to explain the position to you. Should you remain dissatisfied with any aspect of our service, you may of course take matters up with our professional institute. We can provide further information on how you may contact our professional institute.

01 Executive Summary

Executive Summary

We are required to issue an annual audit letter to London Borough of Havering (the Council) and Havering Pension Fund (the Pension Fund) following completion of our audit procedures for the year ended 31 March 2018. Below are the results and conclusions on the significant areas of the audit process.

Area of Work	Conclusion
Opinion on the Council and Pension Fund's: ► Financial statements	Unqualified – the financial statements give a true and fair view of the financial position of the Council and Group and Pension Fund as at 31 March 2018 and of its expenditure and income for the year then ended
► Consistency of other information published with the financial statements	Other information published with the financial statements was consistent with the Annual Accounts
Concluding on the Council's arrangements for securing economy, efficiency and effectiveness	We concluded that you have put in place proper arrangements to secure value for money in your use of resources

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Area of Work	Conclusion
Reports by exception: ► Consistency of Governance Statement	The Governance Statement was consistent with our understanding of the Council
► Public interest report	We had no matters to report in the public interest.
► Written recommendations to the Council, which should be copied to the Secretary of State	We had no matters to report.
► Other actions taken in relation to our responsibilities under the Local Audit and Accountability Act 2014	We had no matters to report.

Area of Work	Conclusion
Reporting to the National Audit Office (NAO) on our review of the Council's Whole of Government Accounts return (WGA).	We had no matters to report. We identified some minor differences between the WGA return and the Council's accounts. The Council amended the WGA to correct these differences.

Executive Summary (cont'd)

As a result of the above we have also:

Area of Work	Conclusion
Issued a report to those charged with governance of the Council communicating significant findings resulting from our audit.	Our Audit Results Report was issued on 26 July 2018
Issued a certificate that we have completed the audit in accordance with the requirements of the Local Audit and Accountability Act 2014 and the National Audit Office's 2015 Code of Audit Practice.	We issued our audit completion certificate on 30 August 2018. Our audit certificate was issued after our audit opinion and value for money conclusion as we did not complete the work necessary to issue our assurance statement in respect of the Council's Whole of Government Accounts consolidation pack until 30 August. We were satisfied that this work did not have a material effect on the financial statements or on our value for money conclusion and therefore were able to issue these on 31 July 2018. We are required to give an opinion on the consistency of the financial statements of the pension fund included in the Pension Fund Annual Report of [name of Pension Fund. We also issued this consistency opinion on 31 July 2018.

In December 2018 we will also issue a report to those charged with governance of the Council summarising the certification work we have undertaken.

We would like to take this opportunity to thank the Council and Pension Fund staff for their assistance during the course of our work.

Debbie Hanson

Executive Director

For and on behalf of Ernst & Young LLP

02 Purpose and Responsibilities

Purpose and Responsibilities

The Purpose of this Letter

The purpose of this Annual Audit Letter is to communicate to Members and external stakeholders, including members of the public, the key issues arising from our work, which we consider should be brought to the attention of the Council and Pension Fund.

We have already reported the detailed findings from our audit work in our 2017/18 Audit Results Reports to the 30 July 2018 Audit Committee, representing those charged with governance. We do not repeat those detailed findings in this letter. The matters reported here are the most significant for the Council.

Responsibilities of the Appointed Auditor

Our 2017/18 audit work has been undertaken in accordance with the Audit Plans we issued on February 2018 and is conducted in accordance with the National Audit Office's 2015 Code of Audit Practice, International Standards on Auditing (UK and Ireland), and other guidance issued by the National Audit Office.

As auditors we are responsible for:

- Expressing an opinion:
  - On the 2017/18 financial statements, including the pension fund; and
  - On the consistency of other information published with the financial statements.
- Forming a conclusion on the arrangements the Council has to secure economy, efficiency and effectiveness in its use of resources.
- Reporting by exception:
  - If the annual governance statement is misleading or not consistent with our understanding of the Council;
  - Any significant matters that are in the public interest;
  - Any written recommendations to the Council, which should be copied to the Secretary of State; and
  - If we have discharged our duties and responsibilities as established by the Local Audit and Accountability Act 2014 and Code of Audit Practice.

Alongside our work on the financial statements, we also review and report to the National Audit Office (NAO) on you Whole of Government Accounts return. The extent of our review and the nature of our report are specified by the NAO.

Responsibilities of the Council

The Council is responsible for preparing and publishing its statement of accounts accompanied by an Annual Governance Statement (AGS). In the AGS, the Council reports publicly each year on how far it complies with its own code of governance, including how it has monitored and evaluated the effectiveness of its governance arrangements in year, and any changes planned in the coming period.

The Council is also responsible for putting in place proper arrangements to secure economy, efficiency and effectiveness in its use of resources.

03 Financial Statement Audit

Financial Statement Audit

Key Issues

The Council's Statement of Accounts is an important tool for the Council to show how it has used public money and how it can demonstrate its financial management and financial health.

We audited the Council and Pension Fund Statement of Accounts in line with the National Audit Office's 2015 Code of Audit Practice, International Standards on Auditing (UK and Ireland), and other guidance issued by the National Audit Office and issued an unqualified audit report on July 2018.

Our detailed findings were reported to the 26 July 2018 Audit Committee.

The key issues identified as part of our audit were as follows:

Significant Risk	Conclusion
Misstatements due to fraud or error There is a risk that the financial statements as a whole are not free of material misstatements whether caused by fraud or error. As identified in ISA (UK and Ireland) 240, management is in a unique position to perpetrate fraud because of its ability to manipulate accounting records directly or indirectly and prepare fraudulent financial statements by overriding controls that otherwise appear to be operating effectively. We identify and respond to this fraud risk on every audit engagement. We identify and respond to this fraud risk on every audit engagement. For the Council, we identified the potential for the incorrect classification of revenue spend as capital as a particular area where there is a risk of fraud in revenue recognition. We focused on aspects of the Council and Pension Fund financial statements where management could inappropriately inflate income or understate expenditure, primarily: ➢ Material accounting estimates. ➢ Accruals near year end ➢ Journal entries. ➢ Unusual transactions.	We obtained a full list of journals posted to the general ledger during the year, and analysed these journals using criteria we set to identify any unusual journal types or amounts. We then tested journals that met our criteria and tested these to supporting documentation. We considered the accounting estimates relating to pensions and property valuations as the most susceptible to bias. We challenged the significant assumptions in the actuarial pension valuation and found no indication of management bias in these estimates. Our work on the property valuations found no material errors in the balances presented within the financial statements. We performed sample testing on additions to the property, plant and equipment balance and found that these items met the relevant accounting requirements to be capitalised. Our testing did not identify any expenditure which had been inappropriately capitalised. We have not identified any material weaknesses in controls or evidence of material management override. We have not identified any instances of inappropriate judgements being applied. We did not identify any other transactions during our audit which appeared unusual or outside the Authority's or Pension Fund's normal course of business. Overall, our audit work has not identified any material issues, inappropriate judgements or unusual transactions which indicate that there has been any misreporting of the Authority or Pension Fund financial position or that management has overridden controls.

Financial Statement Audit (cont'd)

Other Key Findings	Conclusion
Valuation of land and buildings Property, plant and equipment (PPE) represents a significant balance in the Council's accounts and is subject to valuation changes, impairment reviews and depreciation charges. Material judgemental inputs and estimation techniques are required to calculate the year-end PPE balances held in the balance sheet. As the Council's asset base is significant, and the outputs from the valuer are subject to estimation, there is a higher inherent risk PPE may be under/overstated or the associated accounting entries incorrectly posted. ISAs (UK and Ireland) 500 and 540 require us to undertake procedures on the use of experts and assumptions underlying fair value estimates.	We are satisfied that the Council's valuers have the necessary qualifications and experience. We have undertaken appropriate audit procedures to verify and critically challenge the basis of valuation adopted by the valuer in relation to the Council's property, We considered the underlying assumptions made by the expert valuer and concluded that they were reasonable. We noted that the valuation of schools increased significantly in 2017/18, rising from a gross book value in 2016/17 of £323 million, to £523 million in 2017/18 (an overall increase of £200 million). We confirmed that the significant increase in the value of these assets arose from a change in approach adopted to the valuation of land by the Council's valuer. In previous years, the Council's valuer had estimated the value of the land as a percentage of the value of the building. We reported that elements of the Council's specialist's approach to valuation were formulaic. We were, however, able to confirm that overall the combined valuation of the land and buildings was within the acceptable range determined by our own valuers, albeit at the lower end of this range. We note that the approach adopted by the Council's valuer in relation to land this year is improved and takes into account the actual size of the land, the split between developed and undeveloped land, and market values within the London Borough of Havering. As we did in the prior year, we engaged our expert valuer to consider the underlying assumptions made by the Council's valuer, and we were able to conclude that the revised approach to the valuation of land was reasonable and that the valuations fell within an acceptable range. We note that there is a significant amount of subjectivity in relation to the valuation of land for schools, which results in a wide range for these valuations. We considered the Council's assessment of whether the significant year on year change in the value of land associated with schools gave rise to an error in the prior period, and whether, therefore a restatement of prior period amounts was needed. We agreed with the Council's assessment that the change in basis of valuation constituted a change in estimation technique, and did not, therefore requirement a restatement of prior period amounts. The Council has agreed to add some additional narrative disclosures around the reasons for the significant change in value. We also engaged our valuer to test the valuation of the school buildings. We noted that the approach adopted by the Council's valuer was unchanged from the previous year, with obsolescence being capped at 50%. This implies that the residual value of a building will never fall below 50% of the cost of a modern equivalent as long as the asset remains in use. We disagree with this assumption, and consider that this is likely to result in an overstatement of values for older buildings. Again we noted that our own valuers provided a wide range of values due to the judgement involved in making an assessment of remaining life of these assets. Taking into account all the assumptions made in determining the valuation of these combined land and building assets, we have been able to conclude that overall, the Council's valuation of these assets is within the acceptable range determined by our valuer, although we would note that the values are at the top of a wide range of possible values and that the range of values is wide as a result of the level of subjectivity and judgements applied in these valuations.

Financial Statement Audit (cont'd)

Other Key Findings	Conclusion
Pension liability valuation The Local Authority Accounting Code of Practice and IAS19 require the Council to make extensive disclosures within its financial statements regarding the Local Government Pension Scheme (LGPS) in which it is an admitted body. The Council's current pension fund deficit is a highly material and sensitive item and the Code requires that this liability be disclosed on the Council's balance sheet. The information disclosed is based on the IAS 19 report issued to the Council by the actuary. As with other councils, accounting for this scheme involves significant estimation and judgement and due to the nature, volume and size of the transactions we consider this to be a higher inherent risk	We assessed and were satisfied with the competency and objectivity of the Council's actuary. EY Pensions team and PwC (Consulting Actuary to the NAO) reviewed the work of the actuary. We challenged the significant movement in the actuarial valuation and found no indication of management bias in this estimate. We have received reports from the Havering Pension Fund Auditor and the EY actuarial team. The Council's draft financial statements were prepared on the basis of IAS19 data and assumptions taken at December 2017, with a forecast of the 31 March 2018 position of the Fund. Havering Pension Fund's draft financial statements include an up to date estimate of the asset values within the fund at 31st March 2018. This figure is £28.7 million higher than the value reflected in the Council's estimate of its pension liability, reflecting an improvement in market conditions. The Council's share of this difference in estimate is £24 million. As this difference is above our audit materiality, the Council obtained from its actuary an updated IAS19 report. The updated report showed a reduction in the Council's pension liability of £23.9 million. The Council have reflected this change in its financial statements. The accounting entries and disclosures are in line with our expectations and the Code.

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Financial Statement Audit (cont'd)

Other Key Findings	Conclusion
Group financial statements At the point we presented our Audit Planning Report to Members, we indicated that the Council was likely to have entered into a Joint Venture arrangements for the redevelopment and regeneration of the Rainham and Beam Park Housing Zone, Bridge Close, and 12 housing estates within the Borough. The Council subsequently entered into these arrangements after 31 March 2018. We nevertheless considered whether any transactions or balances relating to these joint venture arrangements should be consolidated within its group financial statements, having regard to both the relative size of the joint venture to the group (quantitative criteria), and the specific nature or circumstances of the joint venture (qualitative criteria).	We reviewed the Council's assessment of whether or not to consolidate any transactions or balances relating to the joint venture arrangements The Council concluded that while in future years the three joint venture companies will require consolidation in the Council's financial statements, as no material transactions arose in 2017/18, the Council has not reflected these joint venture arrangements within their 2017/18 financial statements. The Council have, though, drawn attention to these arrangements in their Narrative Report. We are satisfied with this conclusion and the disclosures in the accounts.

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Financial Statement Audit (cont'd)

Our application of materiality

When establishing our overall audit strategy, we determined a magnitude of uncorrected misstatements that we judged would be material for the financial statements as a whole.

Item	
Planning materiality	We determined planning materiality to be £9.8 million (2016/17: £11.2 million), which is 2% of gross expenditure reported in the accounts of £490 million. We used the same materiality level for our audit of the Pension Fund. We consider gross expenditure to be one of the principal considerations for stakeholders in assessing the financial performance of the Council. For the pension fund we consider net assets to be one of the principle considerations for stakeholders, but have used the materiality level set for the overall financial statements as this is lower than the level calculated using 2% of net pension fund assets
Reporting threshold	We agreed with the Audit Committee that we would report to the Committee all audit differences in excess of £490k (2016/17: £563k). We have again used the same level for the pension fund.

We also identified the following areas where misstatement at a level lower than our overall materiality level might influence the reader. For these areas we developed an audit strategy specific to these areas. The areas identified and audit strategy applied include:

- Remuneration disclosures including any severance payments, exit packages and termination benefits:
- Related party transactions.

We evaluate any uncorrected misstatements against both the quantitative measures of materiality discussed above and in light of other relevant qualitative considerations.

04 Value for Money

Value for Money

We are required to consider whether the Council has put in place 'proper arrangements' to secure economy, efficiency and effectiveness on its use of resources. This is known as our value for money conclusion.

Proper arrangements are defined by statutory guidance issued by the National Audit Office. They comprise your arrangements to:

- Take informed decisions;
- Deploy resources in a sustainable manner; and
- Work with partners and other third parties.

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We identified one significant risks around these arrangements, related to the establishment of a Joint Venture for the redevelopment and regeneration of the Rainham and Beam Park Housing Zone, Bridge Close, and 12 housing estates within the Borough.

We have performed the procedures outlined in our Audit Plan. We did not identify any significant weaknesses in the Council's arrangements to ensure it took properly informed decisions and deployed resources to achieve planned and sustainable outcomes for taxpayers and local people

We therefore issued an unqualified value for money conclusion on 31 July 2018.

Value for Money (cont'd)

Significant Risk	Conclusion
Establishment of Joint Venture The Council has entered into a Joint Venture arrangement for the redevelopment and regeneration of the Rainham and Beam Park Housing Zone, Bridge Close, and 12 housing estates within the Borough. Funding these schemes will commit the Council to significant levels of borrowing. Given the significance and importance of these decisions to the Council's strategic, operational and financial priorities, the effectiveness of the governance and risk management arrangements related to these key decisions are crucial. Key issues that should be addressed as part of these arrangements include: • Clear and robust decision making, including consideration of legal powers. • Exploration of options, costs and benefits. • Treasury management and prudential borrowing considerations. • Identification and mitigation of risks. • How the Council identified and secured appropriate expertise and resource to support its decision making.	We have assessed the arrangements in place supporting the Joint Venture, focusing on: • Assessing the governance and financial and risk management arrangements in place to support key decision making • Understanding the financial implications and the key decisions being made • Understanding how the Council is working with other bodies and partners in relation to these projects. We have not identified any issues in the review of the arrangements in place. We are therefore satisfied that the information provide to Members and Officers in respect of the joint venture arrangement is appropriate and is based on third party assessments and advice from appropriately knowledgeable professionals with relevant experience.

05 Other Reporting Issues

Other Reporting Issues

Whole of Government Accounts

We performed the procedures required by the National Audit Office on the accuracy of the consolidation pack prepared by the Council for Whole of Government Accounts purposes. We had no issues to report. We identified some minor differences between the WGA return and the Council's accounts. The Council amended the WGA to correct these differences.

Annual Governance Statement

We are required to consider the completeness of disclosures in the Council's Annual Governance Statement, identify any inconsistencies with the other information of which we are aware from our work, and consider whether it is misleading.

We completed this work and did not identify any areas of concern.

Report in the Public Interest

We have a duty under the Local Audit and Accountability Act 2014 to consider whether, in the public interest, to report on any matter that comes to our attention in the course of the audit in order for it to be considered by the Council or brought to the attention of the public.

We did not identify any issues which required us to issue a report in the public interest.

Written Recommendations

We have a duty under the Local Audit and Accountability Act 2014 to designate any audit recommendation as one that requires the Council to consider it at a public meeting and to decide what action to take in response.

We did not identify any issues which required us to issue a written recommendation.

Other Reporting Issues (cont'd)

Objections Received

We did not receive any objections to the 2017/18 financial statements from members of the public.

Other Powers and Duties

We identified no issues during our audit that required us to use our additional powers under the Local Audit and Accountability Act 2014.

Independence

We communicated our assessment of independence in our Audit Results Report to the Audit Committee on July 2018. In our professional judgement the firm is independent and the objectivity of the audit engagement partner and audit staff has not been compromised within the meaning regulatory and professional requirements.

Control Themes and Observations

It is the responsibility of the Authority to develop and implement systems of internal financial control and to put in place proper arrangements to monitor their adequacy and effectiveness in practice. Our responsibility as your auditor is to consider whether the Authority has put adequate arrangements in place to satisfy itself that the systems of internal financial control are both adequate and effective in practice.

As part of our audit of the financial statements, we obtained an understanding of internal control sufficient to plan our audit and determine the nature, timing and extent of testing performed. As we have adopted a fully substantive approach, we have therefore not tested the operation of controls.

Although our audit was not designed to express an opinion on the effectiveness of internal control we are required to communicate to you significant deficiencies in internal control.

We have not identified any significant deficiencies in the design or operation of an internal control that might result in a material misstatement in your financial statements of which you are not aware.

07 Focused on your future

Focused on your future

The Code of Practice on Local Authority Accounting in the United Kingdom introduces the application of new accounting standards in future years. The impact on the Council is summarised in the table below.

Standard	Issue	Impact
IFRS 9 Financial Instruments	Applicable for local authority accounts from the 2018/19 financial year and will change: ▸ How financial assets are classified and measured; ▸ How the impairment of financial assets are calculated; and ▸ The disclosure requirements for financial assets. There are transitional arrangements within the standard and the 2018/19 Accounting Code of Practice for Local Authorities has now been issued, providing guidance on the application of IFRS 9. In advance of the Guidance Notes being issued, CIPFA have issued some provisional information providing detail on the impact on local authority accounting of IFRS 9, however the key outstanding issue is whether any accounting statutory overrides will be introduced to mitigate any impact.	The Council's view is that the impact of this standard on the Authority's financial statements will be immaterial. The Council will need to keep this standard under continued focus during 2018/19 because statutory overrides may be introduced by Central Government.
IFRS 15 Revenue from Contracts with Customers	Applicable for local authority accounts from the 2018/19 financial year. This new standard deals with accounting for all contracts with customers except: ▸ Leases; ▸ Financial instruments; ▸ Insurance contracts; and ▸ For local authorities; Council Tax and NDR income. The key requirements of the standard cover the identification of performance obligations under customer contracts and the linking of income to the meeting of those performance obligations. Now that the 2018/19 Accounting Code of Practice for Local Authorities has been issued it is becoming clear what the impact on local authority accounting will be. As the vast majority of revenue streams of Local Authorities fall outside the scope of IFRS 15, the impact of this standard is likely to be limited.	Given the nature of the Council's income streams, it is unlikely that the future implementation of IFRS 15 will have a material impact on the financial statements of the Council. The vast majority of the Council's income streams are taxation or grant based, and are therefore outside the scope of IFRS15. The following income streams which are within the scope of IFRS 15 may be considered material by the Council in making its assessment of the impact on IFRS 15 in its 2018/19 accounts: • fees and charges for services under statutory requirements, .g. application fees for taxi licenses or planning fees; • sale of goods provided by the authority e.g. retail sales at leisure centres, concessionary sale at local authority theatres; and • charges for services provided by a local authority e.g. maintenance for council dwellings or transport fares

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Focused on your future (cont'd)

Standard	Issue	Impact
IFRS 16 Leases	It is currently proposed that IFRS 16 will be applicable for local authority accounts from the 2019/20 financial year. Whilst the definition of a lease remains similar to the current leasing standard; IAS 17, for local authorities who lease a large number of assets the new standard will have a significant impact, with nearly all current leases being included on the balance sheet. There are transitional arrangements within the standard and although the 2019/20 Accounting Code of Practice for Local Authorities has yet to be issued, CIPFA have issued some limited provisional information which begins to clarify what the impact on local authority accounting will be. Whether any accounting statutory overrides will be introduced to mitigate any impact remains an outstanding issue.	Until the 2019/20 Accounting Code is issued and any statutory overrides are confirmed there remains some uncertainty in this area. However, what is clear is that the Council will need to undertake a detailed exercise to identify all of its leases and capture the relevant information for them. The Council must therefore ensure that all lease arrangements are fully documented.

08 Audit Fees

Audit Fees

As part of our reporting on our independence, we set out below a summary of the fees paid for the year ended 31 March 2018.

Our fee for 2017/18 is in line with the scale fee set by the PSAA and reported in our 26 July 2018 Annual Results Report.

	Final Fee 2017/18	Planned Fee 2017/18	Scale Fee 2017/18	Proposed Final Fee 2016/17
	£	£	£	£
Total Audit Fee – Code work – audit of Council and Group accounts and value for money conclusion	**TBC****	160,344	151,844	172,702*
Audit work – Certification of grant claims and returns (housing benefit subsidy)	TBC***	15,080	15,080	16,178
Audit Work – Code work 0 audit of the Pension Fund	21,000	21,000	21,000	21,000

* The proposed final fee for 2016/17 includes a proposed variation of £20,858 to the PSAA scale fee of £151,844. This arises from the additional procedures we undertook in relation to:

- The valuation of property, plant and equipment;
- The consolidation of balances relating to Mercury Land Holdings;
- Obtaining transaction listings to support amounts disclosed in the Council's financial statements; and
- The Council's Whole of Government Accounts submission.

Further information on the additional procedures we undertook are included in our 2016/17 Audit Results Report. This report was presented to the September 2017 meeting of the Audit Committee. We have agreed the additional fee with the Council and the variation is currently being considered by PSAA Ltd.

** As reported in our Audit Planning Report, the 2017/18 planned fee did not include the additional audit fee in relation to the work required to address the significant value for money risk, or our consideration of the transactions and balances consolidated in respect of the Council's wholly owned subsidiary, Mercury Land Holdings. The estimated fee for this work is £8,500. As noted elsewhere within this report, we undertook additional work to test the significant movement in the valuation of Schools. The estimated additional fee for this work is £7,500. These fee variations are subject to agreement by management and then approval by PSAA.

*** We will complete our work on the Council's Housing Benefit subsidy claim during September and October 2018. We will confirm our final fee for that work following the conclusion of our work on that claim.

We confirm we have not undertaken any non-audit work outside of the PSAA's requirements.

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ED None

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AUDIT COMMITTEE – FORWARD PLAN

FORWARD PLAN	AGENDA ITEM
January 2019	• External Audit Plan 2019/20 for London Borough of Havering and Havering Pension Fund • Governance Update • 17/18 Grants Certification Report • Assurance Progress Report Q2 • Draft Treasury Management Strategy Report 19/20 • Treasury Management Mid-Year Report • Accounting policies 2018/19 • Closure of Accounts Timetable 2018/19 • 2019/20 Internal Audit Plan, Strategy and Charter • 6 Month Review of Risk Management
April 2019	• Audit Committee – Annual Report 2018/19 • Assurance Progress Report Q3 • Member training plan

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