

# Governance Committee

Monday, 14th July, 2014  
at 6.00 pm

## PLEASE NOTE TIME OF MEETING

Conference Room 3 - Civic Centre

This meeting is open to the public

### Members of the Committee

Councillor Burke (Chair)  
Councillor Chamberlain  
Councillor Daunt  
Councillor Inglis  
Councillor Jeffery  
Councillor Noon  
Councillor O'Neill

### Independent Members

Mr David Blake  
Mr Geoff Wilkinson

### Contacts

Head of Legal and Democratic Services  
Richard Ivory  
Tel. 023 8083 2394  
Email: [richard.ivory@southampton.gov.uk](mailto:richard.ivory@southampton.gov.uk)

Democratic Support Officer  
Pat Wood  
Tel. 023 8083 2302  
Email: [pat.wood@southampton.gov.uk](mailto:pat.wood@southampton.gov.uk)

## PUBLIC INFORMATION

### **Role of the Governance Committee**

Information regarding the role of the Committee's is contained in Part 2 (Articles) of the Council's Constitution.

#### [02 Part 2 - Articles](#)

It includes at least one Councillor from each of the political groups represented on the Council, and at least one independent person, without voting rights, who is not a Councillor or an Officer of the Council.

### **Public Representations**

At the discretion of the Chair, members of the public may address the meeting about any report on the agenda for the meeting in which they have a relevant interest.

### **Southampton City Council's Priorities:**

- **Economic:** Promoting Southampton and attracting investment; raising ambitions and improving outcomes for children and young people.
- **Social:** Improving health and keeping people safe; helping individuals and communities to work together and help themselves.
- **Environmental:** Encouraging new house building and improving existing homes; making the city more attractive and sustainable.
- **One Council:** Developing an engaged, skilled and motivated workforce; implementing better ways of working to manage reduced budgets and increased demand.

**Smoking policy** – The Council operates a no-smoking policy in all civic buildings.

**Mobile Telephones** – Please turn off your mobile telephone whilst in the meeting.

**Fire Procedure** – in the event of a fire or other emergency a continuous alarm will sound and you will be advised by Council officers what action to take.

**Access** – Access is available for disabled people. Please contact the Democratic Support Officer who will help to make any necessary arrangements.

### **Dates of Meetings: Municipal Year 2014/15**

<b>2014</b>	<b>2015</b>
14 July	9 February
15 September	27 April
15 December	

## CONDUCT OF MEETING

### **Terms of Reference**

The terms of reference of the Governance Committee are contained in Part 3 of the Council's Constitution.

[03 - Part 3 - Responsibility for Functions](#)

### **Rules of Procedure**

The meeting is governed by the Council Procedure Rules as set out in Part 4 of the Constitution.

### **Business to be discussed**

Only those items listed on the attached agenda may be considered at this meeting.

### **Quorum**

The minimum number of appointed Members required to be in attendance to hold the meeting is 3.

## **DISCLOSURE OF INTERESTS**

Members are required to disclose, in accordance with the Members' Code of Conduct, **both** the existence **and** nature of any "Disclosable Pecuniary Interest" or "Other Interest" they may have in relation to matters for consideration on this Agenda.

### **DISCLOSABLE PECUNIARY INTERESTS**

A Member must regard himself or herself as having a Disclosable Pecuniary Interest in any matter that they or their spouse, partner, a person they are living with as husband or wife, or a person with whom they are living as if they were a civil partner in relation to:

- (i) Any employment, office, trade, profession or vocation carried on for profit or gain.
- (ii) Sponsorship:

Any payment or provision of any other financial benefit (other than from Southampton City Council) made or provided within the relevant period in respect of any expense incurred by you in carrying out duties as a member, or towards your election expenses. This includes any payment or financial benefit from a trade union within the meaning of the Trade Union and Labour Relations (Consolidation) Act 1992.

(iii) Any contract which is made between you / your spouse etc (or a body in which the you / your spouse etc has a beneficial interest) and Southampton City Council under which goods or services are to be provided or works are to be executed, and which has not been fully discharged.

(iv) Any beneficial interest in land which is within the area of Southampton.

(v) Any license (held alone or jointly with others) to occupy land in the area of Southampton for a month or longer.

(vi) Any tenancy where (to your knowledge) the landlord is Southampton City Council and the tenant is a body in which you / your spouse etc has a beneficial interests.

(vii) Any beneficial interest in securities of a body where that body (to your knowledge) has a place of business or land in the area of Southampton, and either:

- a) the total nominal value of the securities exceeds £25,000 or one hundredth of the total issued share capital of that body, or
- b) if the share capital of that body is of more than one class, the total nominal value of the shares of any one class in which you / your spouse etc has a beneficial interest that exceeds one hundredth of the total issued share capital of that class.

## **Other Interests**

A Member must regard himself or herself as having an, 'Other Interest' in any membership of, or occupation of a position of general control or management in:

Any body to which they have been appointed or nominated by Southampton City Council

Any public authority or body exercising functions of a public nature

Any body directed to charitable purposes

Any body whose principal purpose includes the influence of public opinion or policy

## **Principles of Decision Making**

All decisions of the Council will be made in accordance with the following principles:-

- proportionality (i.e. the action must be proportionate to the desired outcome);
- due consultation and the taking of professional advice from officers;
- respect for human rights;
- a presumption in favour of openness, accountability and transparency;
- setting out what options have been considered;
- setting out reasons for the decision; and
- clarity of aims and desired outcomes.

In exercising discretion, the decision maker must:

- understand the law that regulates the decision making power and gives effect to it. The decision-maker must direct itself properly in law;
- take into account all relevant matters (those matters which the law requires the authority as a matter of legal obligation to take into account);
- leave out of account irrelevant considerations;
- act for a proper purpose, exercising its powers for the public good;
- not reach a decision which no authority acting reasonably could reach, (also known as the "rationality" or "taking leave of your senses" principle);
- comply with the rule that local government finance is to be conducted on an annual basis. Save to the extent authorised by Parliament, 'live now, pay later' and forward funding are unlawful; and
- act with procedural propriety in accordance with the rules of fairness.

## AGENDA

**Agendas and papers are now available via the Council's Website**

### **1 ELECTION OF VICE-CHAIR**

To elect a Vice-Chair to the Committee for the 2014/15 Municipal Year.

### **2 APOLOGIES**

To receive any apologies.

### **3 DISCLOSURE OF PERSONAL AND PECUNIARY INTERESTS**

In accordance with the Localism Act 2011, and the Council's Code of Conduct, Members to disclose any personal or pecuniary interests in any matter included on the agenda for this meeting.

NOTE: Members are reminded that, where applicable, they must complete the appropriate form recording details of any such interests and hand it to the Democratic Support Officer.

### **4 STATEMENT FROM THE CHAIR**

### **5 MINUTES OF PREVIOUS MEETING (INCLUDING MATTERS ARISING)**

To approve and sign as a correct record the Minutes of the meeting held on 28 April 2014 and to deal with any matters arising, attached.

### **6 FREEDOM OF INFORMATION, DATA PROTECTION AND REGULATION OF INVESTIGATORY POWERS ACTS: ANNUAL REVIEW 2013-14**

Report of the Head of Legal and Democratic Services detailing statistical information for the financial year 2014-15, attached.

### **7 REVIEW OF PRUDENTIAL LIMITS AND TREASURY MANAGEMENT OUTTURN 2013/14**

To consider the report of the Chief Financial Officer detailing the Treasury Management activities and performance for 2013/14 against the approved Prudential Indicators for External Debt and Treasury Management, attached

### **8 ANNUAL GOVERNANCE STATEMENT 2013-14**

Report of the Chief Financial Officer seeking to review the draft Annual Governance Statement 2013-14 and to note the status of the 2012-13 Action Plan

**9 EFFECTIVENESS OF INTERNAL AUDIT**

Report of the Chief Internal auditor that In accordance with the Accounts and Audit Regulations (England) 2011 to present to Committee a report detailing the effectiveness of the role of Internal Audit, attached.

**10 CHIEF INTERNAL AUDITOR'S ANNUAL REPORT AND OPINION 2013/2014**

Report of the Chief Internal Auditors detailing the Annual Report and Opinion 2013-14 for approval, attached.

FRIDAY, 4 JULY 2014

HEAD OF LEGAL AND DEMOCRATIC SERVICES

---

GOVERNANCE COMMITTEE  
MINUTES OF THE MEETING HELD ON 28 APRIL 2014

---

Present: Councillors Furnell (Chair), Inglis, Jeffery, Keogh (Vice-Chair) and Letts

Independent Members: Mr D Blake and Mr G Wilkinson

Apologies: Councillor Parnell

34. **STATEMENT FROM THE CHAIR**

The Chair welcomed Councillor Jeffery who was replacing Councillor Laming for the remainder of the municipal year.

35. **MINUTES OF PREVIOUS MEETING (INCLUDING MATTERS ARISING)**

**RESOLVED** that the minutes for the Committee meeting on 3 February 2014 be approved and signed as a correct record.

36. **ANNUAL CHANGES TO THE CONSTITUTION**

The Committee considered the report of the Head of Legal and Democratic Services, seeking approval for recommendation to Council of changes to the Council's Constitution.

It was noted that paragraph 15(a) of Appendix 1 should read "Any **major** planning application will be considered by the Panel if there are five or more objections and a ward councillor wishes it to go rather than one objection as now." The Committee were concerned with this particular issue and requested that Council gave consideration as to whether the "trigger" for referral should be 5 objections **or** one ward member rather than **and** one ward member.

**RESOLVED** that, subject to updated wording for paragraph 15(a), the changes to the Council's Constitution as set out in the report be recommended to Full Council.

37. **CODE OF CORPORATE GOVERNANCE - ANNUAL REVIEW**

The Committee considered the report of Head of Legal and Democratic Services regarding changes to the Council's Code of Corporate Governance.

**RESOLVED** that the updated Code of Corporate Governance (CCG) set out in the report as Appendix 1, be noted and approved with the addition of "2013-16" against the Council Plan lines.

38. **MEMBER LEARNING AND DEVELOPMENT**

The Committee considered the report of the Head of Legal and Democratic Services seeking comments and endorsement of the Member Development Strategy.

**RESOLVED** that the Member Learning and Development Strategy be approved and the outline programme for Member Development for 2014/15 be endorsed.

39. **RISK MANAGEMENT STRATEGY 2014-15 AND ANNUAL ACTION PLAN**

The Committee considered the report of the Chief Financial Officer regarding the Risk Management Strategy 2014-15 and Annual Action Plan.

**RESOLVED:**

- (i) that the Risk Management Strategy 2014-15 as set out in Appendix 1 of the report, be noted and approved;
- (ii) that the Risk Management Action Plan for 2014-15 as set out in Appendix 2 of the report, be noted and approved; and
- (iii) that the Risk Management Actions: Status Report 2013-14 as set out in Appendix 3 of the report, be noted.

40. **INTERNAL AUDIT PROGRESS REPORT - MARCH 2014**

The Committee received and noted the report of the Chief Internal Auditor regarding internal audit progress to the period March 2014.

It was noted that a further update regarding the use of mobile phones within the Authority would be provided to members of the Committee.

41. **INTERNAL AUDIT PLAN 2014-15**

The Committee considered the report of the Chief Internal Auditor regarding the Internal Audit Annual Plan 2014-15.

**RESOLVED** that the Internal Audit Plan for 2014/15 be approved.

42. **INTERNAL AUDIT CHARTER 2014-15**

The Committee considered the report of the Chief Internal Auditor regarding Public Sector Internal Auditing Standards.

**RESOLVED** that the Internal Audit Charter 2014-15 be approved.

43. **EXTERNAL AUDIT ANNUAL PLAN - YEAR ENDING 31 MARCH 2014**

The Committee received and noted the report of the Chief Internal Auditor regarding the External Auditor's Plan for the year ending 31 March 2014.

# Agenda Item 6

<b>DECISION-MAKER:</b>	GOVERNANCE COMMITTEE		
<b>SUBJECT:</b>	FREEDOM OF INFORMATION, DATA PROTECTION AND REGULATION OF INVESTIGATORY POWERS ACTS: ANNUAL REVIEW 2013-14		
<b>DATE OF DECISION:</b>	14 JULY 2014		
<b>REPORT OF:</b>	HEAD OF LEGAL AND DEMOCRATIC SERVICES		
<b><u>CONTACT DETAILS</u></b>			
<b>AUTHOR:</b>	<b>Name:</b>	Tracy Horspool	<b>Tel:</b> 023 8083 2027
	<b>E-mail:</b>	<a href="mailto:Tracy.horspool@southampton.gov.uk">Tracy.horspool@southampton.gov.uk</a>	
<b>Director</b>	<b>Name:</b>	Mark Heath	<b>Tel:</b> 023 8083 2371
	<b>E-mail:</b>	<a href="mailto:mark.heath@southampton.gov.uk">mark.heath@southampton.gov.uk</a>	

## STATEMENT OF CONFIDENTIALITY

None

## BRIEF SUMMARY

A report detailing statistical information for the financial year 2014-15, the ninth year of implementation of the Freedom of Information Act 2000 (FOIA) and associated legislation. This report also details statistical information on requests received under the Data Protection Act 1998 (DPA) and the Council's activity under the Regulation of Investigatory Powers Act 2000 (RIPA).

## RECOMMENDATIONS:

- (i) To note and comment on the update of the statistical information for the year 1<sup>st</sup> April 2013 – 31<sup>st</sup> March 2014 relating to:
  - a. FOIA and associated legislation;
  - b. DPA 1998;
  - c. RIPA 2000;

## REASONS FOR REPORT RECOMMENDATIONS

1. To keep members informed as to the impact of the legislation to the Council and to detail the form and type of requests received in 2013-14, the ninth full year of FOIA implementation.
2. To keep members informed as to the type of DPA requests received and the Council's activity under the RIPA.
3. To ensure that members continue to be aware of the Council's statutory obligations under FOIA and associated legislation, DPA and RIPA.

## ALTERNATIVE OPTIONS CONSIDERED AND REJECTED

4. The alternative to bringing this report before members is to not report the yearly analysis. This was rejected because it is considered to be good governance to report such matters to members, provides an audit trail to demonstrate to the Information Commissioner that the Council has robust

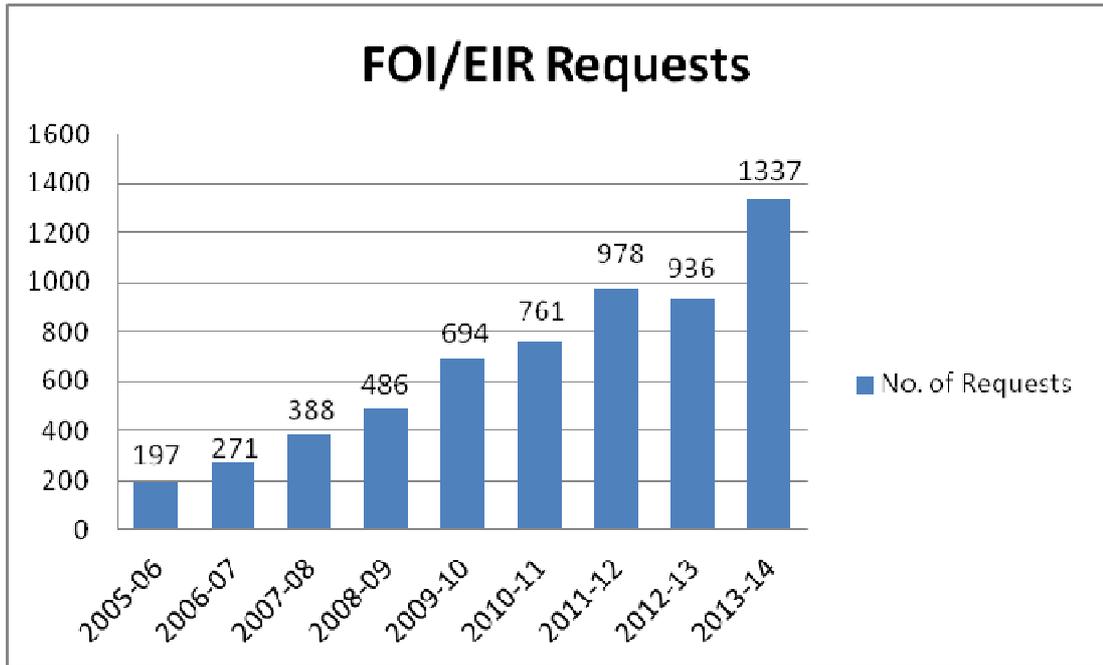
structure in place to comply with the legislation, and to maintain the profile of information law requirements and resource implication within the organisation.

#### **DETAIL (Including consultation carried out)**

5. As soon as possible after the meeting of the Standards and Governance Committee, the information detailed in this report will be reported in the Access to Information pages on the Council's website.

#### FOIA

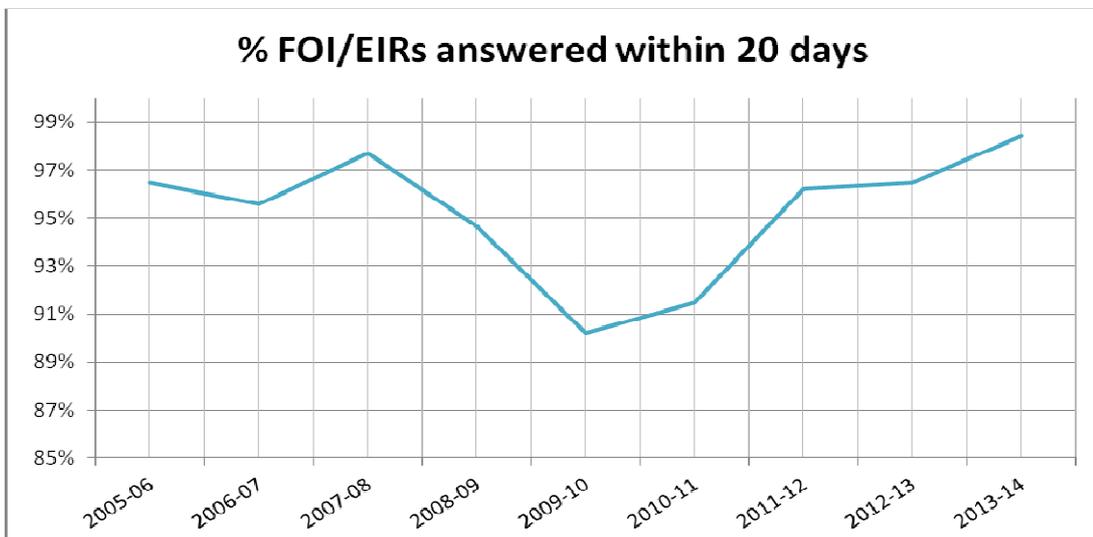
6. The FOIA came fully into force on 1<sup>st</sup> January 2005, marking a major enhancement to the accessibility of information held by public authorities.
7. Running parallel to the FOIA regime is the Environmental Information Regulations (EIRs) that give a separate right to request environmental information from public authorities, the DPA which gives an individual the right to access their own personal data and the Re-Use of Public Sector Information Regulations (RUPSIRs) which allow a requester to re-use (under licence) information provided to them by a public authority.
8. Under the FOIA and associated legislation, anybody may request information from a public authority with functions in England, Wales and/or Northern Ireland. Subject to exemptions, the FOIA confers two statutory rights on applicants:
  - i. The right to be told whether or not the public authority holds that information; and
  - ii. The right to have that information communicated to them
9. There are two types of exemptions that may apply to requests for information – absolute and qualified.
10. Information that falls into a particular exemption category, for example, information relating to commercial interests, will have to be disclosed unless it can successfully be argued that the public interest in withholding it is greater than the public interest in releasing it. Such exemptions are known as qualified exemptions.
11. Where information falls within the terms of an absolute exemption, for example, information reasonably accessible by other means or information contained in court records, a public authority may withhold the information without considering any public interest arguments.
12. The Council has now experienced the ninth full year of the FOIA and statistics show a continued increase in the number of information (FOI/EIR) requests received.



The number has increased from 935 for the year ending March 2013 to 1337 for the year ending March 2014.

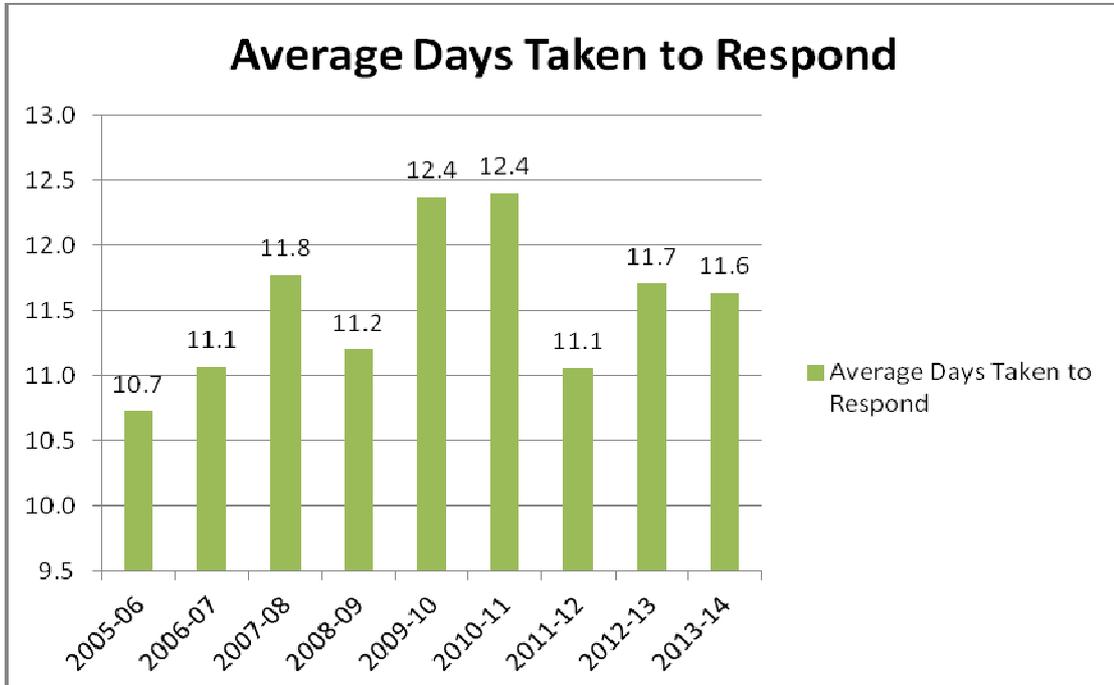
Please see appendix 1 for the directorate breakdown of the requests.

13. To summarise, the Council has received a total of 1337 requests between 1<sup>st</sup> April 2013 and 31<sup>st</sup> March 2014. This comprises 1322 dealt with as FOI requests and 12 EIR requests.
14. 2013/14 has seen an overall increase in the volume of requests received in comparison to previous years. The average number of requests received per month was 111, compared with 78 last year.
15. During the year, 98% of all monitored FOI and EIR requests (excluding those 'on hold' or lapsed) were dealt with within the statutory deadline of 20 working days. This is a 2% increase on last year, and demonstrates a continuing trend of improvement by the organisation.

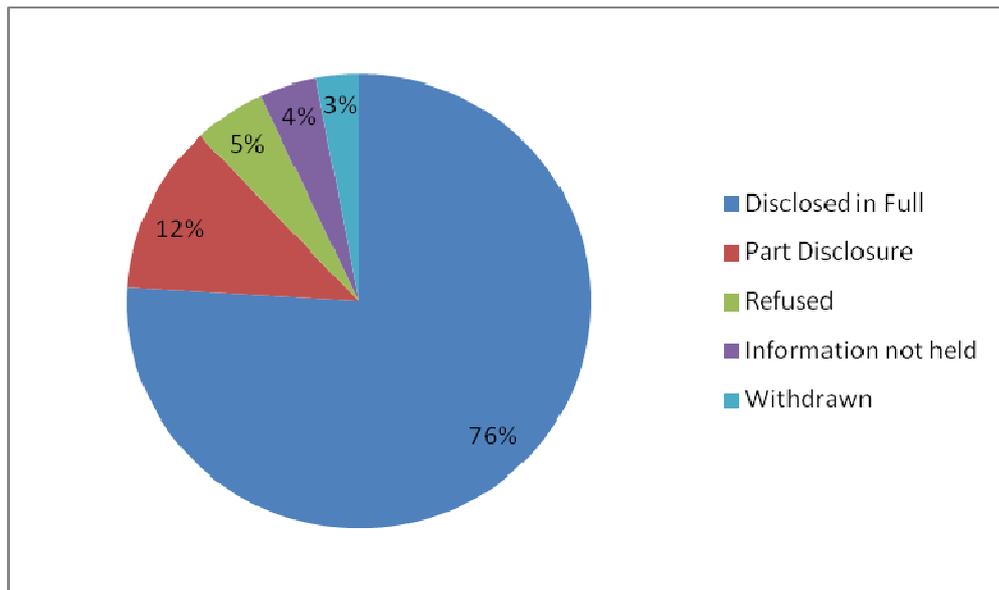


In cases where the deadline was exceeded, this was usually by 1-3 days and reflects the volume, increasing complexity and quantity of information requested.

16. The overall response time remains good, with the Council responding to requests within 11.55 days on average.



17. The complexity and detail of requests has increased again this year. Under FOIA, where the cost of responding to the request will exceed the Freedom of Information and Data Protection (Appropriate Limit and Fees) Regulations 2004 (which is currently set at £450 for local authorities), the Council may refuse to comply with it. For 2013/14, the Council issued 60 Refusal Notices on fees grounds compared with 57 being issued last year.
18. Of all requests received during the year, 76% of information requested was disclosed in full. Of the remaining requests, 4% of information was not held by the Council, 12% were partly responded to by the Council (i.e. some parts of the request were subject to an exemption), and 5% were completely refused as information was withheld because a fees notice was issued or it was exempt (e.g. requests for personal information such as individual/contact details or confidential/commercially sensitive contract or financial information). The remaining 3% of the requests were withdrawn.

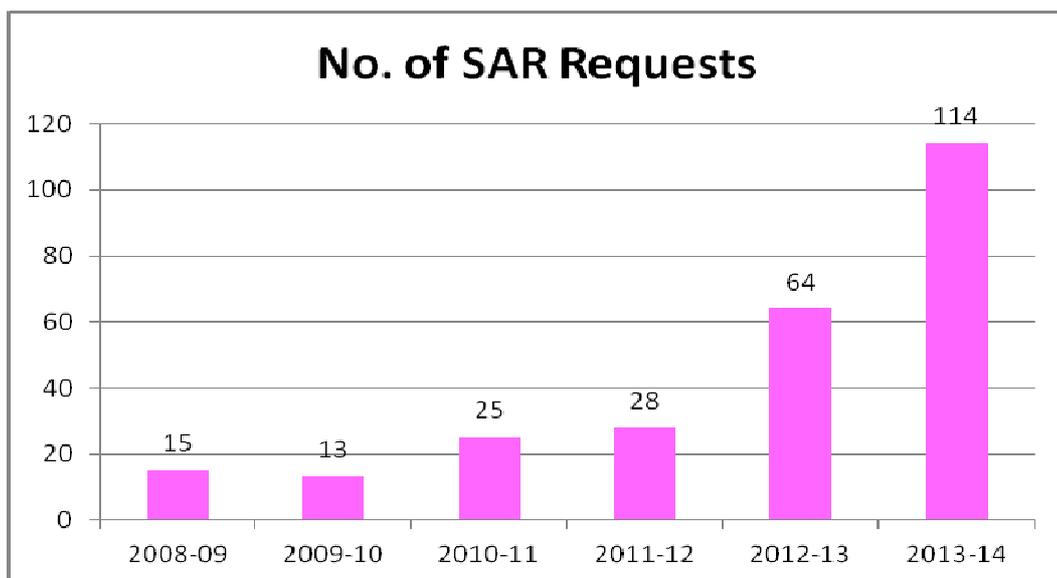


19. Of the 1296 requests responded to (41 were withdrawn), 200 were deemed to be covered by absolute exemptions and accordingly some or all of the requested information was withheld.
20. Of the 1296 requests responded to, 51 requests (20 of which were 'virtual' – so were considered without a physical meeting) were considered by the Public Interest Test Panel as they were deemed to be covered by one or more qualified exemptions.
21. Five individuals approached the Council's Internal Corporate Complaints department, regarding decisions made to withhold or partially withhold information requested. Two appeals were partly upheld and further information was disclosed. In three appeals the original decision was upheld.
22. To our knowledge, there have been two FOI appeals made to the Information Commissioner's Office (ICO).
23. As with all years, types of requests have been varied and covered every service area of the Council, including budget, HR, council tax data, highways maintenance and social services.
24. For the period covered in this report, 57% of requests came from private citizens, 12% came from the media, 17% from companies/businesses. The remaining 14% came from a combination of charities, students, researchers, lobby groups, MP's/ Councillors and other Councils etc.
25. Previously, members requested information as to how much time and resources each directorate spends on dealing with requests. We do not record this information. Previous years (2011/12) have shown that it took us approximately 2 hours to respond to each request. However, current research from Parliamentary post-legislative scrutiny of the Act indicates "the best-performing local authorities took between one and six hours for each request". We can estimate that our time spend on requests is comparable to this, and using the £25 per hour rate that the Act allows us to charge for staff time when refusing requests, we can estimate that each request costs the Council between £25 and £150 to respond on average.

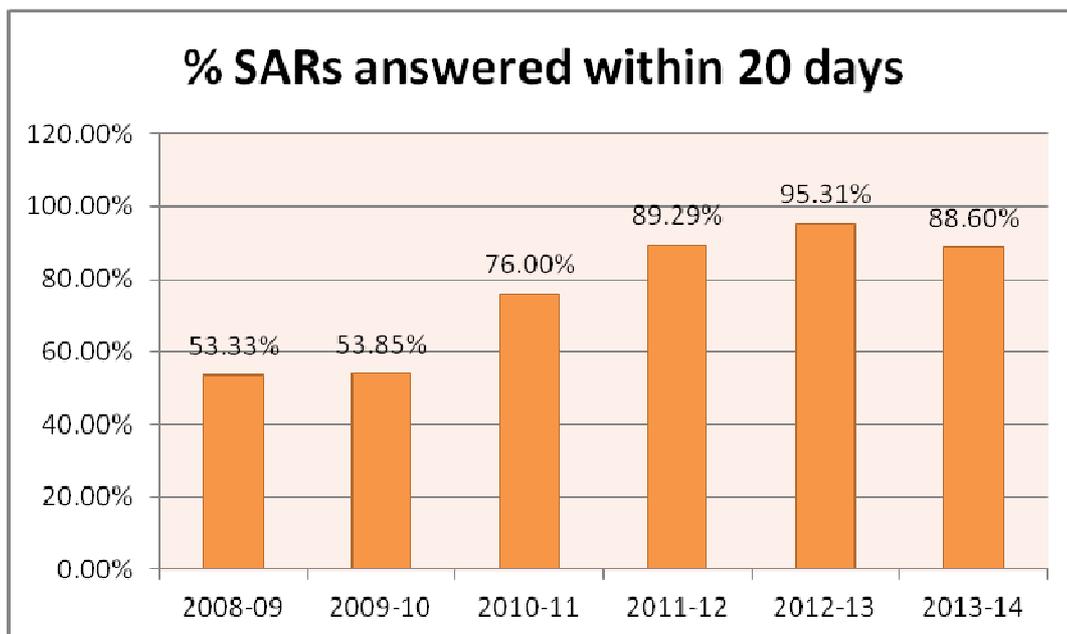
26. In the Corporate Legal team there is only 1 FTE member of staff dedicated to providing advice and monitoring compliance with information law. We are proposing to add a Modern Apprentice post to the Corporate Legal Team in 2014/15 to assist in the administration of information law matters, but this is a “trainee” post, and will require considerable support and training alongside their contribution to workloads. Other members of staff support this function when their capacity allows it.
27. Other members of staff who are involved in the FOI process are the Senior Information Risk Officers (also known as SIROs). They are responsible for managing information compliance within their respective Directorates, as well as being a single point of contact for providing advice and guidance at a “local” level. However, they are not wholly dedicated to information compliance as their roles within the Council are to support business generally.

DPA

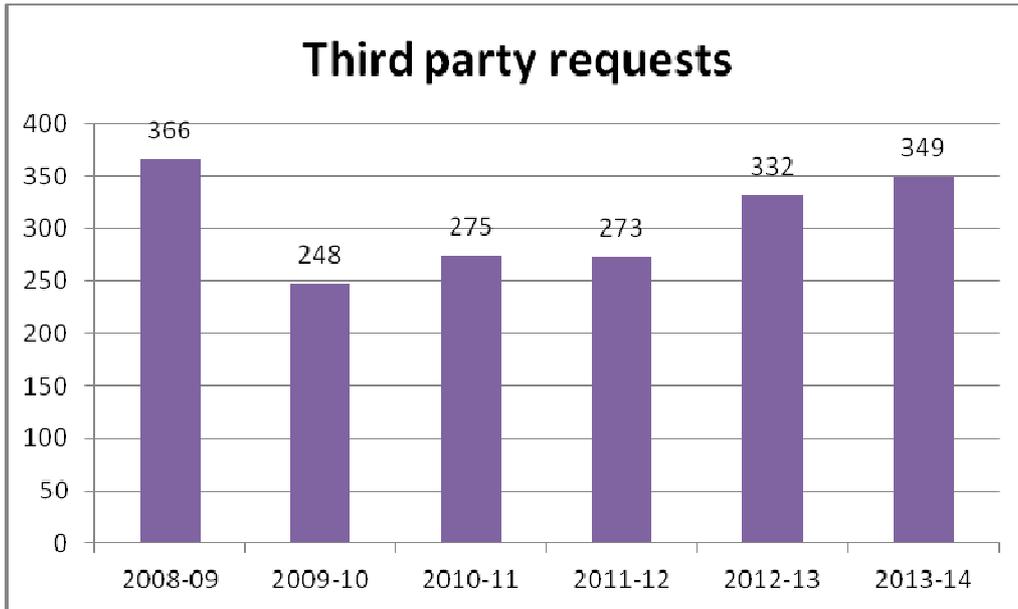
28. The Data Protection Act 1998 gives individuals the right to know what information is held about them and provides a framework to ensure that personal information is handled properly.
29. Under the Act, an individual is entitled to access personal data, held by an organisation, of which that individual is the data subject. Such requests for information are known as subject access requests.
30. For the year 2013/14, the Council received 114 subject access requests compared with 141 last year. 64 of these were dealt under the corporate procedures and 50 were relating to social services (Adult Services and Children Services and Learning requests) and were processed by the Customer Relations Team, with support from the Corporate Legal Team where appropriate.



31. Only 88.6% of the Subject Access Requests were responded within the statutory timescales of 40 calendar days compared with 95% last year. Five of the Corporate and eight of the Social Services’ requests were not responded to within the statutory timescales of 40 calendar day.

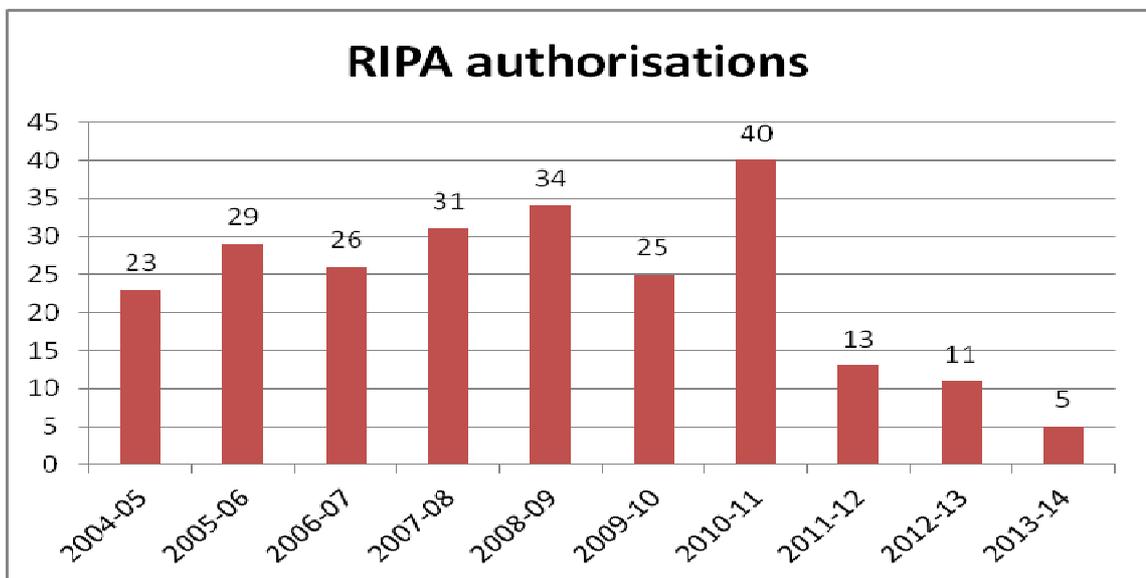


32. Two DP appeals were made to the Council's Internal Corporate Complaints department, regarding decisions made to withhold or partially withhold information requested. In both cases additional information was located and released to the requester.
33. In the year 2013/14 we self reported two instances of loss of personal data by the Council to the Information Commissioner.
34. Sometimes there is a requirement to disclose personal data which might otherwise be in breach of the Act. Where an exemption from the non-disclosure provisions applies, such disclosure is not in breach of the Act. Examples of exemptions include section 29 (the crime and taxation exemption) and section 35 (disclosures required by law or made in connection with legal proceedings). Such requests are typically made to the Council by regulatory authorities such as the police, the Department of Work and Pensions and so on as part of their investigations.
35. For the year 2013/14 the Council received 349 requests for data from such third party organisations compared to 332 in the previous year.



**RIPA**

36. Under RIPA, the Council as a public authority is permitted to carry out directed surveillance, the use of covert human intelligence sources and obtain communications data if it is both necessary for the purpose of preventing or detecting crime and/or disorder and the proposed form and manner of the activity is proportionate to the alleged offence.
37. There have only been 5 authorisations under RIPA in 2013/14, a decrease on last year's 11 authorisations.



The Protection of Freedom Act 2012 gained Royal Assent on 1<sup>st</sup> May 2012 and is now in force. The Act requires judicial approval for surveillance activities through application to the Magistrate Courts, and imposes a higher threshold for use. As such, there has been a significant decrease in applications made by the Council.

38. Examples of activity authorised include covert surveillance of a victim's home to detect acts of criminality, directed surveillance of individuals who were involved in fraudulent activities and a Covert Human Intelligence Source ("CHIS") was used to form an online relationship with a suspect to make a test purchase of suspected counterfeit goods.
39. The Council is required to formally appoint a 'Senior Responsible Officer' for RIPA. The Head of Legal and Democratic Services is the officer who undertakes this role. The Senior Responsible Officer has responsibility for maintaining the central record of authorisations; the integrity of the RIPA process within his authority; compliance with the Act and Codes of Practice; oversight of the reporting of errors to the Surveillance Commissioner; engagement with Inspectors from the Office of Surveillance Inspectors and implementation of any subsequent action plan.
40. Training and guidance for Council officers involved in RIPA processes is currently being arranged by Corporate Legal Team and will take place in Autumn 2014.
41. The Office of Surveillance Commissioners carried out a review of Southampton City Council's management of covert activities in 2013. In his report, Chief Surveillance Inspector, Sir Christopher Rose noted:
 

"Your regularly updated RIPA training, the engaged and conscientious approach of your staff, your very good policy documentation, your internal oversight regime and your good overall compliance standards are commendable".

## **RESOURCE IMPLICATIONS**

### **Capital/Revenue**

42. None directly related to this report.
43. None directly related to this report. The administration of information law within the authority is managed within corporate overheads, but the continuing upward trend in the number of requests received is increasing pressure on finite resources for maintaining compliance with these statutory processes.

### **Property/Other**

44. None directly related to this report..

## **LEGAL IMPLICATIONS**

### **Statutory power to undertake proposals in the report:**

45. The statutory obligations relating to information law are detailed in the body of this report.

### **Other Legal Implications:**

46. None directly related to this report.

## **POLICY FRAMEWORK IMPLICATIONS**

47. The information contained in this report is consistent with and not contrary to the Council's Policy Framework.

KEY DECISION? No

WARDS/COMMUNITIES AFFECTED:	None
-----------------------------	------

**SUPPORTING DOCUMENTATION**

**Appendices**

1.	FOI, EIR and DP requests received in the year 2013-14 (Directorate breakdown)
----	--

**Documents In Members' Rooms**

1.	None
----	------

**Equality Impact Assessment**

Do the implications/subject of the report require an Equality Impact Assessment (EIA) to be carried out.	No
--	----

**Other Background Documents**

**Equality Impact Assessment and Other Background documents available for inspection at:**

Title of Background Paper(s)

Relevant Paragraph of the Access to Information Procedure Rules / Schedule 12A allowing document to be Exempt/Confidential (if applicable)

1.	None	
----	------	--

# Agenda Item 6

## Appendix 1

### Appendix 1

#### FOI, EIR and DP requests received in the year 2013-14 (directorate breakdown)

Directorate	FOI and EIR	SAR	TOTAL
People	424	11	435
% responded to on time	99.29%	80%	99.08%
Place	462	15	477
% responded to on time	96.53%	86.67%	96.23%
Corporate Services	394	33	427
• Corporate Legal	57	9	66
• Customer Relations Team	0	46	46
			= 559
% responded to on time	99.33%	89.77%	97.85%

Please note that some of the above requests were relating to more than one directorate and in the table these have been logged against the directorate who took the lead on such requests and coordinated response across the Council.

This page is intentionally left blank

<b>DECISION-MAKER:</b>	GOVERNANCE COMMITTEE COUNCIL		
<b>SUBJECT:</b>	REVIEW OF PRUDENTIAL LIMITS AND TREASURY MANAGEMENT OUTTURN 2013/14		
<b>DATE OF DECISION:</b>	15 JULY 2014 17 JULY 2014		
<b>REPORT OF:</b>	HEAD OF FINANCE & IT (CHIEF FINANCIAL OFFICER)		
<b><u>CONTACT DETAILS</u></b>			
<b>AUTHOR:</b>	<b>Name:</b>	<b>Andy Lowe</b>	<b>Tel:</b> 023 8083 4049
	<b>E-mail:</b>	<a href="mailto:Andrew.Lowe@southampton.gov.uk">Andrew.Lowe@southampton.gov.uk</a>	
<b>Director</b>	<b>Name:</b>	<b>Mark Heath</b>	<b>Tel:</b> 023 8083 2371
	<b>E-mail:</b>	<a href="mailto:Mark.Heath@southampton.gov.uk">Mark.Heath@southampton.gov.uk</a>	

<b>STATEMENT OF CONFIDENTIALITY</b>
-------------------------------------

NOT APPLICABLE
----------------

### **BRIEF SUMMARY**

The purpose of this report is to inform the Governance Committee and Council of the Treasury Management activities and performance for 2013/14 against the approved Prudential Indicators for External Debt and Treasury Management.

This report specifically highlights that:

- i. Borrowing activities have been undertaken within the borrowing limits approved by Council on 13 February 2014.
- ii. Investment returns during 2013/14 continued to remain low as a result of low interest rates, returning £0.65M. However, the average rate achieved for fixed term deals (0.78%) exceeded the performance indicator of the average 7 day LIBID rate (0.41%), mainly due to the rolling programme of yearly investments which was reintroduced in November 2012, following recommendations from our Treasury Management advisors, Arlingclose.
- iii. The Council's strategy was to minimise borrowing to below its Capital Financing Requirement (CFR), the difference representing balances, reserves, provisions and working capital. This approach lowers interest costs, reduces credit risk and relieves pressure on the Council's counterparty list. Throughout the year, capital expenditure levels, market conditions and interest rate levels were monitored to minimise borrowing costs over the medium to longer term and to maintain stability. The differential between debt costs and investment earnings continued to be acute, resulting in the use of internal resources in lieu of borrowing often being the most cost effective means of financing capital expenditure. As a result the average rate for repayment of debt, (the Consolidated Loans & Investment Account Rate – CLIA), at 3.32%, is lower than that budgeted for and slightly lower than last year (3.35%) as no new loans were taken due to slippage in the capital programme and higher than expected balances. The predicted forecast for longer term debt is a steady increase in

the longer term and so new long term borrowing is likely to be taken out above this rate, leading to an anticipated increase in the CLIA. A Public Works Loan Board (PWLB) 25 year fixed rate maturity loan is currently around 4%.

- iv. In achieving interest rate savings the Council has exposed itself to interest rate risk by taking out variable debt. This was and continues to be very financially favourable in current markets but does mean that close monitoring of the markets is required to ensure that the Council can act quickly should the situation begin to change. During 2014/15 the Council will continue to review the position and take action as necessary to lessen this risk through a balanced combination of:
  - longer term fixed maturity loans,
  - medium term Equal Instalment of Principle (EIP) loans which are currently cheaper than longer term fixed,
  - longer term PWLB variable loans which have the option to be fixed at very short notice for a small fee, and
  - variable rate investments to take advantage of increasing interest rates, mainly through the use of call accounts and money market funds (MMF).
- v. Net loan debt decreased during 2013/14 from £315M to £283M as detailed in paragraph 16.
- vi. The Council can confirm that it has complied with the Prudential Indicators approved by Full Council on 13 February 2013.
- vii. Action has been taken in response to the continued uncertainties and difficulties of the Authority's Bankers, (the Co-operative Bank), as set out in paragraphs 45 to 48.

## **RECOMMENDATIONS:**

### **GOVERNANCE COMMITTEE**

#### **It is recommended that Governance Committee:**

- (i) Notes the Treasury Management (TM) activities for 2013/14 and the outturn on the Prudential Indicators
- (ii) Notes that the continued proactive approach to TM has led to reductions in borrowing costs and safeguarded investment income during the year.
- (iii) Notes the continued action taken in response to the down rating of the Authority's current Bankers, (the Co-operative Bank).
- (iv) Notes the proposed extended scope of the Interest Equalisation Reserve to include the risk associated with 'bail – in' following the banking regulation reform which in future would force losses on investors before taxpayers are asked to support failing banks, and the subsequent change of name of this reserve to the Treasury Risk Reserve.

## **COUNCIL**

### **It is recommended that Council:**

- i) Notes the Treasury Management (TM) activities for 2013/14 and the outturn on the Prudential Indicators
- ii) Notes that the continued proactive approach to TM has led to reductions in borrowing costs and safeguarded investment income during the year.
- iii) Notes the immediate action taken in response to down rating of the Authority's current Bankers, (the Co-operative Bank).
- iv) Approves the extended scope of the Interest Equalisation Reserve to include the risk associated with 'bail – in' following the banking regulation reform which in future would force losses on investors before taxpayers are asked to support failing banks (see paragraphs 23 and 31- 32 for more details), and the subsequent change of name of this reserve to the Treasury Risk Reserve.

### **REASONS FOR REPORT RECOMMENDATIONS**

1. The reporting of the outturn position for 2013/14 forms part of the approval of the statutory accounts. The Treasury Management (TM) Strategy and Prudential Indicators are approved by Council in February each year in accordance with legislation and the Chartered Institute of Public Finance & Accountancy (CIPFA) Code of Practice.
2. The Treasury Management Code requires public sector authorities to determine an annual TM Strategy and now, as a minimum, formally report on their treasury activities and arrangements to full Council mid-year and after the year-end. These reports enable those tasked with implementing policies and undertaking transactions to demonstrate they have properly fulfilled their responsibilities, and enable those with ultimate responsibility/governance of the TM function to scrutinise and assess its effectiveness and compliance with policies and objectives.

### **ALTERNATIVE OPTIONS CONSIDERED AND REJECTED**

3. No alternative options are relevant to this report

### **DETAIL (Including consultation carried out)**

#### **CONSULTATION**

4. Not applicable

#### **BACKGROUND**

5. The Local Government Act 2003 introduced a system for borrowing based largely on self-regulation by local authorities themselves. The basic principle of the new system is that local authorities will be free to borrow as long as their capital spending plans are affordable, prudent and sustainable.
6. The Chartered Institute of Public Finance and Accountancy's Code of Practice for Treasury Management in Public Services, (the "CIPFA TM Code"), and the Prudential Code require local authorities to determine a

Treasury Management Strategy Statement (TMSS) and Prudential Indicators (PIs) on an annual basis. The TMSS also incorporates the Annual Investment Strategy (AIS), which is a requirement of the Department for Communities and Local Government's (CLG) Investment Guidance.

7. In summary the core elements of the Treasury Management (TM) strategy for 2013/14 were:
  - To make use of short term variable rate debt to take advantage of the continuing market conditions of low interest rates.
  - To constantly review longer term forecasts and to lock in to longer term rates through a variety of instruments as appropriate during the year, in order to provide a balanced portfolio against interest rate risk.
  - To secure the best short term rates for borrowing and investments consistent with maintaining flexibility and liquidity within the portfolio.
  - To invest surplus funds prudently, the Council's priorities being:
    - Security of invested capital
    - Liquidity of invested capital
    - An optimum yield which is commensurate with security and liquidity.
  - To approve borrowing limits that provide for debt restructuring opportunities and to pursue debt restructuring where appropriate and within the Council's risk boundaries
8. In essence TM can always be seen in the context of the classic 'risk and reward' scenario and following this strategy will contribute to the Council's wider TM objective which is to minimise net borrowing cost short term without exposing the Council to undue risk either now or in the longer term.
9. Treasury management is defined as "*The management of the local authority's investments and cash flows, its banking, money market and capital market transactions; the effective control of the risks associated with those activities; and the pursuit of optimum performance consistent with those risks.*"
10. Overall responsibility for treasury management remains with the Council. No TM activity is without risk; the effective identification and management of risk are integral to the Council's treasury management objectives.
11. This report:
  - a) is prepared in accordance with the revised CIPFA Treasury Management Code and the revised Prudential Code,
  - b) presents details of capital financing, borrowing, debt rescheduling and investment transactions,
  - c) reports on the risk implications of treasury decisions and transactions,
  - d) gives details of the outturn position on treasury management transactions in 2013/14, and
  - e) confirms compliance with treasury limits and Prudential Indicators.
12. Appendix 1 summarises our Treasury advisors view of the economic outlook and events in the context of which the Council operated its treasury function

during 2013/14.

## BORROWING REQUIREMENT AND DEBT MANAGEMENT

13. The underlying need to borrow for capital purposes is measured by the Capital Financing Requirement (CFR). The CFR, together with balances and useable reserves, are the core drivers of TM Activity.
14. The Authority is able to borrow funds in excess of the current level of its CFR up to the projected level in 2016/17. The Authority is likely to only borrow in advance of need if it felt the benefits of borrowing at interest rates now compared to where they are expected to be in the future, outweighs the current cost and risks associated with investing the proceeds until the borrowing is actually required.
15. The forecast movement in coming years is one of the Prudential Indicators (PIs). The movement in actual external debt and usable reserves combine to identify the Authority's borrowing requirement and potential investment strategy in the current and future years and is shown in the tables below together with activity in the year.

16.

	31-Mar-13 Actual £M	31-Mar-14 Actual £M	31-Mar-15 Current Estimate £M	31-Mar-16 Current Estimate £M	31-Mar-17 Current Estimate £M
<b>External Borrowing:</b>					
Fixed Rate – PWLB Maturity	139	139	183	207	222
Fixed Rate – PWLB EIP	93	81	69	58	46
Variable Rate – PWLB	35	35	35	35	35
Variable Rate – Market	9	9	9	9	9
<b>Long Term Borrowing</b>	<b>276</b>	<b>264</b>	<b>296</b>	<b>309</b>	<b>312</b>
<b>Short Term Borrowing</b>					
Fixed Rate – Market	34	10	20	30	30
<b>Other Long Term Liabilities</b>					
PFI / Finance leases	57	62	67	65	62
Deferred Debt Charges	17	16	16	15	14
<b>Total Gross External Debt</b>	<b>384</b>	<b>352</b>	<b>399</b>	<b>419</b>	<b>418</b>
<b>Investments:</b>					
Deposits and monies on call and Money Market Funds	(66)	(66)	(50)	(50)	(50)
Supranational bonds	(3)	(3)	(3)	(3)	(3)
<b>Total Investments</b>	<b>(69)</b>	<b>(69)</b>	<b>(53)</b>	<b>(53)</b>	<b>(53)</b>
<b>Net Borrowing Position</b>	<b>315</b>	<b>283</b>	<b>346</b>	<b>366</b>	<b>365</b>

17.

	Balance on 01/04/2013 £M	Debt Maturing or Repaid £M	New Borrowing £M	Balance as at 31/3/2014 £M	Increase/ (Decrease) in Borrowing for Year £M
Short Term Borrowing	34	(44)	20	10	(24)
Long Term Borrowing	276	(12)	0	264	(12)
<b>Total Borrowing</b>	<b>310</b>	<b>(56)</b>	<b>20</b>	<b>274</b>	<b>(36)</b>

*Please note that these figures do not reflect the accounting convention of moving loans maturing in the year from long term to short term.*

18. The Council's underlying need to borrow as measured by the CFR as at 31/3/2014 was estimated at £430M in February 2014 when the strategy was last updated, (see Table 1, Appendix 3). The Council's actual CFR at the end of the year was £425M.
19. The PWLB remains the Council's preferred source of long term borrowing given the transparency and control that its facilities continue to provide. However due to the continued depressed markets and the 'cost of carry' associated with long term debt, the Council deferred long term borrowing and raised £20M of new loans (including the replacement of maturing debt) from other Local Authorities through the short term market at an average rate of 0.54%.

### **Loans at Variable Rates**

20. The 'cost of carry' has resulted in an increased reliance upon shorter dated and variable rate borrowing. This type of borrowing injects volatility into the debt portfolio in terms of interest rate risk but is counterbalanced by its affordability and alignment of borrowing costs with investment returns. The Authority's exposure to shorter dated and variable rate borrowing is kept under regular review by reference to the difference or spread between variable rate and longer term borrowing costs. A significant narrowing in the spread (e.g. by 0.5%) between the variable rate and the 30 year fixed maturity will result in an immediate and formal review of the borrowing strategy to determine whether the exposure to shorter dated and variable rates is maintained or altered.
21. The Council has exposed itself to interest rate risk by taking out variable debt. This was and continues to be very financially favourable in current markets but does mean that the Council must monitor markets to ensure it is not caught out by rising interest rates. During 2014/15 the Council will continue to review and take action as necessary to lessen this risk through a balanced combination of:
  - longer term fixed maturity loans,
  - medium term Equal Instalment of Principle (EIP) loans which are currently cheaper than longer term fixed,
  - longer term PWLB variable loans which have the option to be fixed at very short notice for a small fee and
  - variable rate investments to take advantage of increasing interest rates, mainly through the use of money market funds (MMF).
22. In order to mitigate these risks further, the Council approved the creation of an Interest Equalisation Reserve in 2009. At that point a major debt restructuring exercise was undertaken in order to take advantage of market conditions and produce net revenue savings. In achieving this, the Council exposed itself to short term variable interest rate risk and whilst in the current climate of low interest rates this remains a sound strategy, at some point when the market starts to move, the Council will need to act quickly to lock

into fixed long term rates which may be at similar levels to the debt it restructured. It was therefore recommended that an Interest Equalisation Reserve be created to help to manage volatility in the future and ensure that there was minimal impact on annual budget decisions or council tax in any single year. The Reserve will be maintained at an appropriate level to protect the Council from future increase in debt charges where it is prudent to do so. In a speech given by Mark Carney, Governor of the Bank of England on the 12 June 2014, he indicated that the official interest rate could move earlier than the markets expect. Markets have priced the first rise in official interest rates for February/ March 2015.

23. In addition to interest rise risk, the Authority now has to cover the risk associated with 'bail – in' (following the banking regulation reform, see paragraph 32) which in future would force losses on investors before taxpayers are asked to support failing banks. It is recommended that the 'Interest Equalisation Reserve' be renamed 'Treasury Risk Reserve' to recognise this wider risk and the level is reviewed on a regular basis.

#### **Internal Borrowing**

24. Given the significant reductions in local government funding putting pressure on Council finances, the strategy followed was to minimise debt interest payments without compromising the longer-term stability of the portfolio. The differential between the cost of new longer-term debt (3.18% average rate for a 20 year PWLB fixed rate maturity) and the return generated on the Council's temporary investment returns was significant (2.4%).
25. As at the 31 March 2014 the Council used £73M of internal resources in lieu of borrowing which has been the most cost effective means of funding past capital expenditure to date. This has lowered overall treasury risk by reducing both external debt and temporary investments. However, this position will not be sustainable over the medium term and the Council will need to borrow to cover this amount as balances fall. Following the latest update of the Capital Programme, approved by Council in February 2014, the Council is expected to borrow up to £83M between 2014/15 and 2016/17. Of this £51M relates to new capital spend (£6M GF and £45M HRA) and the remainder to the refinancing of existing debt and externalising internal debt to cover the expected fall in balances and also the need to lock back into longer term debt prior to interest rises.

#### **Lender's Option Borrower's Option Loans (LOBOs)**

26. The 2011 revision to the CIPFA Treasury Management Code now requires the prudential indicator relating to Maturity of Fixed Rate Borrowing to reference the maturity of LOBO loans to the earliest date on which the lender can require payment, i.e. the next call date. All of our LOBOs are in their call period so are treated as due within the year for analysis purposes (see Table in paragraph 38). We do not however expect them to be called during the year, but if they were it is likely that they would be replaced by a PWLB loan.

#### **INVESTMENT ACTIVITY**

27. Both the CIPFA and DCLG's Investment Guidance requires the authority to invest prudently and have regard to the security and liquidity of investments

before seeking the optimum yield.

28. Security of capital remained the Council's main investment objective. This was maintained by following the Council's counterparty policy as set out in its TM Strategy Statement for 2013/14 which defined "high credit quality" organisations as those having a long-term credit rating of A- or higher, that domiciled in the UK or a foreign country with a sovereign rating of AA+ or higher. Investments during the year included:

- Deposits with other Local Authorities
- Investments in AAA-rated Stable Net Asset Value Money Market Funds
- Call accounts and deposits with UK Banks and Building Societies
- Bonds issued by Multilateral Development Banks

29. The table below summarises activity during the year:

	Balance on	Investments	New	Balance as	Increase/	Average Life / Average	
	01/04/2013	Repaid	Investments	at	(Decrease) in	Life	Rate %
	£M	£M	£M	£M	£M		
Short Term Investments	26	(34)	26	18	(8)	3 Months	0.78
Money Market Funds & Call Accounts	40	(409)	417	48	8	1 Day	0.59
EIB Bonds	3	0	0	3	0	8 Years	5.40
Long Term Investments	0	0	0	0	0		
<b>Total Investments</b>	<b>69</b>	<b>(443)</b>	<b>443</b>	<b>69</b>	<b>0</b>		

### Credit Developments and Credit Risk Management

30. The Authority assessed and monitored counterparty credit quality with reference to credit ratings; credit default swaps; GDP of the country in which the institution operates; the country's net debt as a percentage of GDP and share price. The minimum long-term counterparty credit rating determined by the Authority for the 2013/14 treasury strategy was A- across rating agencies Fitch, S&P and Moody's.
31. The debt crisis in Cyprus was resolved by its government enforcing a 'haircut' on unsecured investments and bank deposits over €100,000. This resolution mechanism, in stark contrast to the bail-outs during the 2008/2009 financial crisis, sent shockwaves through Europe but allowed banking regulators to progress reform which would in future force losses on investors through a 'bail-in' before taxpayers were asked to support failing banks.
32. The Financial Services (Banking Reform) Act 2013 gained Royal Assent in December, legislating for the separation of retail and investment banks and for the introduction of mandatory bail-in in the UK to wind up or restructure failing financial institutions. EU finance ministers agreed further steps towards banking union, and the Single Resolution Mechanism (SRM) for resolving problems with troubled large banks which will shift the burden of future restructurings/rescues to the institution's shareholders, bondholders and unsecured investors. This means that if 'Bail In' was applied to an institution with which the Council has deposits, the Council would be required to part fund the losses from its investments held (the amount lost in a default

is usually about 50% of the sum lent). This is commonly referred to as a 'Hair Cut'.

33. Proposals were also announced for EU regulatory reforms to Money Market Funds which may result in these funds moving to a VNAV (variable net asset value) basis and losing their 'triple-A' credit rating wrapper in the future.
34. The material changes to UK banks' creditworthiness were (a) the strong progress made by the Lloyds Banking Group in strengthening its balance sheet, profitability and funding positions and the government reducing its shareholding in the Group to under 25%, (b) the announcement by Royal Bank of Scotland of the creation of an internal bad bank to house its riskiest assets (this amounted to a material extension of RBS' long-running restructuring, further delaying the bank's return to profitability) and (c) substantial losses at Co-op Bank which forced the bank to undertake a liability management exercise to raise further capital and a debt restructure which entailed junior bondholders being bailed-in as part of the restructuring.
35. In July Moody's placed the A3 long-term ratings of Royal Bank of Scotland and NatWest Bank and the D+ standalone financial strength rating of RBS on review for downgrade amid concerns about the impact of any potential breakup of the bank on creditors. As a precautionary measure the Authority reduced its duration to overnight for new investments with these banks. In March Moody's downgraded the long-term ratings of both banks to Baa1. As this rating is below the Authority's minimum credit criterion of A-, the banks were withdrawn from the counterparty list for further investment.
36. As reported previously along with many other authorities the Council uses the Co-operative Bank as its banker which no longer meets the minimum credit criteria of A- (or equivalent) long term. The Co-op's long-term ratings were downgraded by Moody's and Fitch to Caa1 and B respectively, both sub-investment grade ratings. The Co-op Bank's capital raising plans to plug a capital shortfall include a contribution from the Co-op Group which is committed to injecting £313m in 2014. However, in order to cover future expected losses and to meet the Prudential Regulation Authority's capital targets, a further £400m is being sought from shareholders, of which Co-operative Group's share is approximately £120m. Given the Co-op Group's own financial position, payment of these sums is by no means certain, leaving the bank with a precarious capital position. Further information is set out in paragraphs 45-48.
37. The table below summarises the nominal value of the Council's investment portfolio at 31 March 2014, and confirms that all investments were made in line with the Council's approved credit rating criteria:

<u>Outstanding Investments as at 31 March 2014</u>									
Counterparty	<u>Credit Rating</u> <u>Criteria Met When</u> <u>Investment</u> <u>Placed</u>	<u>Credit Rating</u> <u>Criteria Met</u> <u>on 31 March</u> <u>2014</u>	<u>Under 1</u> <u>Month</u>	<u>1-3</u> <u>Months</u>	<u>3-6</u> <u>Months</u>	<u>6-9</u> <u>Months</u>	<u>9-12</u> <u>Months</u>	<u>Over 12</u> <u>Months</u>	<u>Total</u>
	YES/NO	YES/NO	£000's	£000's	£000's	£000's	£000's	£000's	£000's
<b>UK</b>									
Bank Deposits	YES	YES	30,929	7,000	4,000	3,000			44,929
Building Societies	YES	YES	1,000		2,000				3,000
Government & Local Authority Deposits	YES	YES							0
Money Market Funds	YES	YES	18,122						18,122
Bonds							0	3,036	3,036
<b>Total Investments</b>			<b>50,051</b>	<b>7,000</b>	<b>6,000</b>	<b>3,000</b>	<b>0</b>	<b>3,036</b>	<b>69,087</b>

## Liquidity Management

38. In keeping with the DCLG's Guidance on Investments, the Council maintained a sufficient level of liquidity through the use of Money Market Funds and call accounts. There is no perceived risk that the Council will be unable to raise finance to meet its commitments. The Council also has to manage the risk that it will be exposed to replenishing a significant proportion of its borrowing at a time of unfavourable interest rates. The Council would only borrow in advance of need where there is a clear business case for doing so and will only do so for the current capital programme or to finance future debt maturities. The maturity analysis of the nominal value of the Council's debt at 31 March 2014 was as follows:

<u>Outstanding</u> <u>31 March 2013</u>	<u>% of Total</u> <u>Debt</u> <u>Portfolio</u>	<u>Total Borrowing</u>	<u>Outstanding</u> <u>31 March 2014</u>	<u>% of Total</u> <u>Debt</u> <u>Portfolio</u>
£000's	%	Source of Loan	£000's	%
267,320	86	Public Works Loan Board	254,815	93
42,673	14	Other Financial Institutions	19,376	7
<b>309,993</b>	<b>100</b>		<b>274,191</b>	<b>100</b>
<b>Analysis of Loans by Maturity</b>				
55,178	18	Less than 1 Year *	30,881	11
11,505	4	Between 1 and 2 years	11,505	4
34,515	11	Between 2 and 5 years	34,515	13
69,948	23	Between 5 and 10 years	58,443	21
0	0	Between 10 and 15 years		0
0	0	Between 20 and 25 years		0
5,000	2	Between 25 and 30 years	10,000	4
10,000	3	Between 30 and 35 years	5,000	2
42,000	13	Between 35 and 40 years	42,000	15
50,600	16	Between 40 and 45 years	54,850	20
31,247	10	Over 45 years	26,997	10
<b>309,993</b>	<b>100</b>		<b>274,191</b>	<b>100</b>

## Yield

39. The Council sought to optimise returns commensurate with its objectives of security and liquidity. The UK Bank Rate has been maintained at 0.5% since

March 2009 and short-term money market rates have remained at very low levels, which continued to have a significant impact on investment income. The average 3-month LIBID rate during 2013/14 was 0.45%, the 6-month LIBID rate averaged 0.53% and the 1-year LIBID rate averaged 0.78%, (See Appendix 2 Table 1). The low rates of return on the Authority's short-dated money market investments reflect prevailing market conditions and the Authority's objective of optimising returns commensurate with the principles of security and liquidity.

40. The Council's investment income for the year was £0.65M and new fixed term deposits for periods up to one year have been made at an average rate of 0.78%. This was mainly as a result of the reintroduction of the rolling programme of yearly deals which was restarted in November 2012 following advice from our Treasury Advisors.
41. Income earned on longer-dated investments (£3M) made in 2007/08 at an average rate of 5.4% provided some cushion against the low interest rate environment.
42. The Authority has estimated it will have sufficient cash balances over the medium term to consider using property funds which offer the potential for enhanced returns over the longer term, but may be more volatile in the shorter term. These funds, which are managed by professional fund managers, will allow the Authority to diversify into asset classes other than cash without the need to own and manage the underlying investments. The Council subsequently invested £5M in a Property fund on the 1 April 2014; further details will be reported as part of the Mid Year Treasury report.

#### **COMPLIANCE WITH PRUDENTIAL INDICATORS**

43. The Council can confirm that it has complied with its Prudential Indicators for 2013/14, approved by Full Council on 13 February 2013. The 2013/14 Treasury Strategy can be found as Item 100 on the Council Meetings Agenda found via the following web link:

<http://www.southampton.gov.uk/modernGov/ieListDocuments.aspx?CId=122&MIId=2322&Ver=4>

These were subsequently revised as part of the Council's Treasury Management Strategy Statement for 2014 on 12 February 2014, item 87.

<http://www.southampton.gov.uk/modernGov/ieListDocuments.aspx?CId=122&MIId=2469&Ver=4>

44. In compliance with the requirements of the CIPFA Code of Practice this report provides members with a summary report of TM activity during 2013/14. None of the Prudential Indicators has been breached and a prudent approach has been taken in relation to investment activity with priority being given to security and liquidity over yield. Details can be found in Appendix 3.

## OTHER ITEMS

### Authority Banking Arrangements:

45. The Authority banks with the Co-operative Bank which does not currently meet the Authority's minimum credit criteria of A- (or equivalent) long term and, as reported previously, has been subject to financial difficulties in recent months.

A rescue package for the Co-operative Bank was agreed in December 2013, and the bank also announced its withdrawal from the local authority market. As the Authority's contract with the Co-operative Bank is due to end in September 2014, a project to tender jointly for banking services was already underway with five other Local Authorities also with the Co-operative Bank, led by the Authority. Following the successful conclusion of the joint tender exercise, the Authority is now in the process of moving its banking arrangements to the successful bidder, Lloyds Bank. This exercise will be complete by September 2014, when the contract with the Co-operative Bank ends.

46. Until the transfer of our banking arrangements to Lloyds Bank is complete, the Authority will continue to take the following actions to mitigate our exposure to credit risk:

- **Pooling Arrangements** – It is common for local authorities to hold a number of accounts at the same bank and to group these together for overdraft limit and interest purposes under a netting-off or pooling arrangement. Under this arrangement, some accounts will have a substantial credit balance while others will have a large overdraft, but the total balance is kept close to zero. Procedures in place were such that staff who manage the TM activity on a daily basis previously aimed for the net closing daily balances across all our accounts to be close to our current 'free' overdraft limit of £50,000. However, Arlingclose advised that it is likely in the event of any insolvency/banking resolution procedure that this netting down may not apply and that we would need to repay our overdrawn accounts in full and credit balances could also be at risk (in part or in full).

As a consequence procedures have been changed so that at the start of each day any account that has a balance in excess of £5,000 will be cleared back to the general account to minimise credit balances and limit our exposure (i.e. we will "sweep" the accounts and action inter-account transfers).

- **Cleared and Ledger Balances** – Overdraft interest charges are calculated in reference to the "cleared balance" and previously staff who manage the TM activity on a daily basis aim for this balance to be close to our current 'free' overdraft limit of £50,000. However, the total sum of money held in the current account is the ledger balance which is normally higher than the cleared balance. Arlingclose have advised that in the event of insolvency or other banking resolution procedure the "ledger balance" at the date of failure represents our exposure. Therefore, we now use the "ledger balance" to calculate our position and inform the action required. We currently aim to have an overdrawn

ledger balance of £300,000.

- **Intraday Exposure** – Arlingclose advice is that although any action by resolution authorities is likely to take place outside banking hours to prevent a disorderly impact on the UK banking system, it cannot be ruled out that a bank will halt operations during the business day. Therefore we aim to reduce our daylight exposure by making outgoing payments at the beginning of the day. In addition, where it is known in advance that a large receipt is expected, (for example, the first day of the month when council tax is collected), we now set up payments to leave the Council's bank account at the commencement of business. Furthermore, arrangements have been made to change the automatic sweep on the pay-point account from weekly to daily, although the balance on this account will still be subject to timing differences.
  - **Government Grants and Capital Receipts** - large sums of money such as government grants and capital receipts are channelled through a Barclays current account which was set up to act as a 'parachute' account until the new banking contract had been awarded. These monies are transferred to the Co-op once appropriate Treasury action for the day has taken place so that the account is never in credit.
  - **Imprest Accounts** – A review of Imprest Accounts (which are held locally to manage small transactions) was undertaken to ensure that the levels held are minimised and we sweep any balances over £5,000 out over the weekend.
  - **Advice to Schools** – Advice has been sent to schools updating them on action that it is appropriate for them to take in respect of any locally held accounts.
47. These changes impact on the level of staff resource required to manage TM activity and is resulting in increased bank charges but this is seen as an acceptable trade off in light of the priority given to security. Staff resource is being redirected to TM activity and priorities have been reassessed in order that this can be managed within existing employee budgets. Additional bank charges can be met from within the current TM estimates. For 2013/14 bank charges totalled £4,100 an increase of £3,800 over the previous year.
48. These actions minimise credit risk but cannot eliminate it entirely.

#### **Investment Training**

49. The needs of the Authority's treasury management staff for training in investment management are assessed as part of the staff appraisal process, and additionally when the responsibilities of individual members of staff change. During 2013/14 staff attended training courses, seminars and conferences provided by Arlingclose and CIPFA

### **RESOURCE IMPLICATIONS**

#### **Capital/Revenue**

50. The report is a requirement of the TM Strategy, which was approved at Council on 13 February 2014.
51. The interest cost of financing the Authority's long term and short term loan

debt is charged corporately to the Income and Expenditure account. The interest cost of financing the Authority's loan debt amounted to £9.7M in 2013/14 compared with an approved estimate of £11.7M, a saving of £2M. This is mainly due to variable interest rates being lower than those estimated and the use of temporary borrowing in place of long term debt.

52. In addition interest earned on temporary balances invested externally is credited to the Income and Expenditure account. In 2013/14 £0.65M was earned against a budget of £0.3M, an increase of £0.36M and was mainly due to the use of Money Market Funds and call accounts which currently pay a higher rate than short term fixed rates and the reintroduction of the rolling yearly investment programme from November 2012.
53. The expenses of managing the Authority's loan debt consist of brokerage and internal administration charges. These are pooled and borne by the HRA and General Fund proportionately to the related loan debt. Debt management expenses amounted to £127,400 in 2013/14 compared to an estimate of £161,400. This decrease was mainly due a reduction in brokerage costs due to fewer treasury deals being undertaken and deferring PWLB borrowing to 2014/15 resulting in a saving on commission paid in year.

**Property/Other**

54. None

**LEGAL IMPLICATIONS**

**Statutory power to undertake proposals in the report:**

55. Local Authority borrowing is regulated by Part 1, of the Local Government Act 2003, which introduced the new Prudential Capital Finance System. From 1 April 2004, investments are dealt with, not in secondary legislation, but through guidance. Similarly, there is guidance on prudent investment practice, issued by the Secretary of State under Section 15(1)(a) of the 2003 Act. A local authority has the power to invest for "any purpose relevant to its functions under any enactment or for the purposes of the prudent management of its financial affairs". The reference to the "prudent management of its financial affairs" is included to cover investments, which are not directly linked to identifiable statutory functions but are simply made in the course of treasury management. This also allows the temporary investment of funds borrowed for the purpose of expenditure in the reasonably near future; however, the speculative procedure of borrowing purely in order to invest and make a return remains unlawful.

**Other Legal Implications:**

56. None

**POLICY FRAMEWORK IMPLICATIONS**

57. This report has been prepared in accordance with the CIPFA Code of Practice on TM.

**KEY DECISION?**

Yes/No

**WARDS/COMMUNITIES AFFECTED:**

--

## SUPPORTING DOCUMENTATION

### Appendices

1.	2013/14 Economic Background
2.	Summary of Interest Rates Movement During 2013/14
3.	Compliance with Prudential Indicators During 2013/14
4.	Glossary of Treasury Terms

### Documents In Members' Rooms

1.	None
----	------

### Equality Impact Assessment

Do the implications/subject of the report require an Equality Impact Assessment (EIA) to be carried out.	Yes/No
--	--------

### Other Background Documents

#### Equality Impact Assessment and Other Background documents available for inspection at:

Title of Background Paper(s)

Relevant Paragraph of the Access to Information Procedure Rules / Schedule 12A allowing document to be Exempt/Confidential (if applicable)

1.	None	
----	------	--

This page is intentionally left blank

## 2013/14 ECONOMIC BACKGROUND

At the beginning of the 2013-14 financial year markets were concerned about lacklustre growth in the Eurozone, the UK and Japan. Lack of growth in the UK economy, the threat of a 'triple-dip' alongside falling real wages (i.e. after inflation) and the paucity of business investment were a concern for the Bank of England's Monetary Policy Committee. Only two major economies – the US and Germany – had growth above pre financial crisis levels, albeit these were still below trend. The Eurozone had navigated through a turbulent period for its disparate sovereigns and the likelihood of a near-term disorderly collapse had significantly diminished. The US government had just managed to avoid the fiscal cliff and a technical default in early 2013, only for the problem to re-emerge later in the year.

With new Governor Mark Carney at the helm, the Bank of England unveiled forward guidance in August pledging to not consider raising interest rates until the ILO unemployment rate fell below the 7% threshold. In the Bank's initial forecast, this level was only expected to be reached in 2016. Although the Bank stressed that this level was a threshold for consideration of rate increase rather an automatic trigger, markets began pricing in a much earlier rise than was warranted and, as a result, gilt yields rose aggressively.

The recovery in the UK surprised with strong economic activity and growth. Q4 2014 GDP showed year-on-year growth of 2.7%. Much of the improvement was down to the dominant service sector, and an increase in household consumption buoyed by the pick-up in housing transactions which were driven by higher consumer confidence, greater availability of credit and strengthening house prices which were partly boosted by government initiatives such as Help-to-Buy. However, business investment had yet to recover convincingly and the recovery was not accompanied by meaningful productivity growth. Worries of a housing bubble were tempered by evidence that net mortgage lending was up by only around 1% annually.

CPI fell from 2.8% in March 2013 to 1.7% in February 2014, the lowest rate since October 2009, helped largely by the easing commodity prices and discounting by retailers, reducing the pressure on the Bank to raise rates. Although the fall in unemployment (down from 7.8% in March 2013 to 7.2% in January 2014) was faster than the Bank of England or indeed many analysts had forecast, it hid a stubbornly high level of underemployment. Importantly, average earnings growth remained muted and real wage growth (i.e. after inflation) was negative. In February the Bank stepped back from forward guidance relying on a single indicator – the unemployment rate – to more complex measures which included spare capacity within the economy. The Bank also implied that when official interest rates were raised, the increases would be gradual – this helped underpin the 'low for longer' interest rate outlook despite the momentum in the economy.

The Office of Budget Responsibility's 2.7% forecast for economic growth in 2014 forecast a quicker fall in public borrowing over the next few years. However, the Chancellor resisted the temptation to spend some of the proceeds of higher economic growth. In his 2013 Autumn Statement and the 2014 Budget, apart from the rise in the personal tax allowance and pension changes, there were no significant giveaways and the coalition's austerity measures remained on track.

The Federal Reserve's then Chairman Ben Bernanke's announcement in May that the Fed's quantitative easing (QE) programme may be 'tapered' caught markets by surprise. Investors began to factor in not just an end to QE but also rapid rises in interest rates. 'Tapering' (a slowing in the rate of QE) began in December 2013. By March 2014, asset purchases had been cut from \$75bn to \$55bn per month with expectation that QE would end by October 2014. This had particular implications for global markets which had hitherto benefited from, and got very accustomed to, the high levels of global liquidity afforded by QE. The impact went further than a rise in the dollar and higher US treasury bond yields. Gilt yields also rose as a consequence and emerging markets, which had previously benefited as investors searched for yield through riskier asset, suffered large capital outflows in December and January.

With the Eurozone struggling to show sustainable growth, the European Central Bank cut main policy interest rates by 0.25% to 0.25% and the deposit rate to zero. Markets were disappointed by the lack of action by the ECB despite CPI inflation below 1% and a looming threat of deflation. Data pointed to an economic slowdown in China which, alongside a weakening property market and a highly leveraged shadow banking sector, could prove challenging for its authorities.

Russia's annexation of the Ukraine in March heightened geopolitical tensions and risk. The response from the West which began with sanctions against Russia which is the second largest gas producer in the world and which supplies nearly 30% of European natural gas needs and is also a significant supplier of crude oil – any major disruption to their supply would have serious ramifications for energy prices.

**Gilt Yields and Money Market Rates:** Gilt yields ended the year higher than the start in April. The peak in yields was during autumn 2013. The biggest increase was in 5-year gilt yields which increased by nearly 1.3% from 0.70% to 1.97%. 10-year gilt yields rose by nearly 1% ending the year at 2.73%. The increase was less pronounced for longer dated gilts; 20-year yields rose from 2.74% to 3.37% and 50-year yields rose from 3.23% to 3.44%.

3-month, 6-month and 12-month Libid rates remained at levels below 1% through the year.

## SUMMARY OF INTEREST RATES MOVEMENT DURING 2013

The average, minimum and maximum rates quoted in the tables below correspond to the rates during the financial year rather than those in the tables below which are for specific dates.

**Table 1: Bank Rate, Money Market Rates**

Date	Bank Rate	O/N LIBID	7-day LIBID	1-month LIBID	3-month LIBID	6-month LIBID	12-month LIBID	2-yr SWAP Bid	3-yr SWAP Bid	5-yr SWAP Bid
01/04/2013	0.50	0.40	0.50	0.40	0.44	0.51	0.75	0.59	0.68	0.97
30/04/2013	0.50	0.50	0.47	0.40	0.44	0.51	0.75	0.57	0.64	0.91
31/05/2013	0.50	0.38	0.42	0.40	0.44	0.51	0.75	0.68	0.82	1.15
30/06/2013	0.50	0.43	0.38	0.40	0.44	0.51	0.75	0.78	0.99	1.52
31/07/2013	0.50	0.42	0.50	0.40	0.44	0.51	0.75	0.68	0.86	1.39
31/08/2013	0.50	0.43	0.41	0.41	0.44	0.51	0.76	0.81	1.10	1.71
30/09/2013	0.50	0.38	0.38	0.41	0.44	0.51	0.76	0.83	1.12	1.73
31/10/2013	0.50	0.38	0.38	0.42	0.45	0.53	0.80	0.79	1.07	1.66
30/11/2013	0.50	0.38	0.36	0.42	0.45	0.54	0.81	0.80	1.11	1.76
31/12/2013	0.50	0.35	0.35	0.42	0.45	0.54	0.81	1.00	1.43	2.13
31/01/2014	0.50	0.36	0.41	0.42	0.45	0.55	0.82	0.94	1.34	1.95
28/02/2014	0.50	0.36	0.40	0.42	0.45	0.60	0.83	0.98	1.34	1.95
31/03/2014	0.50	0.35	0.39	0.42	0.46	0.56	0.84	1.05	1.45	2.03
Minimum	0.50	0.30	0.35	0.40	0.44	0.51	0.75	0.55	0.62	0.87
Average	0.50	0.40	0.41	0.41	0.45	0.53	0.78	0.81	1.08	1.63
Maximum	0.50	0.50	0.50	0.45	0.53	0.65	0.84	1.05	1.47	2.17
Spread	--	0.20	0.15	0.05	0.09	0.14	0.09	0.5	0.85	1.29

**Table 2: PWLB Borrowing Rates – Fixed Rate, Maturity Loans (Standard Rate)**

Change Date	Notice No	1 year	4½-5 yrs	9½-10 yrs	19½-20 yrs	29½-30 yrs	39½-40 yrs	49½-50 yrs
02/04/2013	125/13	1.11	1.74	2.83	3.87	4.18	4.25	4.22
30/04/2013	166/13	1.16	1.72	2.72	3.74	4.06	4.13	4.08
31/05/2013	208/13	1.26	1.97	3.03	3.99	4.29	4.36	4.33
30/06/2013	248/13	1.22	2.34	3.49	4.30	4.52	4.56	4.54
31/07/2013	293/13	1.21	2.22	3.43	4.29	4.50	4.52	4.50
31/08/2013	335/13	1.28	2.53	3.74	4.43	4.54	4.54	4.53
30/09/2013	377/13	1.30	2.50	3.66	4.36	4.49	4.50	4.48
31/10/2013	423/13	1.29	2.43	3.55	4.27	4.42	4.42	4.40
30/11/2013	465/13	1.34	2.60	3.78	4.47	4.57	4.55	4.53
31/12/2013	503/13	1.38	2.96	4.08	4.60	4.64	4.61	4.59
31/01/2014	044/14	1.36	2.75	3.77	4.39	4.49	4.45	4.43
28/02/2014	084/14	1.37	2.76	3.78	4.39	4.49	4.47	4.45
31/03/2014	126/14	1.46	2.87	3.84	4.43	4.53	4.51	4.49
Low		1.11	1.70	2.71	3.71	4.02	4.08	4.04
Average		1.30	2.46	3.58	4.32	4.48	4.49	4.46
High		1.46	3.00	4.11	4.63	4.71	4.72	4.71

**Table 3: PWLB Repayment Rates - Fixed Rate, Maturity Loans**

Change Date	Notice No	1 year	4½-5 yrs	9½-10 yrs	19½-20 yrs	29½-30 yrs	39½-40 yrs	49½-50 yrs
02/04/2013	125/13	0.02	0.51	1.62	2.72	3.05	3.13	3.09
30/04/2013	166/13	0.04	0.49	1.52	2.59	2.94	3.01	2.96
31/05/2013	208/13	0.14	0.73	1.82	2.84	3.16	3.24	3.21
30/06/2013	248/13	0.10	1.07	2.29	3.16	3.39	3.44	3.42
31/07/2013	293/12	0.09	0.95	2.22	3.16	3.37	3.40	3.38
31/08/2013	335/12	0.16	1.25	2.53	3.30	3.42	3.42	3.41
30/09/2013	377/12	0.18	1.23	2.46	3.23	3.37	3.38	3.36
31/10/2013	423/13	0.17	1.16	2.36	3.14	3.30	3.30	3.28
30/11/2013	465/13	0.22	1.31	2.58	3.34	3.45	3.43	3.41
31/12/2013	503/13	0.26	1.67	2.89	3.47	3.52	3.49	3.47
31/01/2014	044/13	0.24	1.47	2.58	3.26	3.37	3.33	3.31
28/02/2014	084/14	0.25	1.49	2.60	3.26	3.37	3.35	3.33
31/03/2014	126/13	0.34	1.60	2.65	3.29	3.41	3.39	3.37
	Low	0.02	0.48	1.51	2.56	2.89	2.96	2.92
	<b>Average</b>	0.18	1.19	2.38	3.18	3.35	3.36	3.34
	High	0.34	1.70	2.92	3.50	3.59	3.60	3.59

**Table 4: PWLB Borrowing Rates – Fixed Rate, EIP Loans (Standard Rate)**

Change Date	Notice No	4½-5 yrs	9½-10 yrs	19½-20 yrs	29½-30 yrs	39½-40 yrs	49½-50 yrs
02/04/2013	125/13	1.30	1.80	2.87	3.52	3.88	4.08
30/04/2013	166/13	1.31	1.77	2.76	3.39	3.75	3.96
31/05/2013	208/13	1.49	2.02	3.07	3.67	4.00	4.19
30/06/2013	248/13	1.66	2.41	3.53	4.05	4.30	4.45
31/07/2013	293/13	1.58	2.29	3.47	4.04	4.30	4.44
31/08/2013	335/13	1.78	2.61	3.77	4.26	4.44	4.51
30/09/2013	377/13	1.79	2.58	3.69	4.17	4.37	4.45
31/10/2013	423/13	1.74	2.51	3.59	4.07	4.28	4.38
30/11/2013	465/13	1.84	2.67	3.81	4.29	4.48	4.55
31/12/2013	503/13	2.10	3.04	4.11	4.48	4.60	4.64
31/01/2014	044/14	1.98	2.82	3.80	4.21	4.40	4.47
28/02/2014	084/14	2.00	2.84	3.81	4.21	4.40	4.47
31/03/2014	126/14	2.11	2.94	3.87	4.26	4.43	4.51
	Low	1.29	1.76	2.75	3.37	3.72	3.91
	<b>Average</b>	1.77	2.53	3.61	4.10	4.32	4.43
	High	2.13	3.08	4.14	4.51	4.63	4.69

**Table 5: PWLB Repayment Rates - Fixed Rate, EIP Loans**

Change Date	Notice No	4½-5 yrs	9½-10 yrs	19½-20 yrs	29½-30 yrs	39½-40 yrs	49½-50 yrs
02/04/2013	125/13	0.14	0.62	1.71	2.38	2.75	2.95
30/04/2013	166/13	0.16	0.60	1.60	2.25	2.62	2.83
31/05/2013	208/13	0.33	0.85	1.91	2.53	2.87	3.06
30/06/2013	248/13	0.47	1.22	2.37	2.91	3.18	3.32
31/07/2013	293/13	0.39	1.10	2.31	2.90	3.17	3.31
31/08/2013	335/13	0.58	1.41	2.62	3.12	3.31	3.39
30/09/2013	377/13	0.59	1.38	2.54	3.04	3.24	3.33
31/10/2013	423/13	0.55	1.31	2.43	2.94	3.15	3.26
30/11/2013	465/13	0.64	1.48	2.66	3.15	3.35	3.43
31/12/2013	503/13	0.87	1.84	2.96	3.35	3.48	3.52
31/01/2014	044/14	0.77	1.63	2.65	3.08	3.27	3.35
28/02/2014	084/14	0.78	1.64	2.66	3.08	3.27	3.35
31/03/2014	126/14	0.90	1.75	2.72	3.12	3.31	3.39
	Low	0.13	0.58	1.59	2.23	2.59	2.79
	Average	0.58	1.34	2.46	2.97	3.20	3.31
	High	0.90	1.88	2.99	3.38	3.51	3.56

**Table 6: PWLB Variable Rates**

	1-M Rate	3-M Rate	6-M Rate	1-M Rate	3-M Rate	6-M Rate
	Pre-CSR			Post-CSR (Standard Rate)		
02/04/2013	0.5700	0.5600	0.5500	1.4700	1.4600	1.4500
28/06/2013	0.5600	0.5600	0.5600	1.4600	1.4600	1.4600
30/09/2013	0.5700	0.5700	0.5700	1.4700	1.4700	1.4700
31/12/2013	0.5700	0.5700	0.5700	1.4700	1.4700	1.4700
31/03/2014	0.5500	0.5600	0.5700	1.4500	1.4600	1.4700
Low	0.5500	0.5500	0.5400	1.4500	1.4500	1.4400
Average	0.5653	0.5641	0.5630	1.4653	1.4641	1.4630
High	0.5800	0.5700	0.5800	1.4700	1.4700	1.4800

This page is intentionally left blank

**COMPLIANCE WITH PRUDENTIAL INDICATORS DURING 2013/14**

The Local Government Act 2003 requires the Authority to have regard to the Chartered Institute of Public Finance and Accountancy's Prudential Code for Capital Finance in Local Authorities (the Prudential Code) when determining how much money it can afford to borrow. The objectives of the Prudential Code are to ensure, within a clear framework, that the capital investment plans of local authorities are affordable, prudent and sustainable, and that treasury management decisions are taken in accordance with good professional practice. To demonstrate that the Authority has fulfilled these objectives, the Prudential Code sets out the following indicators that must be set and monitored each year.

The Council complied with all of its Prudential Indicators. Details of the performance against key indicators are shown below:

**1. Gross Debt and the Capital Financing Requirement**

This is a key indicator of prudence. In order to ensure that over the medium term debt will only be for a capital purpose, the local 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. If in any of these years there is a reduction in the CFR, this reduction is ignored in estimating the cumulative increase in the CFR which is used for comparison with gross external debt. The CFO reports that the Authority had no difficulty meeting this requirement in 2013/14, nor are there any difficulties envisaged for future years. This view takes into account current commitments, existing plans and the proposals in the approved budget.

There is a significant difference between the gross external borrowing requirement and the net external borrowing requirement represented by the Council's level of balances, reserves, provisions and working capital. The Council's current strategy is only to borrow to the level of its net borrowing requirement. The reasons for this are to reduce credit risk, take pressure off the Council's lending list and also to avoid the cost of carry existing in the current interest rate environment. The tables below details our expected debt position and the year-on-year change to the CFR:

	2013/14 Approved	2013/14 Actual	2014/15 Current Estimate	2015/16 Current Estimate	2016/17 Current Estimate
	£M	£M	£M	£M	£M
Borrowing	184.9	188.2	182.5	179.2	172.9
Finance leases and Private Finance Initiative	61.9	61.9	66.9	64.7	62.0
Transferred debt	16.3	16.3	15.6	15.0	14.4
<b>Total General Fund Debt</b>	<b>263.1</b>	<b>266.4</b>	<b>265.0</b>	<b>258.9</b>	<b>249.3</b>
HRA	167.1	158.6	182.3	182.7	187.6
<b>Total</b>	<b>430.2</b>	<b>425.0</b>	<b>447.3</b>	<b>441.6</b>	<b>436.9</b>

Capital Financing Requirement	2013/14 Approved £M	2013/14 Actual £M	2014/15 Current Estimate £M	2015/16 Current Estimate £M	2016/17 Current Estimate £M
<b>Balance B/F</b>	<b>433.2</b>	<b>433.2</b>	<b>425.0</b>	<b>447.3</b>	<b>441.6</b>
Capital expenditure financed from borrowing (inc PFI)					
<i>General Fund (GF)</i>	11.7	10.8	11.7	3.8	1.1
<i>HRA</i>	8.9	0.0	29.0	5.7	10.2
GF Temporary Funding (Repayment)	(5.9)	(5.8)	(3.7)	0.0	0.0
HRA Voluntary Repayment of Debt	(5.6)	(5.6)	(5.3)	(5.3)	(5.3)
GF Revenue provision for debt Redemption.	(9.0)	(4.5)	(6.9)	(7.1)	(7.4)
Movement in Other Long Term Liabilities	(3.1)	(3.1)	(2.5)	(2.8)	(3.3)
<b>Cumulative Maximum External Borrowing Requirement</b>	<b>430.2</b>	<b>425.0</b>	<b>447.3</b>	<b>441.6</b>	<b>436.9</b>

## 2. Authorised Limit and Operational Boundary for External Debt

The Operational Boundary for External Debt is based on the Authority's estimate of most likely, i.e. prudent, but not worst case scenario for external debt. It links directly to the Authority's estimates of capital expenditure, the capital financing requirement and cash flow requirements and is a key management tool for in-year monitoring. Other long-term liabilities comprise finance lease, Private Finance Initiative and other liabilities that are not borrowing but form part of the Authority's debt.

The Authorised Limit for External Debt 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.

The Chief Financial Officer confirms that there were no breaches to the Authorised Limit and the Operational Boundary during 2013/14; borrowing at its peak was £310M.

## 3. Upper Limits for Fixed Interest Rate Exposure and Variable Interest Rate

### Exposure

These indicators allow the Council to manage the extent to which it is exposed to changes in interest rates. The upper limit for variable rate exposure allows for the use of variable rate debt to offset exposure to changes in short-term rates on our portfolio of investments.

	Limits for 2013/14 (%)	Maximum during 2013/14 (%)
Upper Limit for Fixed Rate Exposure	100	84
Compliance with Limits:	Yes	Yes
Upper Limit for Variable Rate Exposure	50	16
Compliance with Limits:	Yes	Yes

#### 4. Total Principal Sums Invested for Periods Longer Than 364 days

This indicator allows the Council to manage the risk inherent in investments longer than 364 days and the limit is set at £30M. In 2013/14 the actual principal sum invested for periods longer than 364 days peaked at £25M, (compared to £13M in 2012/13). This was higher than the previous year due to the reintroduction of the rolling yearly programme of investments.

#### 5. Maturity Structure of Fixed Rate Borrowing

This indicator highlights the existence of any large concentrations of fixed rate debt needing to be replaced at times of uncertainty over interest rates and is designed to protect against excessive exposures to interest rate changes in any one period. This table is not directly comparable to the information shown in paragraph 38 of the main report which for accounting conventions splits out EIP loans in the early period and not the maturity date.

	Lower Limit	Upper Limit	Actual Fixed Debt as at 31/3/2014	Average Fixed Rate as at 31/3/2014	% of Fixed Rate as at 31/3/2014	Compliance with set Limits?
	%	%	£M	%		
Under 12 months	0	45	10	0.95	4.51	Yes
12 months and within 24	0	45	0	0.00	0.00	Yes
24 months and within 5 years	0	50	0	0.00	0.00	Yes
5 years and within 10 years	0	75	81	3.23	35.17	Yes
10 years and within 15 years	0	75	0	0.00	0.00	Yes
15 years and within 20 years	0	75	0	0.00	0.00	Yes
20 years and within 25 years	0	75	0	0.00	0.00	Yes
25 years and within 30 years	0	75	10	4.68	4.34	Yes
30 years and within 35 years	0	75	5	4.60	2.17	Yes
35 years and within 40 years	0	75	42	3.99	18.25	Yes
40 years and within 45 years	0	75	51	3.62	21.98	Yes
45 years and within 50 years	0	75	31	3.56	13.57	Yes
50 years and above	0	100	0	0.00	0.00	Yes
			<b>230</b>	<b>3.32</b>	<b>100.00</b>	

Please note: the TM Code Guidance Notes (Page 15) states: "The maturity of borrowing should be determined by reference to the earliest date on which the lender can require payment. If the lender has the right to increase the interest rate payable without limit, such as in a LOBO loan, this should be treated as a right to require payment". For this indicator, the next option dates on the Council LOBO loans will therefore determine the maturity date of the loans.

#### 6. Capital Expenditure

This indicator is set to ensure that the level of proposed capital expenditure remains within sustainable limits, and, in particular, to consider the impact on Council tax and in the case of the HRA, housing rent levels.

Capital Expenditure	2013/14 Approved £000's	2013/14 Actual £000's	2014/15 Approved £000's	2015/16 Approved £000's
General Fund	47,034	41,094	56,141	20,308
HRA	31,196	30,587	53,399	37,018
<b>Total</b>	<b>78,230</b>	<b>71,681</b>	<b>109,540</b>	<b>57,326</b>

Capital expenditure has been and will be financed or funded as follows:

Capital Financing	2013/14 Approved £000's	2013/14 Actual £000's	2014/15 Approved £000's	2015/16 Approved £000's
Capital receipts	17,758	11,485	12,277	9,675
Government Grants	30,946	30,033	33,388	11,481
Contributions	3,519	2,827	13,574	1,895
Major Repairs Allowance	17,172	18,261	17,931	18,317
Revenue	8,471	11,449	12,339	9,758
<b>Total Financing</b>	<b>77,866</b>	<b>74,055</b>	<b>89,509</b>	<b>51,126</b>
Unsupported borrowing	6,224	3,376	23,431	6,200
<b>Total Funding</b>	<b>84,090</b>	<b>77,431</b>	<b>112,940</b>	<b>57,326</b>
Temporary Financing (Repayment)	(5,860)	(5,750)	(3,400)	0
<b>Total Financing &amp; Funding</b>	<b>78,230</b>	<b>71,681</b>	<b>109,540</b>	<b>57,326</b>

## 7. Ratio of Financing Costs to Net Revenue Stream

This is an indicator of affordability and highlights the revenue implications of existing and proposed capital expenditure by identifying the proportion of the revenue budget required to meet borrowing costs. The definition of financing costs is set out at paragraph 87 of the Prudential Code. The ratio is based on costs net of investment income. The upper limit for this ratio is currently set at 10% for the General Fund to allow for known borrowing decision in the next two years and to allow for additional borrowing affecting major schemes. The table below shows the likely position based on the approved capital programme adjusted for actual borrowing made in year.

This indicator is not so relevant for the HRA, especially since the introduction of self financing, as financing costs have been built into their 30 year business plan, including the voluntary payment of MRP. No problem is seen with the affordability but if problems were to arise then the HRA would have the option not to make principle repayments in the early years.

Ratio of Financing Costs to Net Revenue Stream	2013/14 Approved %	2013/14 Revised %	2013/14 Actual %	2014/15 Estimate %	2015/16 Estimate %
General Fund	6.78	6.98	6.77	6.77	8.20
HRA	17.51	17.51	16.81	15.68	16.48
<b>Total</b>	<b>10.43</b>	<b>10.32</b>	<b>10.27</b>	<b>10.07</b>	<b>11.73</b>

## 8. Adoption of the CIPFA Treasury Management Code

This indicator demonstrates that the authority adopted the principles of best practice.

<p>The Authority adopted the Chartered Institute of Public Finance and Accountancy's <i>Treasury Management Code</i> on 19 February 2003 and has subsequently agreed further updates.</p>
---

## 9. HRA Limit on Indebtedness

Local authorities are required to report the level of the HRA CFR compared to the level of debt which is imposed (or subsequently amended) by the DCLG at the time of implementation of self-financing.

HRA Summary of Borrowing	2013/14 Revised £M	2013/14 Actual £M	2014/15 Approved £M	2015/16 Approved £M
Brought Forward	163.8	163.8	167.1	191
Maturing Debt	(5.6)	(5.6)	(5.1)	(5.1)
New borrowing and transfer from General Fund	8.9	0.4	29.0	5.0
<b>Carried forward</b>	<b>167.1</b>	<b>158.6</b>	<b>191.0</b>	<b>190.9</b>
HRA Debt Cap (as prescribed by CLG)	199.6	199.6	199.6	199.6
<b>Headroom</b>	<b>32.5</b>	<b>41.0</b>	<b>8.6</b>	<b>8.7</b>

## 10. Summary

As indicated in this report none of the Prudential Indicators have been breached.

This page is intentionally left blank

## GLOSSARY OF TREASURY TERMS

### **Authorised Limit (Also known as the Affordable Limit):**

A statutory limit that sets the maximum level of external borrowing on a gross basis (i.e. not net of investments) for the Council. It is measured on a daily basis against all external borrowing items on the Balance Sheet (i.e. long and short term borrowing, overdrawn bank balances and long term liabilities).

### **Balances and Reserves:**

Accumulated sums that are maintained either earmarked for specific future costs or commitments or generally held to meet unforeseen or emergency expenditure.

### **Bank Rate:**

The official interest rate set by the Bank of England's Monetary Policy Committee and what is generally termed at the "base rate". This rate is also referred to as the 'repo rate'.

### **Basis Point:**

A unit of measure used in finance to describe the percentage change in the value or rate of a financial instrument. One basis point is equivalent to 0.01% (1/100th of a percent). In most cases, it refers to changes in **interest rates** and **bond yields**. For example, if interest rates rise by 25 basis points, it means that rates have risen by 0.25% percentage points. If rates were at 2.50%, and rose by 0.25%, or 25 basis points, the new interest rate would be 2.75%. In the bond market, a basis point is used to refer to the yield that a bond pays to the investor. For example, if a bond yield moves from 5.45% to 5.65%, it is said to have risen by 20 basis points. The usage of the basis point measure is primarily used in respect to yields and interest rates, but it may also be used to refer to the percentage change in the value of an asset such as a stock.

### **Bond:**

A certificate of debt issued by a company, government, or other institution. The bond holder receives interest at a rate stated at the time of issue of the bond. The price of a bond may vary during its life.

### **Capital Expenditure:**

Expenditure on the acquisition, creation or enhancement of capital assets.

### **Capital Financing Requirement (CFR):**

The CFR is simply the total historic outstanding capital expenditure which has not yet been paid for from either revenue or capital resources. It is essentially a measure of the Council's underlying borrowing need.

### **Capital Receipts:**

Money obtained on the sale of a capital asset.

### **CD's:**

Certificates of Deposits with banks and building societies

**Comprehensive Spending Review (CSR):**

Comprehensive Spending Review is a governmental process in the United Kingdom carried out by **HM Treasury** to set firm expenditure limits and, through public service agreements, define the key improvements that the public can expect from these resources. Spending Reviews typically focus upon one or several aspects of public spending while the CSR focuses upon each government department's spending requirements from a zero base (i.e. without reference to past plans or, initially, current expenditure).

**Constant Net Asset Value (CNAV)**

These are Money Market Funds which maintain a stable price of £1 per share when investors redeem or purchase shares which mean that that any investment will not fluctuate in value.

**Corporate Bonds:**

Corporate bonds are bonds issued by companies. The term is often used to cover all bonds other than those issued by governments in their own currencies and includes issues by companies, supranational organisations and government agencies.

**Cost of Carry:**

The "cost of carry" is the difference between what is paid to borrow compared to the interest which could be earned. For example, if one takes out borrowing at 5% and invests the money at 1.5%, there is a cost of carry of 3.5%.

**Counterparty List:**

List of approved financial institutions with which the Council can place investments with.

**CPI :**

Consumer Price Index – the UK's main measure of inflation.

**Credit Rating:**

Formal opinion by a registered rating agency of a counterparty's future ability to meet its financial liabilities; these are opinions only and not guarantees.

**Department for Communities and Local Government (DCLG) :**

The DCLG is the UK Government department for Communities and Local Government in England. It was established in May 2006 and is the successor to the Office of the Deputy Prime Minister, established in 2001.

**Debt Management Office (DMO):**

The DMO is an Executive Agency of Her Majesty's Treasury and provides direct access for local authorities into a government deposit facility known as the **DMADF**. All deposits are guaranteed by HM Government and therefore have the equivalent of a sovereign triple-A credit rating.

**Diversification /diversified exposure:**

The spreading of investments among different types of assets or between markets in order to reduce risk.

**Federal Reserve:**

The US central bank. (Often referred to as "the Fed").

**FTSE 100 Index:**

The FTSE 100 Index is a share index of the 100 companies listed on the London Stock Exchange with the highest market capitalisation. It is one of the most widely used stock indices and is seen as a gauge of business prosperity for business regulated by UK company law. The index is maintained by the FTSE Group, a subsidiary of the London Stock Exchange Group.

**General Fund:**

This includes most of the day-to-day spending and income.

**Gilts:**

Gilts are bonds issued by the UK Government. They take their name from 'gilt-edged': being issued by the UK government, they are deemed to be very secure as the investor expects to receive the full face value of the bond to be repaid on maturity.

**Gross Domestic Product (GDP):**

Gross Domestic Product measures the value of goods and services produced within a country. GDP is the most comprehensive overall measure of economic output and provides key insight as to the driving forces of the economy.

**The G7:**

The G7, is a group consisting of the finance ministers of seven industrialised nations: namely the US, UK, France, Germany, Italy, Canada and Japan. They are seven of the eight (China excluded) wealthiest nations on Earth, not by GDP but by global net wealth. The G7 represents more than the 66% of net global wealth (\$223 trillion), according to Credit Suisse Global Wealth Report September 2012.

**IFRS:**

International Financial Reporting Standards.

**International Labour Organisation (ILO):**

The ILO Unemployment Rate refers to the percentage of economically active people who are unemployed by ILO standard and replaced the Claimant Unemployment Rate as the international standard for unemployment measurement in the UK. Under the ILO approach, those who are considered as unemployed are either out of work but are actively looking for a job or out of work and are waiting to start a new job in the next two weeks. ILO Unemployment Rate is measured by a monthly survey, which is called the Labour Force Survey in United Kingdom. Approximately 40,000 individuals are interviewed each month, and the unemployment figure reported is the average data for the previous three months.

**LIBID:**

The London Interbank Bid Rate (LIBID) is the rate bid by banks on Eurocurrency deposits (i.e. the rate at which a bank is willing to borrow from other banks). It is "the opposite" of the LIBOR (an offered, hence "ask" rate, the rate at which a bank will lend). Whilst the British Bankers' Association set LIBOR rates, there is no correspondent official LIBID fixing.

**LIBOR:**

The London Interbank Offered Rate (LIBOR) is the rate of interest that banks charge to lend money to each other. The British Bankers' Association (BBA) work with a small group of large banks to set the LIBOR rate each day. The wholesale markets allow banks who need money to be more fluid in the marketplace to borrow from those with surplus amounts. The

banks with surplus amounts of money are keen to lend so that they can generate interest which it would not otherwise receive.

**LOBO:**

Stands for Lender Option Borrower Option. The underlying loan facility is typically very long-term - for example 40 to 60 years - and the interest rate is fixed. However, in the LOBO facility the lender has the option to call on the facilities at pre-determined future dates. On these call dates, the lender can propose or impose a new fixed rate for the remaining term of the facility and the borrower has the 'option' to either accept the new imposed fixed rate or repay the loan facility. The upshot of this is that on the option exercise date, the lender could propose an extreme fixed rate, say 20 per cent, which would effectively force the repayment of the underlying facility. The borrower's so called 'option' is only the inalienable right to accept or refuse a new deal such as a fixed rate of 20 per cent.

**Maturity:**

The date when an investment or borrowing is repaid.

**Maturity Structure / Profile:**

A table or graph showing the amount (or percentage) of debt or investments maturing over a time period. The amount or percent maturing could be shown on a year-by-year or quarter-by-quarter or month-by-month basis.

**Minimum Revenue Provision (MRP):**

An annual provision that the Council is statutorily required to set aside and charge to the Revenue Account for the repayment of debt associated with expenditure incurred on capital assets.

**Money Market Funds (MMF):**

Pooled funds which invest in a range of short term assets providing high credit quality and high liquidity.

**Multilateral Development Banks:**

See Supranational Bonds below.

**Non Specified Investment:**

Investments which fall outside the CLG Guidance for **Specified investments** (below).

**Operational Boundary:**

This linked directly to the Council's estimates of the CFR and estimates of other day to day cash flow requirements. This indicator is based on the same estimates as the Authorised Limit reflecting the most likely prudent but not worst case scenario but without the additional headroom included within the Authorised Limit.

**Premiums and Discounts:**

In the context of local authority borrowing,

(a) the premium is the penalty arising when a loan is redeemed prior to its maturity date and

(b) the discount is the gain arising when a loan is redeemed prior to its maturity date.

If on a £1 million loan, it is calculated that a £150,000 premium is payable on premature redemption, then the amount paid by the borrower to redeem the loan is £1,150,000 plus

accrued interest. If on a £1 million loan, it is calculated\* that a £50,000 discount receivable on premature redemption, then the amount paid by the borrower to redeem the loan is £950,000 plus accrued interest. PWLB premium/discount rates are calculated according to the length of time to maturity, current market rates (plus a margin), and the existing loan rate which then produces a premium/discount dependent on whether the discount rate is lower/higher than the coupon rate.

*\*The calculation of the total amount payable to redeem a loan borrowed from the Public Works Loans Board (PWLB) is the present value of the remaining payments of principal and interest due in respect of the loan being repaid prematurely, calculated on normal actuarial principles. More details are contained in the PWLB's lending arrangements circular.*

**Prudential Code:**

Developed by CIPFA and introduced on 01/4/2004 as a professional code of practice to support local authority capital investment planning within a clear, affordable, prudent and sustainable framework and in accordance with good professional practice.

**Prudential Indicators:**

Indicators determined by the local authority to define its capital expenditure and asset management framework. They are designed to support and record local decision making in a manner that is publicly accountable; they are not intended to be comparative performance indicators

**Public Works Loans Board (PWLB):**

This is a statutory body operating within the United Kingdom Debt Management Office, an Executive Agency of HM Treasury. The PWLB's function is to lend money from the National Loans Fund to local authorities and other prescribed bodies, and to collect the repayments.

**Quantitative Easing (QE):**

In relation to the UK, it is the process used by the Bank of England to directly increase the quantity of money in the economy. It *“does not involve printing more banknotes. Instead, the Bank buys assets from private sector institutions – that could be insurance companies, pension funds, banks or non-financial firms – and credits the seller’s bank account. So the seller has more money in their bank account, while their bank holds a corresponding claim against the Bank of England (known as reserves). The end result is more money out in the wider economy”*. Source: Bank of England.

**Repo Rate:**

The interest rate at which the central bank in a country repurchases government securities (such as Treasury securities) from commercial banks. The central bank raises the repo rate when it wishes to reduce the money supply in the short term, while it lowers the rate when it wishes to increase the money supply and stimulate growth.

**Revenue Expenditure:**

Expenditure to meet the continuing cost of delivery of services including salaries and wages, the purchase of materials and capital financing charges.

**RPI:**

Retail Prices Index is a monthly index demonstrating the movement in the cost of living as it tracks the prices of goods and services including mortgage interest and rent. Pensions and index-linked gilts are uprated using the RPI index.

**(Short) Term Deposits:**

Deposits of cash with terms attached relating to maturity and rate of return (Interest).

**Specified Investments:**

Term used in the CLG Guidance and Welsh Assembly Guidance for Local Authority Investments. Investments that offer high security and high liquidity, in sterling and for no more than one year. UK government, local authorities and bodies that have a high credit rating.

**Supported Borrowing:**

Borrowing for which the costs are supported by the government or third party.

**Supranational Bonds:**

Instruments issued by supranational organisations created by governments through international treaties (often called **multilateral development banks**). The bonds carry a AAA rating in their own right. Examples of supranational organisations are the European Investment Bank, the International Bank for Reconstruction and Development.

**T-Bills:**

Treasury Bills are short term Government debt instruments and, just like temporary loans used by local authorities, are a means to manage cash flow. Treasury Bills (T-Bills) are issued by the Debt Management Office and are an eligible sovereign instrument, meaning that they have a AAA-rating.

**Temporary Borrowing:**

Borrowing to cover peaks and troughs of cash flow, not to fund capital spending.

**Treasury Management Code:**

CIPFA's Code of Practice for Treasury Management in the Public Services, initially brought in 2003, subsequently updated in 2009 and 2011.

**Treasury Management Practices (TMP):**

Treasury Management Practices set out the manner in which the Council will seek to achieve its policies and objectives and prescribe how it will manage and control these activities.

**Unsupported Borrowing:**

Borrowing which is self-financed by the local authority. This is also sometimes referred to as Prudential Borrowing.

**Variable Net Asset Value (VNAV):**

Redemptions and investments in Money Market Funds (MMF's) are on the basis of the fund's Net Asset Value (NAV) per share. The NAV of any money market fund is the market value of the fund's assets minus its liabilities and is stated on a per share basis. The net value of the assets held by an MMF can fluctuate, and the market value of a share may not always be exactly the amount that has been invested.

**Yield:**

The measure of the return on an investment instrument.

# Agenda Item 8

<b>DECISION-MAKER:</b>	GOVERNANCE COMMITTEE			
<b>SUBJECT:</b>	ANNUAL GOVERNANCE STATEMENT 2013-14			
<b>DATE OF DECISION:</b>	14 JULY 2014			
<b>REPORT OF:</b>	CHIEF FINANCIAL OFFICER			
<b><u>CONTACT DETAILS</u></b>				
<b>AUTHOR:</b>	<b>Name:</b>	Peter Rogers	<b>Tel:</b>	023 8083 2835
	<b>E-mail:</b>	<a href="mailto:peter.rogers@southampton.gov.uk">peter.rogers@southampton.gov.uk</a>		
<b>Director</b>	<b>Name:</b>	Andy Lowe	<b>Tel:</b>	023 8083 2049
	<b>E-mail:</b>	<a href="mailto:andrew.lowe@southampton.gov.uk">andrew.lowe@southampton.gov.uk</a>		

## STATEMENT OF CONFIDENTIALITY

N/A

## BRIEF SUMMARY

In accordance with the Accounts and Audit Regulations the Council is required to develop and publish an Annual Governance Statement ('AGS'). The AGS is intended to provide an accurate representation of the corporate governance arrangements in place during the year and identify or highlight any significant gaps or areas where improvements are required.

Although the AGS does not need to be approved until 30 September, CIPFA recommends that Audit [Governance] Committees are provided with sight of an early draft in order to provide opportunity for comments and contributions to be made.

## RECOMMENDATIONS:

The Governance Committee is asked to:

- (i) Review the draft 2013-14 AGS (Appendix 1);
- (ii) Note the status of the 2012-13 Action Plan (Appendix 2).

## REASONS FOR REPORT RECOMMENDATIONS

1. The Governance Committee has responsibility to provide independent assurance on the adequacy of the risk management framework and the internal control and reporting environment, including (but not limited to) the reliability of the financial reporting process and the annual governance statement.
2. This responsibility extends to receiving, reviewing and approving the draft AGS.

## ALTERNATIVE OPTIONS CONSIDERED AND REJECTED

3. No alternative options have been considered

## **DETAIL (Including consultation carried out)**

4. Regulation 4(3) of the Accounts and Audit (England) Regulations 2011 requires that the relevant body must conduct a review at least once a year of the effectiveness of its system of internal control and to prepare a statement on internal control in accordance with proper practices.
5. Under the 2011 Regulations, the AGS must be approved by 30 September however CIPFA has recently recommended that “the AGS is first reviewed by members of the audit [governance] committee at an earlier stage to allow comments and contributions to be made. The AGS must be current at the time it is published, so the audit [governance] committee should review it again in September”.
6. The AGS is produced following a review of the systems and processes that comprise the council’s governance arrangements. This review, based on CIPFA /SOLACE guidance, is informed by an ‘assurance gathering process’. The key components of this process are completion of an ‘Assurance Framework’ document, which looks at overall governance framework, together with completion of ‘Self Assessment Statements’ by each Director. Both documents cover the key processes and systems that comprise the council’s governance arrangements and are intended to identify any areas where improvement or further development is required.
7. The draft AGS is then developed by a ‘Controls Assurance Management Group’ (comprising the Section 151 Officer, Chair of the Governance Committee, Monitoring Officer, Assistant Chief Executive and Chief Internal Auditor) which has responsibility for evaluating the assurances and supporting evidence and for drafting the AGS.
8. The draft AGS has also been reviewed by the ‘Council Management Team’ on 17th June 2014.
9. The AGS must be current at the time it is published so the Governance Committee will be invited to review the final draft AGS again in September, prior to the document being signed by the Leader of the Council and the Chief Executive.

## **RESOURCE IMPLICATIONS**

### **Capital/Revenue**

10. None

### **Property/Other**

11. None

## LEGAL IMPLICATIONS

### Statutory power to undertake proposals in the report:

12. The Accounts and Audit (England) Regulations 2011 require the Council to adopt Good Governance arrangements in respect of the discharge of its functions. The above arrangements are intended to meet those responsibilities.

### Other Legal Implications:

13. None

## POLICY FRAMEWORK IMPLICATIONS

14. None

KEY DECISION? No

WARDS/COMMUNITIES AFFECTED:	none
-----------------------------	------

### SUPPORTING DOCUMENTATION

#### Appendices

1.	Draft Annual Governance Statement 2013-14
2.	AGS 2012-13 Action Plan - Status Report

#### Documents In Members' Rooms

1.	n/a
Do the implications/subject of the report require an Equality Impact Assessment (EIA) to be carried out.	No

#### Other Background Documents

#### Equality Impact Assessment and Other Background documents available for inspection at:

Title of Background Paper(s)	Relevant Paragraph of the Access to Information Procedure Rules / Schedule 12A allowing document to be Exempt/Confidential (if applicable)
1. n/a	

This page is intentionally left blank

### **ANNUAL GOVERNANCE STATEMENT**

#### **SCOPE OF RESPONSIBILITY**

Southampton City Council (“the council”) is responsible for ensuring that its business is conducted in accordance with the law and proper standards, and that public money is safeguarded and properly accounted for, and used economically, efficiently and effectively. The council also has a duty under the Local Government Act 1999 to make arrangements to secure continuous improvement in the way in which its functions are exercised, having regard to a combination of economy, efficiency and effectiveness.

In discharging this overall responsibility, the council is responsible for putting in place proper arrangements for the governance of its affairs, and facilitating the effective exercise of its functions, which includes arrangements for the management of risk.

The council has approved and adopted a Code of Corporate Governance that is consistent with the principles of the CIPFA/SOLACE Framework ‘Delivering Good Governance in Local Government’. A copy of the code is on our website at <http://www.southampton.gov.uk/council-partners/decisionmaking/corporategovernance/> or can be obtained from the:

Head of Legal and Democratic Services,  
Southampton City Council,  
Civic Centre,  
Southampton,  
SO14 7LY

This statement explains how the council has complied with the code and also meets the requirements of the Accounts and Audit (England) Regulations 2011, regulation 4(3), which requires all relevant bodies to prepare an annual governance statement.

#### **THE PURPOSE OF THE GOVERNANCE FRAMEWORK**

The governance framework comprises the systems and processes, cultures and values by which the council is directed and controlled and its activities through which it accounts to, engages with and leads its communities. It enables the council to monitor the achievement of its strategic objectives and to consider whether those objectives have led to the delivery of appropriate services and value for money.

The system of internal control is a significant part of that framework and is designed to manage risk to a reasonable level. It cannot eliminate all risk of failure to achieve policies, aims and objectives and can therefore only provide reasonable and not absolute assurance of effectiveness. The system of internal control is based on an ongoing process designed to identify and prioritise the risks to the achievement of the council’s policies, aims and objectives, to evaluate the likelihood and potential impact of those risks being realised, and to manage them efficiently, effectively and economically.

The governance framework has been in place at the council for the year ended 31 March 2014 and up to the date of approval of the statement of accounts.

# ANNUAL GOVERNANCE STATEMENT

## THE GOVERNANCE FRAMEWORK

The key elements of the systems and processes that comprise the council's governance arrangements include arrangements for:

### a) Identifying and communicating the authority's vision of its purpose and intended outcomes for citizens and service users

Service delivery is guided by a framework of strategic plans and policies which are developed and agreed at three different levels:

- Sub-regional level, which cover more than one local authority;
- City level at 'Southampton Connect' and with our partners; and
- Council level for services which we deliver or commission.

The sub-regional level is through the Partnership for Urban South Hampshire ("PUSH") and the Solent Local Enterprise Partnership ("Solent LEP"). PUSH is a collaborative partnership working arrangement between the local authorities in the region to support the sustainable economic growth of the sub region and the Solent LEP is a locally-owned partnership between businesses and local authorities and seeks to play a central role in determining local economic priorities and undertaking activities to drive economic growth and the creation of local jobs.

Southampton Connect is the strategic partnership in the city which seeks to promote the city and to address the key challenges facing Southampton. This collaborative arrangement brings together the private, public and community and voluntary sectors to work together to tackle the key city challenges facing Southampton and improve outcomes for all those who live, work and visit the city. The 'Southampton Connect Plan for 2012-2015' is based on a single, comprehensive assessment of needs in the city (supported by resident feedback, a city profile and ward profiles) and sets out a vision for the city and a challenging programme of ten priority projects. This is currently being refreshed with the intention of developing and agreeing the 2014-2025 City Strategy in July 2014.

### b) Reviewing the authority's vision and its implications for the authority's governance arrangements

The Southampton City Council Plan (the "Council Plan") covers a 3 year period to 2016 and sets out, in one concise document, the council's priorities, challenges and opportunities for the forthcoming period. It was formally approved by Full Council in July 2013 and is reviewed annually. The new Council Strategy will be presented to Cabinet and Council in July 2014. This will take into consideration the feedback from the City Survey in March/April 2014 and the priorities detailed in the City Strategy to ensure that it continues to reflect the needs and aspirations of our customers, services users and communities.

The council has adopted a Code of Corporate Governance ("CCG") which identifies, in one document, how the council ensures that it runs itself in a lawful, structured, ethical and professional manner. The CCG is administered by the Head of Legal and Democratic Services and is subject to an annual 'light touch' review with any recommendations presented to the Governance Committee.

### c) Translating the vision into objectives for the authority and its partnerships

The council's vision is reflected in the Council Plan which sets out 'Our priorities', 'How we will work' and 'Our Challenges' and 'Our Opportunities'. The Council Plan links the planned outcomes set out in the Southampton Connect Plan, and other key partnership plans, with the council's own priorities, statutory obligations and resources forecasts. The Cabinet will be considering the next phase of the transformation programme in the autumn which will detail how the council will transform to implement the Council Strategy in the medium term.

# ANNUAL GOVERNANCE STATEMENT

**d) Measuring the quality of services for users, ensure they are delivered in accordance with the authority's objectives and to ensure they represent the best use of resources and value for money**

The Council Plan identifies the 'Success Measures' in respect of the 'Key Actions'. These indicators are monitored by the Council's Management Team. Service areas also undertake a variety of performance review activities. In 2013/14 the council undertook a review of its performance management framework resulting in a comprehensive set of measures and management information for the Council's Management Team to consider and monitor on a quarterly basis. Performance reports were published for Quarters 2, 3 and 4 of 2013/14.

In addition, all significant commercial partnership working arrangements have a range of key performance indicators which are used to verify and manage service performance.

The council is committed to achieving best value from its suppliers and ensuring that goods and services are procured in the most efficient and effective way. The council's 'Contract Procedure Rules', which form part of the Council's Constitution, govern how the council buys the supplies, services and works that it needs.

**e) Defining and documenting the roles and responsibilities of the executive, non-executive, scrutiny and officer functions, with clear delegation arrangements and protocols for effective communication in respect of the authority and partnership arrangements**

The council has a Constitution that sets out how it operates, how decisions are made (including an Officer Scheme of Delegation) and the procedures followed to ensure that these are efficient, transparent and accountable to local people. Some of these processes are required by the law, while others are a matter for the council to choose. The Constitution, which is divided into 15 Articles and sets out the detailed rules governing the council's business and is published on the internet at: <http://www.southampton.gov.uk/council-partners/decisionmaking/constitution.aspx>

**f) Developing, communicating and embedding codes of conduct, defining the standards of behaviour for members and staff**

The council's Constitution contains both an Officer Code of Conduct and a Members' Code of Conduct which set out the expected behavior and standards to be adhered to. In addition, a 'Disciplinary Policy and Code of Conduct' is in place for employees and sets out the standards of service and conduct that are expected of employees.

**g) Reviewing the effectiveness of the authority's decision making framework, including delegation arrangements, decision making in partnerships and robustness of data quality**

The council's constitution details how the council operates, including how decisions are made and the role of Overview and Scrutiny. It also includes an Officer Scheme of Delegation setting out the powers, duties or functions that may be exercised under Delegated Powers. The Head of Legal and Democratic Services conducts an annual review of the council's constitutional arrangements, which is considered by the council's Governance Committee, in its governance role, prior to submission to the Annual General Meeting of the council in May.

The Internal Audit Programme for 2013/14 included a review of partnership working and the recommendations will be implemented once they have been considered by the Council's Management Team. The council has also worked with Southampton Connect to review the strategic partnerships in the city and the final framework will be approved in July 2014.

# ANNUAL GOVERNANCE STATEMENT

## **h) Reviewing the effectiveness of the framework for identifying and managing risks and demonstrating clear accountability**

The council has in place a Risk Management Policy and Strategy which is subject to annual review to ensure that it continues to reflect good practice and remains aligned with current business processes and practices. The policy and strategy is presented to the Governance Committee for review and approval.

The Governance Committee has responsibility to provide independent assurance on the adequacy of the risk management framework and the internal control and reporting environment. In addition, the Risk Management Strategy summarises the principal roles and responsibilities recognising that all employees, members and those who act on behalf of the council have a role to play in the effective management of risk.

## **i) Ensuring effective counter-fraud and anti-corruption arrangements are developed and maintained**

The council is committed to the highest possible standards of openness, probity and accountability. An 'Anti Fraud and Anti Corruption Policy' is signed by both the Chief Executive and Leader of the Council and is published on the internet together with an 'Anti-Fraud and Anti Corruption Strategy' and Bribery Act Policy. These documents reflect the council's approach and commitment to the prevention and detection of fraud and corruption.

## **j) Ensuring effective management of change and transformation**

The council has in place a Change Programme which is led by the Transformation and Improvement Board, which is chaired by the Cabinet Member for Education and Change and supported by the Council's Management Team.

In 2013/14 the council prioritised transformation work within the People Directorate and the one council programme includes a number of defined 'workstreams'. The key aims of the programme are to secure 'Better outcomes for residents', 'Better quality of service' and 'Significantly reduce cost'. A co-ordinated, strategic approach has been agreed with the initial focus on 'Service Transformation', 'Working Environment Transformation' and 'Community Asset Transfer'. Progress in respect of the defined workstreams is reported to and monitored by the Transformation and Improvement Board and detailed are updated on the Change micro site on the intranet.

In addition, each service is required to update their service 'Blueprint' documents which is intended to capture key service information in a standard format which is then used to support and inform the council in terms of taking a strategic approach to organisational redesign and proposals to meet the ongoing financial challenges.

Further work has been undertaken and the next phase of the transformation programme will be considered by Cabinet in July 2014.

## **k) Ensuring the authority's financial management arrangements conform with the governance requirements of the CIPFA 'Statement on the Role of the Chief Financial Officer in Local Government (2010)'**

The council's financial management arrangements conform to the governance requirements of the CIPFA 'Statement on the Role of the Chief Financial Officer in Local Government (2010)'. The Chief Financial Officer ("CFO") is professionally qualified and is a key member of the Council Management Team and has direct access to the Chief Executive. The CFO is actively involved in ensuring that all immediate and longer term risks and opportunities are considered, and in ensuring the strategic objectives are aligned to the longer-term finance strategy.

# ANNUAL GOVERNANCE STATEMENT

The CFO has input into all major decisions, advises the Executive on financial matters and is responsible for ensuring that budgets are agreed in advance, that the agreed budget is robust and that the finance function is fit for purpose.

## **l) Ensuring the authority's assurance arrangements conform with the governance requirements of the CIPFA 'Statement on the Role of the Head of Internal Audit (2010)'**

The council's assurance arrangements conform to the governance requirements of the CIPFA 'Statement on the Role of the Head of Internal Audit (2010)'. The Head of Internal Audit (Chief Internal Auditor) is professionally qualified and is responsible for reviewing and reporting on the adequacy of the council's internal control environment, including the arrangements for achieving value for money.

The Chief Internal Auditor has direct access to the Chief Executive, and to the council's Monitoring Officer where matters arise relating to Chief Executive responsibility, legality and standards. Where it is considered necessary to the proper discharge of internal audit function, the Chief Internal Auditor has direct access to elected Members of the Council and in particular those who serve on committees charged with governance (i.e. the Governance Committee).

## **m) Ensuring effective arrangements are in place for the discharge of the monitoring officer function**

The Director of Corporate Services is designated as the Monitoring Officer with responsibility for ensuring compliance with established policies, procedures, laws and regulation, and reporting any actual or potential breaches of the law, or maladministration, to the full Council and/or to the Cabinet. The Head of Legal and Democratic Services is the nominated Deputy Monitoring Officer.

## **n) Ensuring effective arrangements are in place for the discharge of the head of paid service function**

The Chief Executive is designated as the Head of Paid Service with responsibility for leading the Council Management Team in driving forward the strategic agenda, set by Cabinet, improving the efficiency and performance of the council and ensuring that the community receives high quality, value-for-money services.

## **o) Undertaking the core functions of an audit committee, as identified in CIPFA's Audit Committee – Practical Guidance for Local Authorities**

The council has a formally constituted Governance Committee that undertakes the core functions of an audit committee and operates in accordance with CIPFA guidance. It provides independent assurance on the adequacy of the risk management framework, the internal control environment and the integrity of the financial reporting and annual governance statement process.

## **p) Ensuring compliance with relevant laws and regulations, internal policies and procedures, and that expenditure is lawful**

'Corporate Standards and Guidance for Officers' is published on the internet and sets out those aspects of decision making that are compulsory and must be complied with in all respects.

In addition, the council has Financial Procedure Rules which provide the framework for managing the council's financial affairs and, Contract Procedure Rules which govern the method by which the council spends money on supplies, services and works. Both documents form part of the council's Constitution.

# ANNUAL GOVERNANCE STATEMENT

## **q) Whistle blowing and receiving and investigating complaints from the public**

The council has in place 'Whistleblowing Policy' (Duty to Act) which reflects the legal framework and obligation on the council to enable staff to raise concerns which may involve unlawful conduct, illegality, financial malpractice or dangers to the public, employees or the environment.

There is a Corporate Complaints policy and procedure in place which is published on the council's website. An annual report is produced and published on the council's website which includes information about comments, compliments and complaints experience. There is a separate policy and procedure in place in respect of dealing with complaints made about Members.

## **r) Identifying the development needs of members and senior officers in relation to their strategic roles, supported by appropriate training**

A Member Development Strategy is in place which sets out how Member development will be identified, delivered and managed. The Strategy, which was reviewed, updated and approved the Governance Committee in September 2013, is based on the following criteria:

- Induction Programme
- Development needs as identified through Personal Development Planning;
- Corporate objectives and initiatives;
- External Development activities.

Senior Officer development needs form part of the annual performance appraisal process with a requirement that learning and development priorities are linked to key objectives and service plan priorities. There are five strategic priorities for employee development which are as follows:

- Meeting the compulsory demands placed on the Council;
- Developing and maintaining Corporate Standards;
- Supporting the Change Agenda and Customer Care;
- Developing Current and Future Managers (Leaders);
- Improving the level of essential skills in the workforce.

## **s) Establishing clear channels of communication with all sections of the community and other stakeholders, ensuring accountability and encouraging open consultation**

The council supports the principle that people should have the opportunity to voice their opinions on issues that affect them. The views of customers are at the heart of the council's service delivery arrangements and are actively sought by services via questionnaires, text messaging, focus groups and community consultation events.

Information on 'Consultation' and 'Other ways to have your say' is also published on the council's website and provides an opportunity for stakeholders to voice their opinions and shape service delivery. For example, comments and suggestions from public consultation (including engagement with partners, external organisations and provider organisations) together with a pre budget priority survey were reflected in, and helped shape, the 2014-15 budget report. Following this the feedback from the budget consultation process was reported to Cabinet before they made their final recommendations to Council. Information was made available in an easy to understand format and respondents were informed on how their feedback was used.

Market research is one the tools the council uses to obtain opinions and perceptions on a variety of issues affecting life in the city. The council is conducting a 'City Survey' in partnership with other key organisations working in the city including the local Clinical Commissioning Group, Police, NHS Trusts, Fire Service and further education bodies. The survey is an important step in building a better understanding of our residents and will be repeated every other year for the next five years.

# ANNUAL GOVERNANCE STATEMENT

## **t) Enhancing the accountability for service delivery and effectiveness of other public service providers**

The 'Priorities', 'Key Actions' and 'Success measures' identified in the Council Plan are monitored by the Council's Management Team and reported to informal Cabinet and published on the council's website. The council has developed quarterly 'performance scorecards' to improve the management information available to managers that reflects corporate, directorate, service and partner priorities.

A number of the council's key services are delivered in partnership with external service providers. These outsourced contracts are managed by a centralised Contract Management Team which provides a senior management interface between the council and our partnership service provider. All such arrangements include a suite of key performance indicators and are based upon a culture of continuous improvement, recognising the need to achieve a balance between the council's short term financial challenges and long term strategic aims.

## **u) Incorporating good governance arrangements in respect of partnerships and other joint working as identified by the Audit Commission's report on the governance of partnerships, and reflecting these in the authority's overall governance arrangements**

A Partnership Code, which forms part of the council's Constitution, identifies the key considerations when developing a partnership including 'is there clarity of purpose and is it compelling' and 'how will decisions be made and acted upon'. The intention is to ensure that sound governance arrangements are in place and reviewed as the partnership working arrangement develops and evolves. Recommendations from the recent Internal Audit review on partnerships arrangements will be implemented once they have been considered by the Council's Management Team.

## **REVIEW OF EFFECTIVENESS**

The council has responsibility for conducting, at least annually, a review of the effectiveness of its governance framework including the system of internal control. The review of effectiveness is led by a 'Controls Assurance Management Group' (comprising the Section 151 Officer, Chair of the Governance Committee, Assistant Chief Executive, Monitoring Officer and Chief Internal Auditor).

The review process, applied in respect of maintaining and reviewing the effectiveness of the system of internal control, is informed by:-

- The views of Internal Audit regularly reported to Governance Committee via the 'Internal Audit: Progress Report' which include executive summaries of new reports published where critical weaknesses or unacceptable levels of risk were identified. In addition, where appropriate, the relevant Director and/or Head of Service being required to attend a meeting to update the Committee regarding progress and actions;
- The views of external auditors, regularly reported to the Governance Committee, including regular progress reports, the Annual Audit Letter and Audit Results Report – ISA260;
- The Chief Internal Auditors 'Annual Report and Opinion' on the adequacy and effectiveness of the Council's internal control environment;
- The Internal Audit Charter and delivery of the annual operational plan;
- The work of the executive managers within the authority who have responsibility for the development and maintenance of the governance environment;

# ANNUAL GOVERNANCE STATEMENT

- The completion of an annual 'Self Assessment Statement' by Directors which covers the key processes and systems that comprise the council's governance arrangements and is intended to identify any areas where improvement or further development is required;
- Completion of an 'Assurance Framework' document which reflects the key components of the Council's overall governance and internal control environment. This document, based on CIPFA/SOLACE guidance, records the key controls in place, and sources of assurance, and identifies any significant gaps or weaknesses in key controls;
- The independent views of regulatory inspection agencies such as Ofsted and the Care Quality Commission;
- The Risk Management Policy and Strategy, specifically the Strategic and Directorate Risk Registers;
- The work of the Governance Committee in relation to the discharge of its responsibility to lead on all aspects of corporate governance.

We have been advised on the implications of the result of the review of the effectiveness of the governance framework by the Governance Committee, and that the arrangements continue to be regarded as fit for purpose in accordance with the governance framework. The areas already addressed and those to be specifically addressed with new actions planned are outlined below.

## SIGNIFICANT GOVERNANCE ISSUES

The following significant governance issues have been identified:

	Governance Issue	Planned Action
1.	The Council's Anti Money Laundering Policy has not been updated since Feb 2009.	Policy to be reviewed and updated to reflect current good practice together with a commitment for future periodic reviews. Appropriate arrangements to be made to communicate the updated policy.
	<b>Responsible Officer:</b> Director of Corporate Services <b>Target for completion:</b> July 14	
2.	The Corporate Procurement Strategy refers to the period 2009-12	Contract Procedure Rules to be reviewed and updated by end of 2014 with the revised and updated Strategy by early 2015.
	<b>Responsible Officer:</b> Director of Corporate Services <b>Target for completion:</b> March 15	
3.	Transparency information published on the internet includes a Members' 'Gifts & Hospitality Register' however the last entry on the document is dated April 2012.	The requirement to make such declarations was dropped when the new code, under the Localism Act, came into being in July 2012. It is however considered appropriate, in terms of transparency, to review the current approach to the publication of Members 'Gifts and Hospitality'. A report to be taken to Governance Committee in Sept 14 with both an updated draft Code and proposed addition in relation to members gifts and hospitality with a de minimus level of £50 for registration.
	<b>Responsible Officer:</b> Director of Corporate Services <b>Target for completion:</b> Sept 14	

## ANNUAL GOVERNANCE STATEMENT

<b>4.</b>	The 'Children's Services & Learning Complaints and Representation Procedure' published on the internet is dated September 2006.	Review and update the 'Children's Services & Learning Complaints and Representation Procedure' to ensure that it remains aligned with statutory procedures with a commitment for future periodic reviews.
<b>Responsible Officer:</b> Director of Corporate Services		<b>Target for completion:</b> July 14
<b>5.</b>	Understanding of and compliance with Information Governance policies and procedures.	Information Governance e-learning (including Data Protection, Freedom Of Information Act and Protecting Information) to be mandatory for all staff and new starters.
<b>Responsible Officer:</b> Director of Corporate Services		<b>Target for completion:</b> Implemented as of now – ongoing
<b>6.</b>	Business continuity plans need to reflect the high level of organisational change that has taken place and is ongoing.	Business continuity plans to be reviewed, tested and evaluated to ensure that they reflect the new organisational structure.
<b>Responsible Officer:</b> Director of Place		<b>Target for completion:</b> May 15
<b>7.</b>	Understanding of and compliance with the council's 'Corporate Standards'.	Learning and communication exercise to be rolled out to relevant officers in respect of the legal decision making process.
<b>Responsible Officer:</b> Director of Corporate Services		<b>Target for completion:</b> Commence Summer 14

We propose over the coming year to take steps to address the above matters to further enhance our governance arrangements. We are satisfied that these steps will address the need for improvements that were identified in our review of effectiveness, and will monitor their implementation and operation as part of our next annual review.

**Signed**

.....  
**Dawn Baxendale**  
 (Chief Executive)

.....  
**Councillor Simon Letts**  
 (Leader of the Council)

on behalf of Southampton City Council

This page is intentionally left blank

## ANNUAL GOVERNANCE STATEMENT 2012-13 : Status Report

The following is a summary of the status of the agreed actions that were identified to address the significant governance issues were identified and recorded on the Council's Annual Governance Statement 2012-13:

	Governance Issue	Agreed Action	Target Date	Responsible Officer	Status	Comments
1.	The Council's Anti Fraud and Corruption Policy and Strategy has not been updated since 2008.	Anti Fraud and Corruption Policy and Strategy to be reviewed and updated to reflect current good practice together with a commitment for future periodic reviews. Appropriate arrangements to be made to communicate the updated Policy and Strategy.	Oct 2013	Director of Corporate Services	<b>COMPLETED (Dec 2013)</b>	A revised and updated 'Anti Fraud and Anti Corruption' strategy and policy statement was approved by the Governance Committee at the 16 <sup>th</sup> December 2013 meeting.
2.	Performance management reporting arrangements need to capture and reflect the most up to date information or position and to enable improvement in outcomes.	A review of performance management arrangements has been undertaken and a new approach, in the form of a monthly 'scorecard' format, is being developed and will be in place in December.	Dec 2013	Assistant Chief Executive	<b>COMPLETED (Dec 13)</b>	The Council's performance management framework was reviewed resulting in a comprehensive set of measures and management information for the Council's Management Team to consider and monitor on a quarterly basis. Performance reports were published for Quarters 2, 3 and 4 of 2013/14.
3.	Reduced capacity and resilience within the senior management team.	Review of senior management structure and capacity will follow the new Chief Executive appointment in June 2013.	Dec 2013	Chief Executive	<b>COMPLETED (Sept 2013)</b>	The new Chief Executive was appointed in July 2013, and in September 2013, the Chief Executive formalised 2 existing roles and changed their job titles to reflect the due importance of these posts in the organisation. They are the Chief Financial Officer, and the Assistant Chief Executive.

4.	Development of a co-ordinated and consistent approach to workforce learning and development including corporate induction and succession planning.	Delivery of the workstreams as part of the overall Workforce Plan	Mar 2014	Director of Corporate Services	<b>COMPLETED (Initial actions)</b>	A council wide Learning and Development plan, which includes corporate induction, is now in place however further work is required in terms of prioritisation and delivery of the plan.  Succession planning will form part of the developing Performance Management workstream
5.	The provision and access to internal/external training and development for members should be on a more structured basis and the scope and level of member engagement with internal learning and development opportunities needs to be reviewed.	A review of the approach and delivery of Member learning and development opportunities is being undertaken by the Governance Committee in consultation with Group Leaders and the Members User Group.	Sept 2013	Director of Corporate Services	<b>COMPLETED (Sept 2013)</b>	A new Member Development Strategy was endorsed by the Governance Committee at the 23 <sup>rd</sup> September 2013 meeting.
6.	Understanding of and compliance with the council's 'Corporate Standards' by relevant officers.	A review of the current provision is being undertaken with a view to introducing a revised training programme for officers.	Oct 2013	Director of Corporate Services	<b>DEFERRED</b>	Preparations are in hand however, due to competing priorities and staff resignations, implementation has been delayed. It is intended is to start rolling this out over the summer months of 2014.

<b>DECISION-MAKER:</b>	GOVERNANCE COMMITTEE		
<b>SUBJECT:</b>	EFFECTIVENESS of the SYSTEM of INTERNAL AUDIT		
<b>DATE OF DECISION:</b>	14 JULY 2014		
<b>REPORT OF:</b>	CHIEF INTERNAL AUDITOR		
<b><u>CONTACT DETAILS</u></b>			
<b>AUTHOR:</b>	<b>Name:</b>	Neil Pitman	<b>Tel:</b> 01962 845139
	<b>E-mail:</b>	<a href="mailto:Neil.pitman@southampton.gov.uk">Neil.pitman@southampton.gov.uk</a>	
<b>Director</b>	<b>Name:</b>	Mark Heath	<b>Tel:</b> 023 8083 2371
	<b>E-mail:</b>	<a href="mailto:Mark.heath@southampton.gov.uk">Mark.heath@southampton.gov.uk</a>	

<b>STATEMENT OF CONFIDENTIALITY</b>
N/A

## **BRIEF SUMMARY**

Under the Accounts and Audit (England) Regulations 2011 the Council is required, at least once a year, 'to conduct a review of the effectiveness of its internal audit'. The purpose of this paper is to provide the Governance Committee with an overview of the measures currently in place to monitor and maintain internal audit effectiveness, taking cognisance of the Public Sector Internal Audit Standards and the Local Government Application Note.

## **RECOMMENDATIONS:**

That the Governance Committee

- (i) approve the review conducted in assessing the 'Effectiveness of the System of Internal Audit'; and
- (ii) endorse the action plan generated from the assessment against the Public Sector Internal Audit Standards and Local Government Application Note.

## **REASONS FOR REPORT RECOMMENDATIONS**

1. In accordance with the Accounts and Audit (England) Regulations 2011 and proper internal audit practices (Public Sector Internal Audit Standards & Local Government Application Note), the Governance Committee is required to receive a report on the effectiveness of the system of internal audit.

## **ALTERNATIVE OPTIONS CONSIDERED AND REJECTED**

2. None.

## **DETAIL (Including consultation carried out)**

3. The Accounts and Audit (England) Regulations 2011 - S6 states:  
*'(1) A relevant body must undertake an adequate and effective internal audit of its accounting records and of its system of internal control in accordance with the proper practices in relation to internal control.'*  
*'(3) A larger relevant body must, at least once in each year, conduct a review of the effectiveness of its internal audit'*
4. With effect from 1 April 2013 the Public Sector Internal Audit Standards (PSIAS) and the Local Government Application Note (LGAN) together are recognised as proper practices.
5. There is no prescriptive guidance to conducting the effectiveness review, however, the Public Sector Internal Audit Standards require the Head of the Southern Internal Audit Partnership (Chief Internal Auditor) to develop and maintain a Quality Assurance and Improvement Programme (QAIP) that covers all aspects of the internal audit service and includes provision for both internal and external assessment.
6. To ensure effective use of resource, the requirements and subsequent outputs from internal / external assessments required within the Standards have been used to underpin the report on the 'Effectiveness of Internal Audit' as prescribed in the Accounts and Audit (England) Regulations 2011.

### **Quality Assurance and Improvement Plan (QAIP)**

7. The QAIP through its interpretation in the Public Sector Internal Audit Standards is:  
*'a quality assurance and improvement programme designed to enable an evaluation of the internal audit activity's conformance with the Definition of Internal Auditing and the Standards and an evaluation of whether internal auditors apply the Code of Ethics. The programme also assesses the efficiency and effectiveness of the internal audit activity and identifies opportunities for improvement'*
8. The QAIP must make provision for both internal and external assessments of the audit service

### **Internal Assessments**

9. Internal assessments must include:
  - On-going monitoring of the performance of the internal audit activity; and
  - Periodic self-assessments or assessments by other persons within the organisation with sufficient knowledge of internal audit practices (sufficient knowledge of internal audit practices requires at least an understanding of all elements of the International Professional Practices Framework).

## On-going Monitoring

10. The Head of the Southern Internal Audit Partnership has established procedures to guide internal audit staff in performing their duties to ensure they conform to the Public Sector Internal Audit Standards. This is demonstrated through the maintenance of key policies and procedures that are regularly reviewed and updated to reflect changes in working practices and standards, underpinned by an audit management software system providing consistency and common principles in the conduct of audit reviews.
11. In order to ensure that work is carried out to an appropriate level and quality, the Head of the Southern Internal Audit Partnership ensures that audit work is allocated to staff with the appropriate skills, experience and competence.
12. The Head of the Southern Internal Audit Partnership also ensures that internal audit staff at all levels are appropriately supervised and work is reviewed throughout all audits to monitor progress, assess quality and coach staff.
13. The Southern Internal Audit Partnership operates a quality system (ISO 9001:2008) which covers all our audit reviews including irregularity reviews. Compliance against our quality processes are regularly assessed by an external/independent accreditor from the British Standards Institution (BSI)
14. On-going performance monitoring also incorporates:
  - A set of targets to measure performance, developed in consultation with appropriate parties. Such measures are monitored and regularly reported through quarterly progress reports to 'senior management' and 'the board'.
  - Stakeholder feedback in the form of Quality Appraisal Questionnaires; and
  - An action plan to implement improvements (QAIP)
15. Performance measures as at the end of 2013-14 were:

Performance Measure	2013-14
Revised plan delivered (including 2012/13 c/f)	98%
Positive response to quality appraisal questionnaire	98%
Compliant with Public Sector Internal Audit Standards	Yes

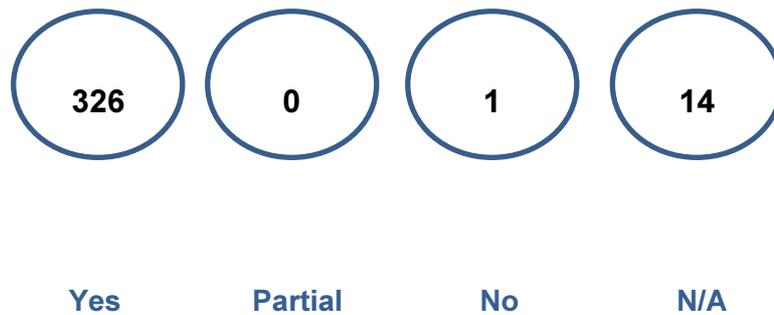
## Internal Self-Assessment

16. For 2013/14 a self-assessment against the Public Sector Internal Audit Standards has been undertaken.

The 'Local Government Application Note for the United Kingdom Public Sector Internal Audit Standards' provides a checklist that has been developed to enable periodic self-assessment as part of the Quality Assurance and Improvement Programme. It is this checklist that has been used as the basis of the 2013-14 self-assessment review.

17. In compiling the self-assessment, the Head of the Southern Internal Audit Partnership undertook an initial evaluation of the audit service against the checklist, and compiled documentary evidence to verify compliance.
18. To provide independent scrutiny the Deputy Monitoring Officer (Hampshire County Council) then considered the Standards for compliance against the self-assessment and supporting documentation, concluding:  
*'I am satisfied that this is an accurate assessment of the internal audit function'*
19. The summary of the self-assessment against the 341 Standards highlights

**Compliance**



20. In areas where the Southern Internal Audit Partnership do not meet 'the Standards' an action plan has been compiled to explain non-conformance or stimulate improvement.

**External Assessments**

21. External assessments must be conducted at least once every five years by a qualified, independent assessor or assessment team from outside of the organisation.
22. The Head of the Southern Internal Audit Partnership must agree with the sponsor (the S151 or Chair of the Audit Committee):
  - The form of external assessments;
  - The qualifications and independence of the external assessor or assessment team, including any potential conflict of interest.

**Form of External Quality Assessment (EQA)**

23. External assessment can be in the form of a full external assessment or a self-assessment with external validation.

### **Full External Assessment**

24. A full EQA incorporates surveys and interviews with the Head of the Southern Internal Audit Partnership, internal audit staff, customers and stakeholders. This is supported by examination of the internal audit approach and methodology leading to the completion of an independent report.

### ***Validated self-assessment***

25. An initial self-assessment is carried out by the Head of Southern Internal Audit Partnership. The external assessment team will review / validate evidence produced and conduct interviews with internal audit staff, senior management and the chair of the board.
26. A validation report will be appended to the Head of the Southern Internal Audit Partnership's self-assessment.

### **Qualification and Independence of the External Assessor**

27. A qualified assessor or assessment team must demonstrate competence in two areas:
- the professional practice of internal auditing; and
  - the external assessment process
28. Competence can be demonstrated through a mixture of experience and theoretical learning. Experience gained in organisations of similar size, complexity, sector or industry and technical issues is more valuable than less relevant experience.
29. An independent assessor or assessment team means not having either a real or an apparent conflict of interest and not being a part of, or under the control of, the organisation to which the internal audit activity belongs.
30. The Head of the Southern Internal Audit Partnership will present a paper to the Key Stakeholder Board exploring the options, form, timing and scope of the external assessment in September 2014.

### **RESOURCE IMPLICATIONS**

#### **Capital/Revenue**

31. None

#### **Property/Other**

32. None.



# Agenda Item 9

## Appendix 1

### Summary of Compliance against the Public Sector Internal Audit Standards

Section	Standard	Compliant				Total
		Yes	Partial	No	N/A	
1	Definition of Internal Auditing	3	-	-	-	3
2	Code of Ethics	13	-	-	-	13
3	Attribute Standards					
3.1	Purpose, Authority and Responsibility	23	-	-	-	23
3.2	Independence and Objectivity	30	-	1	3	34
3.3	Proficiency and Due Professional Care	21	-	-	-	21
3.4	Quality Assurance and Improvement Programme	20	-	-	7	27
4	Performance Standards					
4.1	Managing the Internal Audit Activity	46	-	-	1	47
4.2	Nature of Work	31	-	-	-	31
4.3	Engagement Planning	58	-	-	-	58
4.4	Performing the Engagement	23	-	-	-	23
4.5	Communicating Results	52	-	-	3	55
4.6	Monitoring Progress	4	-	-	-	4
4.7	Communicating the Acceptance of Risks	2	-	-	-	2
Total		326	-	1	14	341

**Public Sector Internal Auditing Standards  
Action Plan – No Compliance**

Standard	Compliant	Comment	Action	Responsible Officer	Implementation Date
3.2 - Independence and Objectivity					
Does the board: e) approve decisions relating to the appointment and removal of the CAE	No	Such actions are not constitutionally permissible to be undertaken by 'the board' (Local Authorities (Standing Orders) (England) Regulations 2001)	To continue to follow existing County Council Standing Orders and procedures in the appointment and dismissal of the Chief Internal Auditor	-	-

**Public Sector Internal Auditing Standards  
Action Plan – Not Applicable**

Standard	Compliant	Comment	Action	Responsible Officer	Implementation Date
<b>3.2 - Independence and Objectivity</b>					
Have any instances been discovered where an internal auditor has used information obtained during the course of duties for personal gain?	N/A	There have been no known instances where an internal auditor has used information for personal gain	-	-	-
If there has been any real or apparent impairment of independence or objectivity, has this been disclosed to appropriate parties (depending on the nature of the impairment and the relationship between the CAE and senior management/the board as set out in the internal audit charter)?	N/A	There have been no known instances of real or apparent impairment of independence or objectivity.	-	-	-
If there have been any assurance engagements in areas over which the CAE also has operational responsibility, have these engagements been overseen by someone outside of the internal audit activity?	N/A	The Chief Internal Auditor has no operational responsibilities outside of the internal audit function.	-	-	-
<b>3.4 - Quality Assurance and Improvement Programme</b>					
Has the CAE considered the pros and cons for the different types of external assessment (i.e. 'full' or self-assessment plus 'independent validation')?	N/A	The requirement for an external assessment (to be undertaken every 5 years) is new. The PSIAS took effect from 1 April 2013; as such there is no requirement to have completed an external assessment until 31 March 2018.	The Chief Internal Auditor will present a paper to Senior Management and the Board exploring the options, form, timing and scope of the external assessment.	Chief Internal Auditor	September 2014
Has the CAE discussed the proposed form of the external	N/A	The requirement for an external assessment (to be undertaken	The Chief Internal Auditor will present a paper to Senior	Chief Internal	September 2014

Standard	Compliant	Comment	Action	Responsible Officer	Implementation Date
assessment and the qualifications and independence of the assessor or assessment team with the board?		every 5 years) is new. The PSIAS took effect from 1 April 2013; as such there is no requirement to have completed an external assessment until 31 March 2018.	Management and the Board exploring the options, form, timing and scope of the external assessment.	Auditor	
Has the CAE agreed the scope of the external assessment with an appropriate sponsor, such as the chair of the audit committee, the CFO or the chief executive?	N/A	The requirement for an external assessment (to be undertaken every 5 years) is new. The PSIAS took effect from 1 April 2013; as such there is no requirement to have completed an external assessment until 31 March 2018.	The Chief Internal Auditor will present a paper to Senior Management and the Board exploring the options, form, timing and scope of the external assessment.	Chief Internal Auditor	September 2014
Has the CAE agreed the scope of the external assessment with the external assessor or assessment team?	N/A	The requirement for an external assessment (to be undertaken every 5 years) is new. The PSIAS took effect from 1 April 2013; as such there is no requirement to have completed an external assessment until 31 March 2018.	The Chief Internal Auditor will develop a formal terms of engagement for the external assessor or assessment team	Chief Internal Auditor	September 2014
Has the assessor or assessment team demonstrated its competence in both areas of professional practice of internal auditing and the external assessment process? Competence can be determined in the following ways: a) experience gained in organisations of similar size b) complexity c) sector (ie the public sector) d) industry (ie local government), and	N/A	The requirement for an external assessment (to be undertaken every 5 years) is new. The PSIAS took effect from 1 April 2013; as such there is no requirement to have completed an external assessment until 31 March 2018.	The Chief Internal Auditor will undertake due diligence checks on prospective external assessors / assessment teams to ensure credibility,, competence and independence.	Chief Internal Auditor	September 2014

Standard	Compliant	Comment	Action	Responsible Officer	Implementation Date
e) technical experience. Note that if an assessment team is used, competence needs to be demonstrated across the team and not for each individual member.					
How has the CAE used his or her professional judgement to decide whether the assessor or assessment team demonstrates sufficient competence to carry out the external assessment?	N/A	The requirement for an external assessment (to be undertaken every 5 years) is new. The PSIAS took effect from 1 April 2013; as such there is no requirement to have completed an external assessment until 31 March 2018.	The Chief Internal Auditor will undertake due diligence checks on prospective external assessors / assessment teams to ensure credibility,, competence and independence.	Chief Internal Auditor	September 2014
Does the assessor or assessment team have any real or apparent conflicts of interest with the organisation? This may include, but is not limited to, being a part of or under the control of the organisation to which the internal audit activity belongs.	N/A	The requirement for an external assessment (to be undertaken every 5 years) is new. The PSIAS took effect from 1 April 2013; as such there is no requirement to have completed an external assessment until 31 March 2018.	The Chief Internal Auditor will undertake due diligence checks on prospective external assessors / assessment teams to ensure credibility,, competence and independence.	Chief Internal Auditor	September 2014
<b>4.1 - Managing the Internal Audit Activity</b>					
Where an external internal audit service provider acts as the internal audit activity, does that provider ensure that the organisation is aware that the responsibility for maintaining and effective internal audit activity remains with the organisation?	N/A	Internal audit is not provided by an external service provider.	-	-	-

Standard	Compliant	Comment	Action	Responsible Officer	Standard
4.5 - Communicating Results					
Where any non-conformance with the PSIAS has impacted on a specific engagement, do the communication of the results disclose the following:					
a) The principle or rule of conduct of the <i>Code of Ethics</i> or <i>Standard(s)</i> with which full conformance was not achieved?	N/A	Occasion has not arisen whereby non-conformance with PSIAS has impacted on an engagement.	-	-	-
b) The reason(s) for non-conformance?	N/A	Occasion has not arisen whereby non-conformance with PSIAS has impacted on an engagement.	-	-	-
c) The impact of non-conformance on the engagement and the engagement results?	N/A	Occasion has not arisen whereby non-conformance with PSIAS has impacted on an engagement.	-	-	-

<b>DECISION-MAKER:</b>	GOVERNANCE COMMITTEE		
<b>SUBJECT:</b>	CHIEF INTERNAL AUDITOR'S ANNUAL REPORT AND OPINION 2013/14		
<b>DATE OF DECISION:</b>	14 JULY 2014		
<b>REPORT OF:</b>	CHIEF INTERNAL AUDITOR		
<b><u>CONTACT DETAILS</u></b>			
<b>AUTHOR:</b>	<b>Name:</b>	<b>Neil Pitman</b>	<b>Tel: 01962 845139</b>
	<b>E-mail:</b>	<a href="mailto:Neil.pitman@southampton.gov.uk">Neil.pitman@southampton.gov.uk</a>	
<b>Director</b>	<b>Name:</b>	<b>Mark Heath</b>	<b>Tel: 023 8083 2371</b>
	<b>E-mail:</b>	<a href="mailto:Mark.heath@southampton.gov.uk">Mark.heath@southampton.gov.uk</a>	

<b>STATEMENT OF CONFIDENTIALITY</b>
NOT APPLICABLE

## **BRIEF SUMMARY**

In accordance with proper internal audit practices, the Chief Internal Auditor is required to provide an opinion on the adequacy and effectiveness of the Council's framework of risk management, internal control and governance. The attached report (Appendix 1) provides the Chief Internal Auditor's opinion and summarises audit work from which that opinion has been derived for the year ending 31 March 2014. The report concludes that Southampton City Council's framework of governance, risk management and management control is 'Adequate'. Where weaknesses have been identified through internal audit review, we have worked with management to agree appropriate corrective actions and a timescale for improvement.

## **RECOMMENDATIONS:**

- (i) That the Governance Committee approves the Chief Internal Auditor's Annual Report and Opinion for 2013/14

## **REASONS FOR REPORT RECOMMENDATIONS**

1. The Accounts and Audit (England) Regulations 2011 state 'a relevant body must undertake an adequate and effective internal audit of its accounting records and of its system of internal control in accordance with the proper practices in relation to internal control'

## **ALTERNATIVE OPTIONS CONSIDERED AND REJECTED**

2. None

## **DETAIL (Including consultation carried out)**

3. In accordance with proper internal audit practices, the Chief Internal Auditor is required to provide an opinion on the adequacy and effectiveness of the Council's framework of risk management, internal control and governance and to assist in producing the Annual Governance Statement

4. The Annual Report for 2013/14 provides the Chief Internal Auditor's opinion on the system of internal control and summarises audit work from which that opinion is derived for the year ending 31 March 2014.
5. The Committee's attention is drawn to the following points:
  - Internal audit was compliant with the Public Sector Internal Audit Standards during 2013/14;
  - The revised internal audit plan for 2013/14 has been substantially delivered;
  - The Council's framework of governance, risk management and management control is considered to be 'Adequate' and audit testing has demonstrated controls to be working in practice; and
  - Where internal audit work identified areas where management controls could be improved or where systems and laid down procedures were not fully followed, appropriate corrective actions and a timescale for improvement were agreed with the responsible managers.

**RESOURCE IMPLICATIONS**

**Capital/Revenue**

6. None

**Property/Other**

7. None

**LEGAL IMPLICATIONS**

**Statutory power to undertake proposals in the report:**

8. The Accounts and Audit (England) Regulations 2011 state 'a relevant body must undertake an adequate and effective internal audit of its accounting records and of its system of internal control in accordance with the proper practices in relation to internal control'.

**Other Legal Implications:**

9. None

**POLICY FRAMEWORK IMPLICATIONS**

10. None

**KEY DECISION?** No

<b>WARDS/COMMUNITIES AFFECTED:</b>	None
------------------------------------	------

## SUPPORTING DOCUMENTATION

### Appendices

1.	Chief Internal Auditor's Annual Report and Opinion 2013/14
----	--

### Documents In Members' Rooms

1.	None
----	------

### Equality Impact Assessment

Do the implications/subject of the report require an Equality Impact Assessment (EIA) to be carried out.	Yes/No
--	--------

### Other Background Documents

**Equality Impact Assessment and Other Background documents available for inspection at:**

Title of Background Paper(s)

Relevant Paragraph of the Access to Information Procedure Rules / Schedule 12A allowing document to be Exempt/Confidential (if applicable)

1.	None	
----	------	--

This page is intentionally left blank

# Annual Internal Audit Report & Opinion

2013 – 14

Southampton City Council



## Southern Internal Audit Partnership

Assurance through excellence  
and innovation

Agenda Item 10  
Appendix 1

## Contents

Section	Page
1. Role of Internal Audit	3
2. Internal Audit Approach	4
3. Internal Audit Opinion	5
4. Internal Audit Coverage and Output	6-7
5. Significant Issues Arising	8
6. Anti Fraud and Corruption	8-9
7. Quality Assurance and Improvement	9-10
8. Disclosure of Non-Conformance	10
9. Quality control	11
10. Internal Audit Performance	11
11. Acknowledgement	12
<b>Appendices</b>	
A Quality Assessment & Improvement Programme	13

## 1. Role of Internal Audit

The requirement for an internal audit function in local government is detailed within the Accounts and Audit (England) Regulations 2011, which states that a relevant body must:

***‘Undertake an adequate and effective internal audit of its accounting records and of its system of internal control in accordance with the proper practices in relation to internal control’.***

The standards for ‘proper practices’ in relation to internal audit are laid down in the Public Sector Internal Audit Standards 2013 [the Standards].

The role of internal audit is best summarised through its definition within the Standards, as an:

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

The Council is responsible for establishing and maintaining appropriate risk management processes, control systems, accounting records and governance arrangements. Internal audit plays a vital role in advising the Council that these arrangements are in place and operating effectively.

The Council’s response to internal audit activity should lead to the strengthening of the control environment and, therefore, contribute to the achievement of the organisations objectives.

## 2. Internal Audit Approach

To enable effective outcomes, internal audit provide a combination of assurance and consulting activities. Assurance work involves assessing how well the systems and processes are designed and working, with consulting activities available to help to improve those systems and processes where necessary.

A full range of internal audit services is provided in forming the annual opinion.

The approach to each review is determined by the Head of the Southern Internal Audit Partnership and will depend on the:

- level of assurance required;
- significance of the objectives under review to the organisations success;
- risks inherent in the achievement of objectives; and
- level of confidence required that controls are well designed and operating as intended.

All formal internal audit assignments will result in a published report. The primary purpose of the audit report is to provide an independent and objective opinion to the Council on the framework of internal control, risk management and governance in operation and to stimulate improvement.



### 3. Internal Audit Opinion

The Head of the Southern Internal Audit Partnership is responsible for the delivery of an annual audit opinion and report that can be used by the Council to inform its governance statement. The annual opinion concludes on the overall adequacy and effectiveness of the organisation's framework of governance, risk management and control

In giving this opinion, assurance can never be absolute and therefore, only reasonable assurance can be provided that there are no major weaknesses in the processes reviewed. In assessing the level of assurance to be given, I have based my opinion on:

- written reports on all internal audit work completed during the course of the year (assurance & consultancy);
- results of any follow up exercises undertaken in respect of previous years' internal audit work;
- the results of work of other review bodies where appropriate;
- the extent of resources available to deliver the internal audit work;
- the quality and performance of the internal audit service and the extent of compliance with the Standards; and
- the proportion of Southampton City Council's audit need that has been covered within the period

#### Audit Opinion

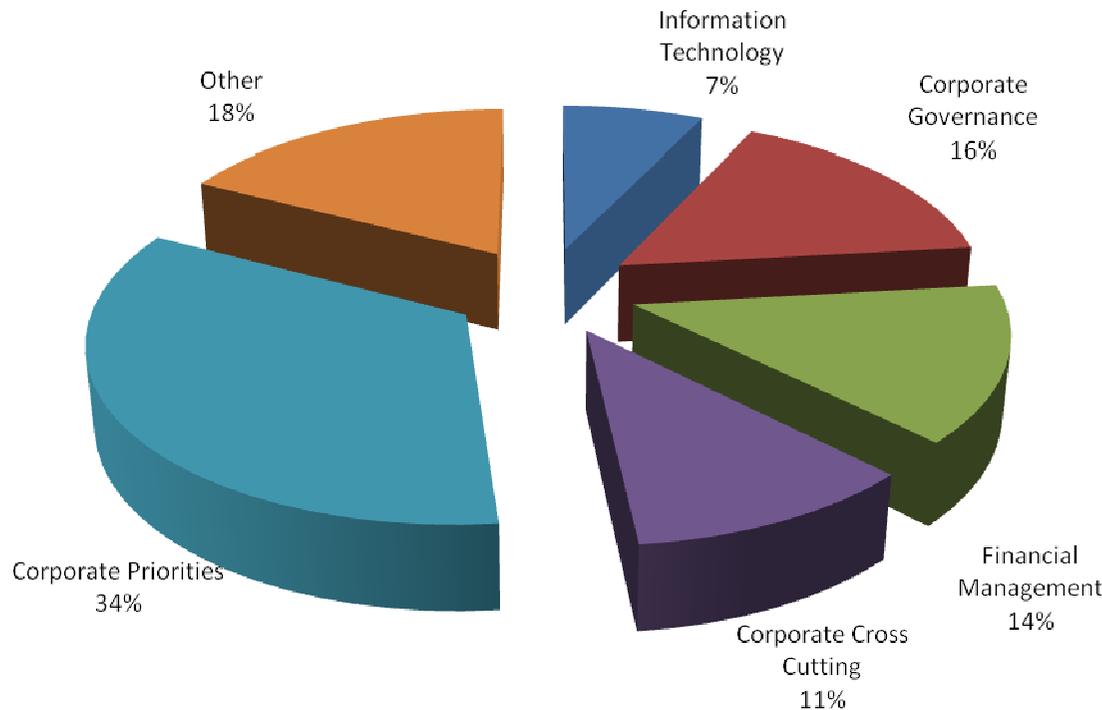
I am satisfied that sufficient assurance work has been carried out to allow me to form a reasonable conclusion on the adequacy and effectiveness of Southampton City Council's internal control environment.

In my opinion, Southampton City Council's framework of governance, risk management and management control is 'Adequate' and audit testing has demonstrated controls to be working in practice.

Where weaknesses have been identified through internal audit review, we have worked with management to agree appropriate corrective actions and a timescale for improvement.

#### 4. Internal Audit Coverage and Output

The annual internal audit plan was prepared to take account of the characteristics and relative risks of the Council’s activities and to support the preparation of the Annual Governance Statement.



Work has been planned and performed so as to obtain sufficient information and explanation considered necessary in order to provide evidence to give reasonable assurance that the internal control system is operating effectively.

The 2013-14 Internal audit plan, approved by the Governance Committee, 30 April 2013, was informed by internal audits own assessment of risk and materiality in addition to consultation with management to ensure it aligned to key risks facing the organisation.

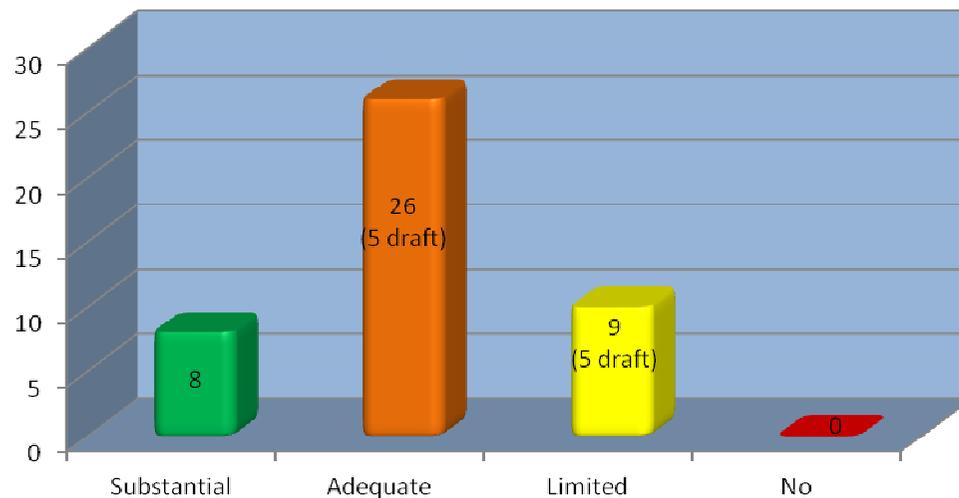
The plan has remained fluid throughout the year to maintain an effective focus.

The Southern Internal Audit Partnership delivered 999 days across 61 review areas over the course of the year ending 31 March 2014

The revised 2013-14 internal audit plan has been delivered with the following exceptions:

- Work is substantially complete and an opinion has been formed for 10 reviews, however, final reports have not yet been agreed with management:

I do not consider these exceptions to have an adverse impact on the delivery of my overall opinion for the period. The opinion assigned to each internal audit review on issue (including draft reports) is defined as follows:



**Substantial** - A sound framework of internal control is in place and operating effectively. No risks to the achievement of system objectives have been identified;

**Adequate** - Basically a sound framework of internal control with opportunities to improve controls and / or compliance with the control framework. No significant risks to the achievement of system objectives have been identified;

**Limited** - Significant weakness (es) identified in the framework of internal control and / or compliance with the control framework which could place the achievement of system objectives at risk; or

**No** - Fundamental weaknesses identified in the framework of internal control or the framework is ineffective or absent with significant risk to the achievement of system objectives

\*18 reviews did not culminate in an audit opinion as they relate to work conducted in respect of consultancy, assurance mapping, grant certification or investigations

## 5. Significant Issues Arising

There were no significant issues arising from internal audit work carried out in accordance with the 2013/14 audit plan.

Where our work identified risks that we considered fell outside the parameters acceptable to the Council, we agreed appropriate corrective actions and a timescale for improvement with the responsible managers

## 6. Anti Fraud and Corruption

The Council continue to conform to the National Fraud Initiative (NFI). Feedback through the 2012/13 NFI exercise (during 2013-14) identified 2,452 'recommended matches'. Within the year work has been on-going to investigate identified matches for fraudulent activity.

	Recommended Matches	Processed	% Complete
Housing Benefits	675	216 (16)	32
Payroll	95	54 (8)	57
Housing Tenants	32	32 (4)	100
Right to Buy	10	10 (3)	100
Blue Badge	755	724	96
Concessionary Passes	441	441	100
Residents Parking Permits	15	15	100
Private Residential Homes	7	7	100
Creditors	343	343	100
VAT	79	79	100
	2,452	1,921	

Outcomes from investigations to date have identified three fraudulent cases and 35 errors providing saving of £62,213.83. Work will continue to review the remaining 'recommended matches'

In addition, we have assessed and where appropriate, advised, investigated or supported the investigation of four allegations of fraud, corruption or improper practice. A number of these cases were allegations made under the Duty to Act ("Whistle blowing") Policy. Of these:

- 1 officer resigned during the course of our investigation;
- 2 were investigated, resulting in disciplinary action; and
- 1 investigation remains on-going

We have subsequently provided advice to management on a number other cases as required

## **7. Quality Assurance and Improvement**

The Quality Assurance and Improvement Programme (QAIP) is a new requirement within 'the Standards'.

The Standards require the Head of the Southern Internal Audit Partnership to develop and maintain a QAIP to enable the internal audit service to be assessed against 'the Standards' and the Local Government Application Note (LGAN) for conformance.

The QAIP must include both internal and external assessments: internal assessments are both on-going and periodical and external assessment must be undertaken at least once every five years.

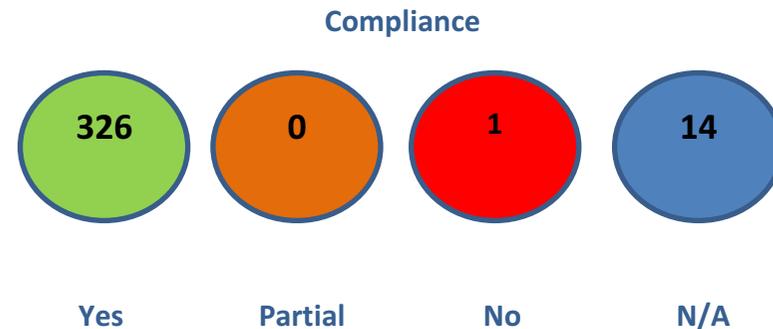
In addition to evaluating compliance with the Standards, the QAIP also assesses the efficiency and effectiveness of the internal audit activity, identifying areas for improvement.

The Standards stipulate that ‘internal assessments’ should be undertaken as a self-assessment or by other persons within the organisation with sufficient knowledge of internal audit processes.

During 2013 – 14 The Head of the Southern Internal Audit Partnership undertook a self-assessment against the Standards and the LGAN. To provide independence to the process the self –assessment was reviewed by Hampshire County Council’s Monitoring Officer to ensure it presented a true and fair view.

Independent analysis confirmed that the self-assessment provided ‘a fair assessment of the internal audit activity’

The form of the external assessment must be agreed with Senior Management and the Board. A paper is scheduled to be presented to the Partnership Board in September 2014 to review the alternative options for external assessment.



**8. Disclosure of Non-Conformance**

‘It is my opinion that in all material respects the Southern Internal Audit Partnership conforms to the, Definition of Internal Auditing; the Code of Ethics; and the Standards’

Whilst the Standards only require non-conformance to be disclosed when it impacts the overall scope or operation of the internal audit activity, the additional requirements for the public sector state ‘that all instances of non-conformance and progress against improvement plans must be reported in the annual report’. The QAIP Action Plan is provided at Appendix 1.

## 9. Quality control

Our aim is to provide a service that remains responsive to the needs of the Council and maintains consistently high standards. In complementing the QAIP this was achieved in 2013-14 through the following internal processes:

- On-going liaison with management to ascertain the risk management, control and governance arrangements, key to corporate success;
- On-going development of a constructive working relationship with the External Auditors to ensure development of a cooperative assurance approach;
- A tailored audit approach using a defined methodology and assignment control documentation;
- A review of the ‘Effectiveness of the System of Internal Audit’ in accordance with the Accounts and Audit (England) Regulations 2011;
- Registration under British Standard BS EN ISO 9001:2008, the international quality management standard complimented by a comprehensive set of audit and management procedures; and
- Review and quality control of all internal audit work by professional qualified senior staff members.

## 10. Internal Audit Performance

The following performance indicators are maintained to monitor effective service delivery:

Annual performance indicators			
Aspect of service	2012-13 Actual (%)		2013-14 Actual (%)
Revised plan delivered (including 2012/13 c/f)	97		98
Positive customer responses to quality appraisal questionnaire	94		98
Compliant with the Public Sector Internal Audit Standards	Yes		Yes

## 11. Acknowledgement

I would like to take this opportunity to thank all those staff throughout Southampton City Council with whom we have made contact in the year. Our relationship has been positive and management were responsive to the comments we made both informally and through our formal reporting.

Neil Pitman  
Head of Southern Internal Audit Partnership  
June 2014

## Appendix 1 – Quality Assessment & Improvement Action Plan

---

Compliance against the Public Sector Internal Audit Standards / Local Government Application Note

**Public Sector Internal Auditing Standards  
Action Plan – No Compliance**

Standard	Compliant	Comment	Action	Responsible Officer	Implementation Date
3.2 - Independence and Objectivity					
Does the board: e) approve decisions relating to the appointment and removal of the CAE	No	Such actions are not constitutionally permissible to be undertaken by the board (Local Authorities (Standing Orders) (England) Regulations 2001)	To continue to follow existing County Council Standing Orders and procedures in the appointment and dismissal of the Chief Internal Auditor	-	-

**Public Sector Internal Auditing Standards  
Action Plan – Not Applicable**

Standard	Compliant	Comment	Action	Responsible Officer	Implementation Date
<b>3.2 - Independence and Objectivity</b>					
Have any instances been discovered where an internal auditor has used information obtained during the course of duties for personal gain?	N/A	There have been no known instances where an internal auditor has used information for personal gain	-	-	-
If there has been any real or apparent impairment of independence or objectivity, has this been disclosed to appropriate parties (depending on the nature of the impairment and the relationship between the CAE and senior management/the board as set out in the internal audit charter)?	N/A	There have been no known instances of real or apparent impairment of independence or objectivity.	-	-	-
If there have been any assurance engagements in areas over which the CAE also has operational responsibility, have these engagements been overseen by someone outside of the internal audit activity?	N/A	The Chief Internal Auditor has no operational responsibilities outside of the internal audit function.	-	-	-
<b>3.4 - Quality Assurance and Improvement Programme</b>					
Has the CAE considered the pros and cons for the different types of external assessment (i.e. 'full' or self-assessment plus 'independent validation')?	N/A	The requirement for an external assessment (to be undertaken every 5 years) is new. The PSIAS took effect from 1 April 2013; as such there is no requirement to have completed an external assessment until 31	The Chief Internal Auditor will present a paper to the Partnership Board exploring the options, form, timing and scope of the external assessment.	Chief Internal Auditor	September 2014

Standard	Compliant	Comment	Action	Responsible Officer	Implementation Date
		March 2018.			
Has the CAE discussed the proposed form of the external assessment and the qualifications and independence of the assessor or assessment team with the board?	N/A	The requirement for an external assessment (to be undertaken every 5 years) is new. The PSIAS took effect from 1 April 2013; as such there is no requirement to have completed an external assessment until 31 March 2018.	The Chief Internal Auditor will present a paper to the Partnership Board exploring the options, form, timing and scope of the external assessment.	Chief Internal Auditor	September 2014
Has the CAE agreed the scope of the external assessment with an appropriate sponsor, such as the chair of the audit committee, the CFO or the chief executive?	N/A	The requirement for an external assessment (to be undertaken every 5 years) is new. The PSIAS took effect from 1 April 2013; as such there is no requirement to have completed an external assessment until 31 March 2018.	The Chief Internal Auditor will present a paper to the Partnership Board exploring the options, form, timing and scope of the external assessment.	Chief Internal Auditor	September 2014
Has the CAE agreed the scope of the external assessment with the external assessor or assessment team?	N/A	The requirement for an external assessment (to be undertaken every 5 years) is new. The PSIAS took effect from 1 April 2013; as such there is no requirement to have completed an external assessment until 31 March 2018.	The Chief Internal Auditor will present a paper to the Partnership Board exploring the options, form, timing and scope of the external assessment.	Chief Internal Auditor	September 2014
Has the assessor or assessment team demonstrated its competence in both areas of professional practice of	N/A	The requirement for an external assessment (to be undertaken every 5 years) is new.	The Chief Internal Auditor will present a paper to the Partnership Board exploring the	Chief Internal Auditor	September 2014

Standard	Compliant	Comment	Action	Responsible Officer	Implementation Date
<p>internal auditing and the external assessment process?                      Competence can be determined in the following ways:</p> <ul style="list-style-type: none"> <li>a) experience gained in organisations of similar size</li> <li>b) complexity</li> <li>c) sector (ie the public sector)</li> <li>d) industry (ie local government), and</li> <li>e) technical experience.</li> </ul> <p>Note that if an assessment team is used, competence needs to be demonstrated across the team and not for each individual member.</p>		<p>The PSIAS took effect from 1 April 2013; as such there is no requirement to have completed an external assessment until 31 March 2018.</p>	<p>options, form, timing and scope of the external assessment.</p>		
<p>How has the CAE used his or her professional judgement to decide whether the assessor or assessment team demonstrates sufficient competence to carry out the external assessment?</p>	N/A	<p>The requirement for an external assessment (to be undertaken every 5 years) is new.                      The PSIAS took effect from 1 April 2013; as such there is no requirement to have completed an external assessment until 31 March 2018.</p>	<p>The Chief Internal Auditor will present a paper to the Partnership Board exploring the options, form, timing and scope of the external assessment.</p>	Chief Internal Auditor	September 2014
<p>Does the assessor or assessment team have any real or apparent conflicts of interest with the organisation? This may include, but is not limited to, being a part of or under the control of the organisation to which the internal audit activity belongs.</p>	N/A	<p>The requirement for an external assessment (to be undertaken every 5 years) is new.                      The PSIAS took effect from 1 April 2013; as such there is no requirement to have completed an external assessment until 31 March 2018.</p>	<p>The Chief Internal Auditor will present a paper to the Partnership Board exploring the options, form, timing and scope of the external assessment.</p>	Chief Internal Auditor	September 2014

Standard	Compliant	Comment	Action	Responsible Officer	Implementation Date
<b>4.1 - Managing the Internal Audit Activity</b>					
Where an external internal audit service provider acts as the internal audit activity, does that provider ensure that the organisation is aware that the responsibility for maintaining and effective internal audit activity remains with the organisation?	N/A	Internal audit is not provided by an external service provider.	-	-	-
<b>4.5 - Communicating Results</b>					
Where any non-conformance with the PSIAS has impacted on a specific engagement, do the communication of the results disclose the following:					
a) The principle or rule of conduct of the <i>Code of Ethics</i> or <i>Standard(s)</i> with which full conformance was not achieved?	N/A	Occasion has not arisen whereby non-conformance with PSIAS has impacted on an engagement.	-	-	-
b) The reason(s) for non-conformance?	N/A	Occasion has not arisen whereby non-conformance with PSIAS has impacted on an engagement.	-	-	-
c) The impact of non-conformance on the engagement and the engagement results?	N/A	Occasion has not arisen whereby non-conformance with PSIAS has impacted on an engagement.	-	-	-

Opportunities for Improvement - Section briefing– 3 March 2014

Improvement opportunities:	Suggested actions:	Responsible Officer	Implementation
<p><b>Communication</b></p> <p>With additional organisations joining the Partnership, the transient nature of audit staff, flexible working options and the fluidity of planning to meet the needs of the client, it is considered that current channels of communication should be enhanced to compliment changing working practices.</p>	<p>Head of Southern Internal Audit Partnership to attend ASMT monthly to capture key messages from the team</p> <p>A monthly email to be circulated to all staff with the key messages (corporate and local)</p> <p>To ensure all relevant staff are notified with any plan changes (ASMT to be copied in on email(s) due to potential impact on other workloads).</p>	<p>Head of Southern Internal Audit Partnership</p> <p>Head of Southern Internal Audit Partnership</p> <p>All of ASMT</p>	<p>Complete</p> <p>Complete</p> <p>Complete</p>
<p><b>MKI</b></p> <p>Limitations within MKI prior to the recent upgrade have required a number of workarounds questioning the effectiveness and efficiency of the system. Additionally attaining relevant management information is a cumbersome and timely process.</p>	<p>MKI are currently developing a progress report that will replace the progress control sheet. This will make the monitoring of audits for all staff much easier.</p> <p>Looking to change the hosting of MKI back to the vendor rather than internal. This will resolve the live mobile issues.</p> <p>Once the progress report has been developed, we will ask MKI to develop automated audit reports/outlines and</p>	<p>LE / MKI</p> <p>LE / MKI</p> <p>LE / MKI</p>	<p>June 2014.</p> <p>May 2014</p> <p>June/July 2014</p>

Improvement opportunities:	Suggested actions:	Responsible Officer	Implementation
	<p>facility to track management actions.</p> <p>Staff to be reminded on the level of scanning needed. We don't need every single document scanned.</p> <p>Should the scanner in room 241 be out of action, an alternative device is available in room 321.</p>	All staff	immediately
<p><b>Travel</b></p> <p>Clarity required on with regard travel entitlements in light of the expansion of the Partnership</p>	To introduce a travel policy for the partnership	Head of Southern Internal Audit Partnership	June 2014
<p><b>Manager review</b></p> <p>Quality standards require manager and senior manager sign off of all reports with Limited and No assurance reports cleared by the Head of Partnership. Does this remain practicable in light of the extension of the partnership.</p>	Quality standards will not be compromised. To review the current reporting protocol and timescales for practicalities.	Senior Management Team	May 2014
<p><b>Planning</b></p> <ul style="list-style-type: none"> <li>○ Need more scope / background reasons for inclusion in the plan</li> <li>○ Need more involvement of staff in the annual planning process</li> </ul>	This has been rectified in the 2014/15 plans.	Audit Services Management Team / Senior Management Team	Complete
<p><b>Allocation of audit</b></p>			

Improvement opportunities:	Suggested actions:	Responsible Officer	Implementation
<p>Is the allocation of audit assignments effective. Are we maximising individuals knowledge and experience.</p>	<p>Matrix working is in place across the partnership to ensure that we maintain flexibility to apportion relevant experience at all times.</p> <p>Not looking to develop “experts” with the notable exceptions of IT, Fraud and Procurement / Contract Management.</p> <p>Any training needs to be raised with relevant managers</p>	<p>All staff</p>	<p>on-going</p>
<p>IT –connectivity at one satellite site remains restrictive.</p>	<p>Head of Southern Internal Audit Partnership to liaise with relevant S151 to effect a long term solution.</p>	<p>Head of Southern Internal Audit Partnership</p>	<p>June 2014</p>
<p><b>Auditees</b></p> <p>There are increasing incidences where the duration of audit assignments are prolonged due to client availability both in terms of fieldwork and report clearance. Significant delays in issuing reports can impact on relevance and reflect poorly on the audit service.</p>	<p>Head of Southern Internal Audit Partnership to raise with CMT’s as a general discussion about the impact of delays etc.</p> <p>Formalise an escalation policy.</p> <p>Need to ensure any delays are escalated to the relevant Audit Manager / SMT member promptly.</p> <p>Report template to include timeline</p>	<p>Head of Southern Internal Audit Partnership</p> <p>Senior Management Team</p> <p>All staff / ASMT</p> <p>To align with automated reports from MKI</p>	<p>April – June 2014</p> <p>June 2014</p> <p>Complete</p> <p>June / July 2014</p>
<p><b>Information extraction</b></p>			

Improvement opportunities:	Suggested actions:	Responsible Officer	Implementation
<p>The addition of new partners coupled with the matrix management approach introduces challenges in maintaining a working knowledge of all applications and systems across the partnership.</p>	<p>Look at system training needs across the section and determine who needs what training. (in- house or provided elsewhere.)</p> <p>Identify staff with specific knowledge as contacts for key systems to provide internal training</p> <p>For sites with restricted access to systems consider including a more specific list of required reports etc. in the AO</p>	<p>ASMT</p> <p>ASMT</p> <p>AMs</p>	<p>May 2014</p> <p>May 2014</p> <p>May 2014</p>
<p><b>Working in silos</b></p> <p>Look for opportunities for team building – socials, group work etc.</p>	<p>To ensure section briefings include more opportunities for group work.</p> <p>To arrange regular social events outside of work.</p>	<p>Deputy Head of Southern Internal Audit Partnership</p> <p>NJ</p>	<p>June 2014</p> <p>on-going</p>