

# AGENDA

## Audit and Governance Committee

Date: **Tuesday 24 November 2015**

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Time: **10.00 am**

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Place: **Committee Room 1, Shire Hall, St. Peter's Square,  
Hereford, HR1 2HX**

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Notes: Please note the **time, date** and **venue** of the meeting.

For any further information please contact:

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# **Agenda for the Meeting of the Audit and Governance Committee**

**Chairman**  
**Vice-Chairman**

**Councillor BA Durkin**  
**Councillor FM Norman**

**Councillor ACR Chappell**  
**Councillor DG Harlow**  
**Councillor EPJ Harvey**  
**Councillor PD Newman OBE**  
**Councillor RJ Phillips**  
**Councillor J Stone**  
**Councillor LC Tawn**

## AGENDA

		Pages
<b>PUBLIC INFORMATION AND FIRE INFO</b>		
<b>1.</b>	<b>APOLOGIES FOR ABSENCE</b> To receive apologies for absence.	
<b>2.</b>	<b>NAMED SUBSTITUTES (IF ANY)</b> To receive details any details of Members nominated to attend the meeting in place of a Member of the Committee.	
<b>3.</b>	<b>DECLARATIONS OF INTEREST</b> To receive any declarations of interest by Members in respect of items on the agenda.	
<b>4.</b>	<b>CHAIRMAN'S ANNOUNCEMENTS</b>	
<b>5.</b>	<b>MINUTES</b> To approve and sign the minutes of the meeting held on 23 September 2015.	7 - 16
<b>6.</b>	<b>ANNUAL AUDIT LETTER</b> To consider and note the external auditor's statutory annual audit letter (AAL) for 2014/15 which primarily sets out the unqualified audit opinion on both the financial statements and value for money conclusion. The AAL is intended to communicate key messages to the Council and external stakeholders.	17 - 28
<b>7.</b>	<b>INTERNAL AUDIT PLAN PROGRESS REPORT</b> To update members on the progress of internal audit work and to bring to their attention any key internal control issues arising from work recently completed.	29 - 42
<b>8.</b>	<b>CORPORATE RISK REGISTER</b> To inform the Committee of the risks on the corporate risk register, so as to give assurance that risks are being managed.	43 - 44
<b>9.</b>	<b>ENERGY FROM WASTE (EFW) LOAN UPDATE</b> To provide assurance on the status of the energy from waste (EfW) loan arrangement.	45 - 70
<b>10.</b>	<b>ANNUAL REPORT OF THE MONITORING OFFICER</b> To inform the committee of performance in the areas within the remit of the monitoring officer for the municipal year 2014/15.	71 - 76
<b>11.</b>	<b>GOVERNANCE IMPROVEMENT WORKING GROUP UPDATE</b> To note the work of the governance improvement working group to date and agree the draft design principles to inform the further work of the group.	77 - 86
<b>12.</b>	<b>WORK PROGRAMME UPDATE</b> To provide an update on the work programme for the committee for 2015-16.	87 - 92



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HEREFORDSHIRE COUNCIL

**MINUTES of the meeting of Audit and Governance Committee held at Committee Room 1, Shire Hall, St. Peter's Square, Hereford, HR1 2HX on Wednesday 23 September 2015 at 10.00 am**

**Present:** Councillor BA Durkin (Chairman)  
Councillor FM Norman (Vice Chairman)

Councillors: ACR Chappell, DG Harlow, EPJ Harvey, PD Newman OBE, J Stone and LC Tawn

**In attendance:** Councillors AJW Powers, P Rone

**Officers:** Annie Brookes, Paula Gibson (SWAP), Jacqui Gooding (SWAP), Phil Jones (Grant Thornton), Peter Robinson, Josie Rushgrove and Terry T Tobin (Grant Thornton)

**74. APOLOGIES FOR ABSENCE**

Apologies were received from Councillor RJ Phillips.

**75. NAMED SUBSTITUTES**

None.

**76. DECLARATIONS OF INTEREST**

None.

**77. CHAIRMAN'S ANNOUNCEMENTS**

There would be a change to the order of items on the agenda, to consider Item 9 before Item 5 and Item 7 before Item 6. This would help to contextualise the statement of accounts by the external auditors and for all financial agenda items to be grouped together.

The Chairman and Vice-chairman attended a training event earlier in the month hosted by external auditors, Grant Thornton, from which the slides would be circulated to committee members.

Members were reminded about forthcoming training in October hosted by internal auditors, SWAP which had been circulated previously.

**78. MINUTES**

**RESOLVED**

**That the minutes of the meeting held on 16 July 2015 be accepted as a correct record.**

## 79. EXTERNAL AUDIT FINDINGS REPORT 2014-15

The director of resources introduced the findings from Grant Thornton. The report was positive, and reflected the information that had been reported throughout the year. The accounts reflected compliance with regulations and focus on the balance sheet, giving the committee opportunity to consider issues such as the pension deficit, asset base and collections fund rather than budgetary issues.

Representatives from Grant Thornton gave an overview of their findings from the executive summary. Few issues were found with the accounts and officers were commended for their work in producing good accounts. A key issue related to school assets, which are generally complicated for councils and assumptions needed to be made with regard to what needed to be shown on the balance sheet.

In terms of value for money conclusion, it was reported that three of the eight authorities audited in the area by Grant Thornton were qualified. Herefordshire was unqualified and rated green on all areas of financial performance. A surplus was reported in 2014-15, and future challenges were recognised.

Officers were thanked and congratulated for assisting with reporting and for modernising the process which was slicker. Any issues were in one area as a one-off in relation to school assets, and guidance had been given on improving some processes.

The council had a more robust medium term financial plan. Adult spending was now under control and it was noted that this was unusual for councils.

The chairman welcomed the positive comments and thanks to officers were noted.

A member welcomed the higher reserve figures for the year and asked how Herefordshire compared with other councils with regard to schools reserves. It was confirmed that school reserves were probably slightly over average in comparison with others, noting that there were restrictions on powers in controlling school funds. Schools were monitored and it was clear what work was required in managing this issue. There were variations between schools and changes such as inflationary increases and salaries would put pressure on schools, and so support would be offered. It was noted that reserves were finite.

A member commended officers for this report. In answer to his question regarding what was considered to be of concern, it was explained that some judgements had to be made regarding the valuation of assets. It was noted that advice from CIPFA was not clear regarding the inclusion of assets with regard to voluntary aided and voluntary controlled schools. It was noted further that judgements were required with regard to non-domestic rates (NNDR) for GP surgeries. Pension funds were also coming under pressure. Auditors formed conclusions on whether the assumptions were reliable with the advice from the actuary.

Officers were congratulated by a member on the more robust process. She pointed out issues around deficit and risk management and asked for more information on the impact of reductions in staff numbers on the pension fund. It was clarified that there was budgetary provision in the accounts to manage the pension fund deficit which is reviewed annually. In answer to her further question regarding the management of reserves, explanation was given that reserves had been too low but this had been addressed and although they were at a safe level, they required monitoring to ensure they were sufficient and used appropriately. Auditors confirmed that there was reasonable confidence regarding reserves but it was noted that some reserves were kept for risk mitigation such as with regard to NNDR appeals from GP surgeries where there was some degree of uncertainty regarding required funds.



The member noted that the mix of services implied a continued increase in reserves in line with increasing difficulty in managing responsibility. She commented that the report takes account of underspend, noting that if current spending plans were realised there would have been an over spend in 2015/16 of £1.2m.

The director of resources gave assurance that there would be more robust estimates for children's safeguarding in view of there being comparatively higher spending in 2016/17.

The member noted that the medium term financial strategy included the generation of £60m from the sale of assets based on their valuation, noting that care was needed to get best value and reduce risk for council. In answer to her question regarding earlier settlement of the pension deficit, it was confirmed that this would be recommended should there be an appropriate opportunity.

A member asked if there were any material bearings on the accounts that should be brought to the committee's attention. It was confirmed that the balance sheet was prepared with as much up to date information as possible and any issues raised in the letter of representation. However, it was positive in terms of reduced risks and there was nothing material to draw attention to.

## **RESOLVED**

**That the content of the external audit findings report be noted.**

## **80. 2014-15 STATEMENT OF ACCOUNTS**

### Statement of Accounts

The director of resources presented the report, highlighting that the accounts were better presented and provided more explanation in order to reflect good practice in making them more user friendly.

In answer to a member's question regarding any borrowing from the local enterprise partnership (LEP), it was confirmed that the LEP did not have funds from which the council could borrow.

A member complimented officers on the user-friendly presentation of the accounts. In response the director of resources explained that the accounts were produced by a small team which did an excellent job. The team had responded one year early to national year end timescales being brought forward by one month which very few councils had achieved.

The Chairman commended officers for reducing the process by one month.

### **Annual Governance Statement**

The governance manager presented the annual governance statement, a draft of which was presented to the committee in July 2015. The statement provided an updated outturn from last year's action plan and showed more robust information and focus on expected outcomes to complete the action plan.

A member commented that in terms of transparency and in the context of the current consultation on the council's budget, there was work to do around increasing access for the public to participate. In particular this was in regard to technology and communications to ensure that aspirations were realised.

The chairman noted these comments and acknowledged that progress was being made. Progress reports on the annual governance statement action plan would be presented to committee during the year.

In response to comments about the website, the director of resources clarified that improvement work was under way with Hoople and the communications and customer service teams, with plans in place to improve the website. It was acknowledged that although web content was of good quality, it could be hard to find information. Other best practice solutions were being considered, provided they could be delivered within current resources.

In response to a member's question regarding school relocation overspend, it was clarified that this was not captured on the annual governance statement as not all parts of the risk register were included.

A member sought assurance that there were sufficient governance resources to discharge responsibilities particularly around sound and informed decision making. It was clarified that whilst not part of this committee's remit at this stage, reassurance had been given to the employment panel that the role of the monitoring officer was adequately resourced.

## **RESOLVED**

**That:**

- (a) the 2014/15 statement of accounts (appendix a) be approved; and**
- (b) the letter of representation (appendix b) be signed by the chairman of audit & governance committee and the director of resources; and**
- (c) the annual governance statement (appendix c) be approved and signed by the chairman of audit and governance committee, the chief executive and the director of resources.**

**1 member abstained from recommendation (c) above.**

### **81. 2015-16 BI-ANNUAL FORECAST OF REVENUE AND CAPITAL OUTTURN**

The director of resources presented the report, which provided assurance that budget monitoring and management were appropriate. This was reported twice a year and showed how forecasting informed the accounts. This had already predicted an overspend of £1.3m in children's safeguarding which had been mitigated and assurance was given that the budget would balance over all. The report as a whole gave a high level of assurance.

In response to a member's question regarding schools relocation overspend, it was confirmed that that was within children's services, mitigation was identified and the position was being addressed.

## **RESOLVED**

**That the report and the forecast position be noted.**

### **82. COMMUNITY GOVERNANCE REVIEW**

The governance manager presented the report.

It was a requirement to carry out community governance reviews (CGRs) periodically and good practice suggested that this took place every 10 to 15 years. There were also a number of triggers for one to be considered, such as requests from the community, for example the recent review in Ross-on-Wye, or where it is shown that there are significant anomalies such as population changes. There had not been a review for some twenty years, and in line with good practice, a review was due.

A timetable for establishing the case for a county-wide review was set out in the report for consideration. The alternative would be to focus on individual areas. The report took a cautious approach in recognition of the statutory requirement to complete a review once it was decided to conduct it, and in consideration of the resources that would be required. A further consideration was the timing of implementing any changes alongside other electoral activity.

The chairman reminded the committee of the 2012 boundary commission changes and advised caution that this could happen again around 2018 and would have a bearing on a review.

A member acknowledged the potential scale of a review based on previous experience of the Ross review. It was confirmed that the permitted timescale commences once council decides it will undertake a county wide CGR. There was no discretion for the council to vary this and so evidence was being gathered at this stage. All parish and town councils were consulted and were meeting in September. They were asked to identify what issues they would like to have covered in any review. At the same time, data were being collected on elector numbers and aligning this to population growth predictions. Herefordshire Association of Local Councils (HALC) was engaged and was supporting parishes. As much ground work as possible was being carried out without entering into consultation as this would be part of the statutory process.

A member sought reassurance that the problems and challenges were sufficiently clear and that it had been made clear to parishes about their responsibilities with regard to a review. It was confirmed that there had been discussions with HALC and it was concluded that that it would be better in practice to work alongside parishes to ensure that they did not feel passive in a review although the council had a responsibility to lead the process.

The chairman welcomed the point that HALC were involved. It was noted that not all parish councils had HALC membership and that it was essential that all parish councils were included.

The vice chairman welcomed a more receptive approach to parishes and an awareness of their concerns.

A member in attendance commented on the determination of parish boundaries and asked how a review would align with area plans. In response, explanation was given that community identity, physical boundaries and also those boundaries defined by partners such as the police were taken into account in a review, and that timescales would need to be considered in relation to mapping of area plans.

Further comments from members included:

- Observation that the review had been discussed at some parish council meetings within a ward although it was not clear to what extent its significance had been acknowledged. There was also concern regarding capacity at parish level to respond to devolved responsibility;
- feedback that parishes were content with their current arrangements;

- implications related to issues in addition to area plans and that any future reviews of constituency boundaries may have an impact on how parish boundaries are aligned;
- more devolved powers may attract a different range of people taking part on parish councils, increasing opportunities for greater proactivity;
- localities had been a useful concept with regard to service centres for delivering services especially in remoter areas; and
- Stage 1 of the process outlined in the report was felt to be too short

## **RESOLVED**

**That the timetable as set out at paragraph 9 of the report be agreed.**

**1 member abstained.**

### **83. WHISTLEBLOWING POLICY**

Review of this policy was part of the committee's work programme. Consultation had taken place with unions and legislative changes had been recognised such as the inclusion of agency workers within the scope of the policy. There was also procedural guidance available and a discrepancy was noted between the policy and the procedure in relation to members, which would be corrected.

Reporting on use of the procedure to the committee was via the annual monitoring officer's report.

A member welcomed the inclusion of the revised policy on the agenda and commented on the practical application of and relationship between this procedure and the grievance procedure, under which there is less protection. It was noted that matters pertaining to individuals were not for discussion at committee. However, the intention was that the grievance process would be followed in the first instance, and referring to the whistleblowing procedure if there were concerns about conduct or application of the grievance procedure. It was the expectation that staff members would be directed to the grievance process.

It was further noted that clarity was required on the length of time that a whistle blower would receive protection under the policy and not be placed in detriment and that the policy needed to be seen in practice to determine its effectiveness. It was noted that timescales were not prescribed within the process and this would be considered.

## **RESOLVED**

**That the revised whistle blowing policy be approved, effective 1 October 2015.**

**1 member abstained.**

### **84. PUBLIC INTEREST DISCLOSURE ACT (PIDA) WORKING GROUP UPDATE**

The update report summarised the working group that was established in 2014 in response to a report from external auditors, Grant Thornton, which highlighted areas of learning for future major projects, following the procurement and implementation of the customer relationship management (CRM) system.

There remained one member of the group, who described that the group was set up as a task and finish group to consider the processes followed for the procurement and

implementation of the customer relationship management (CRM) system following a whistleblowing matter raised by a member of staff. The working group met once in December 2014 to scope the work. The member added, however, that the group was advised to await development work on the whistleblowing policy and the constitution. There was a lack of continuity and the group did not meet again due to changes in personnel, resulting in the group not reaching a conclusion and issues not pursued.

A member proposed that the group be reconvened, which was seconded by the vice chairman.

There followed a discussion during which the following points were made by members:

- a working group was required to investigate the processes followed for the implementation of the CRM and to identify lessons to be learned for other projects;
- there was concern that the majority of members of the group were no longer around and that the findings so far lacked depth;
- the group did not meet again after the initial meeting;
- there was potential to gather people who have an interest in addressing the issues and to make it known that this is happening;
- outcomes must be seen to be robust and so there would need to be a clear topic for a reconvened group to work to;
- the report was factually correct but is not conclusive;
- concern that work was held up pending work on the constitution.

The governance manager referred to the report which described the group's belief that the CRM processes were robust and sufficient. The greatest concern was regarding processes not being followed and this may be a focus for a future working group.

A member suggested that it would be practical to repeat process unless the report was accurate and provided the necessary information. However, the view from the proposer was that there were outstanding issues and the matter needed comprehensive consideration. A member added that the original requirement to capture learning points with regard to the treatment of staff and procurement had not been met and that it would not be complete to accept the report as it stands.

The chairman proposed that the report be noted and that the proposer and seconder produce a form of words to enable a proposal for the working party, which would be discussed with the chairman of the General Overview and Scrutiny Committee.

A motion was carried to take the item and investigate the findings and determine the need to undertake further work. A working party would be formed to guide this review, and authority delegated to the chairman to determine the terms of reference for the group.

## **85. PROGRESS REPORT ON 2015/16 INTERNAL AUDIT PLAN**

The report was presented by representatives from internal auditors, SWAP.

It was noted that there was overall control assurance and there were no audits which had no or partial assurance. There was slow progress in bringing some reports to audit stage due to resource issues but an update report would be presented in November. There were no special reviews or unplanned work but the work plan was adjusted to look at grants.

In response to a member's question regarding solutions to minimise the impact of processes relating to the pupil premium and free school meals, it was confirmed that six schools were investigated. It showed that there can be reluctance to sign up and whilst no problems were found with the process, schools needed to convey to parents that they needed to actively apply.

A member commented on the role of the committee having an overview for internal audit work and that the section 151 officer may add work to the programme. He noted that one audit was removed, and asked how this would happen without reference to the committee. It was explained that the audit plan was agreed in March with the caveat that it may change in response to emerging risk, and that changing the plan would be in agreement between audit and the section 151 officer, reporting back to the committee. The member expressed concern that work had gone from the plan without consultation and that this represented poor governance.

It was clarified that the area was removed because it was considered low risk, and that a number of contract management audits were added to plan and so adjusting the plan to have overview of contract management. This represented a change to the plan rather than a material removal of an item.

The member stated uneasiness about agreed items being removed without the committee's approval. The director of resources confirmed that he was happy to bring items to committee for approval.

The chairman moved that items were not to be removed or amended without the committee's approval.

A member questioned how lessons to be learned were identified and actioned following the May elections. It was noted that feedback had been sought from staff and agents involved in the process and used internally to inform improvement in addition to any statutory returns made to electoral commission. Assurance was given that issues are picked up and activity is scheduled to assure that issues are recognised. However there were some issues relating to the returning officer functions which are separate to the council.

The vice chairman noted that there was no debriefing after the elections and this was unfortunate.

A member commented that she was not approached for feedback and noted that independent candidates would not have agents.

## **RESOLVED**

**That subject to amendment regarding items being removed from the plan, the report be noted.**

## **86. WORK PROGRAMME UPDATE**

The committee's updated work programme was presented, showing additions which included a review of the risk register and updates on the annual governance statement.

It was noted that the whistleblowing policy had been presented earlier than planned and so that could be removed from the work plan for November.

A member commented on the inclusion of consideration of performance appraisals for members and it was clarified that council had agreed for an options report to come to the committee. Research was in progress to inform this report.

**RESOLVED**

**That subject to the amendment noted, the updated work programme be agreed.**

The meeting ended at 12.35 pm

**CHAIRMAN**





<b>Meeting:</b>	<b>Audit and governance committee</b>
<b>Meeting date:</b>	<b>24 November 2015</b>
<b>Title of report:</b>	<b>Annual audit letter 2014/15</b>
<b>Report by:</b>	<b>Director of resources</b>

## 1. Classification

Open

## 2. Key Decision

This is not an executive key decision

## 3. Wards Affected

County-wide

## 4. Purpose

4.1 To consider and note the external auditor's statutory annual audit letter (AAL) for 2014/15 which primarily sets out the unqualified audit opinion on both the financial statements and value for money conclusion.

4.2 The AAL is intended to communicate key messages to the Council and external stakeholders.

## 5. Recommendation

**THAT the audit and governance committee discusses and takes note of the content of the annual audit letter for 2014/15 attached to this report.**

## 6. Alternative Options

This is a report reflecting the statutory annual audit letter process and therefore no alternative options are outlined.

## 7. Reasons for Recommendation

7.1 The code of audit practice in local government requires the external auditor to report to those charged with governance the conclusions they have drawn from their audit work and their opinion on the financial statements and value for money.

## 8. Key Considerations

8.1 The external auditors issued an unqualified opinion on the statement of accounts for 2014/15 and reported improvements in both the quality and timeliness thereof.

8.2 An unqualified conclusion was issued in respect of value for money. The external auditors are satisfied that the Council has proper arrangements in place securing the economy, efficiency and effectiveness in its use of resources.

8.3 The external auditors have highlighted two recommendations for the Council to focus on in the coming year; the closedown process and property assets. Improvements are already being progressed in these areas.

## **9. Community Impact**

None.

## **10. Equality and Human Rights**

The content of the report has no direct impact on equality or human rights.

## **11. Financial Implications**

The external audit fee is detailed in appendix B of the letter and funded within existing budgets.

## **12. Legal Implications**

This report has no legal implications.

## **13. Risk Management**

The audit and governance committee has responsibility for corporate governance and will mitigate risks by overseeing the delivery of the recommendations identified in the external auditor's annual audit letter for 2014/15.

## **14. Consultees**

None.

## **15. Appendices**

Appendix A - annual audit letter 2014/15

## **16. Background Papers**

None.



# The Annual Audit Letter for Herefordshire Council

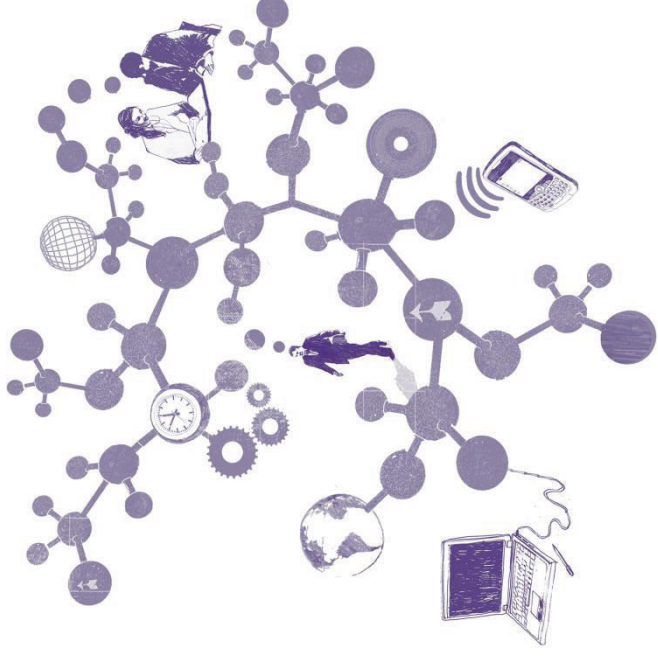
Year ended 31 March 2015

October 2015

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The contents of this report relate only to those matters which came to our attention during the conduct of our normal audit procedures which are designed primarily for the purpose of expressing our opinion on the financial statements. Our audit is not designed to test all internal controls or identify all areas of control weakness. However, where, as part of our testing, we identify any control weaknesses, we will report these to you. In consequence, our work cannot be relied upon to disclose defalcations or other irregularities, or to include all possible improvements in internal control that a more extensive special examination might identify.

We do not accept any responsibility for any loss occasioned to any third party acting, or refraining from acting on the basis of the content of this report, as this report was not prepared for, nor intended for, any other purpose.

# Key messages

Our Annual Audit Letter summarises the key findings arising from the work that we have carried out at Herefordshire Council ('the Council') for the year ended 31 March 2015

The Letter is intended to communicate key messages to the Council and external stakeholders, including members of the public. Our annual work programme, which includes nationally prescribed and locally determined work, has been undertaken in accordance with the Audit Plan that we issued in March 2015 and was conducted in accordance with the Audit Commission's Code of Audit Practice, International Standards on Auditing (UK and Ireland) and other guidance issued by the Audit Commission.

## 21 Financial statements audit (including audit opinion)

We reported our findings arising from the audit of the financial statements in our Audit Findings Report on 23 September 2015 to the Audit and Governance Committee. The key messages reported were:

- The draft accounts presented for audit were of a good quality, a improvement on previous years.
- The accounts were produced earlier and the audit completed earlier than in previous years.
- There were no unadjusted errors. The only misstatements we found related to the omission of some schools from the balance sheet and not including some more up to date school valuations. The effect of this was to increase the value of property in the balance sheet by £9.1 million.
- The quality of working papers and speed of response showed an improvement on previous years and the Council is fully aware of the few areas it still needs to improve on for future years.
- In view of the significance of the judgement needed to be exercised in relation to the accounting for school land and buildings this year, our audit work considered in some detail the basis for and evidence underlying the exercise of management judgement applied. The judgement applied has led to the Council recognising an additional net £35.4 million of assets on the balance sheet this year. Based on our work, we confirmed agreement with Management's treatment.

We issued an unqualified opinion on the Council's 2014/15 financial statements on 29 September 2015, meeting the deadline set by the Department for Communities and Local Government. Our opinion confirms that the financial statements give a true and fair view of the Council's financial position and of the income and expenditure recorded by the Council.

# Key messages

## Value for Money (VfM) conclusion

We issued an unqualified VfM conclusion for 2014/15 on 29 September 2015. On the basis of our work, and having regard to the guidance on the specified criteria published by the Audit Commission, we are satisfied that in all significant respects the Council put in place proper arrangements to secure economy, efficiency and effectiveness in its use of resources for the year ending 31 March 2015.

## Overall Financial Position

The Council, like most others nationally, continues to face challenges in how to balance its budget. The outturn position in 2014/15 shows the budget has been achieved which is a positive achievement. Overall our work highlighted that the Council has satisfactory arrangements in place to secure financial resilience. In particular:

- a robust corporate strategy, medium term financial strategy and savings plan are in place
- the Council delivered its overall savings target
- arrangements for governance processes including risk management and the production of the Annual Governance Statement are satisfactory
- financial management is sound with effective reporting of variances from plans

The Council has further strengthened its arrangements to challenge value for money by improving how savings schemes are monitored and reported in the year. Budget monitoring and reporting throughout the year was comprehensive and enabled members to understand the on going financial position. It is pleasing to note that Adults and Well-Being underspent as a directorate in 2014/15 given that this was a major overspending area until fairly recently. The Council had previously taken a significant step by returning the management of social workers to its direct control

## Waste PFI

We reported to the July Audit and Governance Committee our response to an objection we received in relation to the variation to the waste PFI scheme to build an energy from waste plant in Hartlebury. Whilst we identified areas where processes could be improved, we concluded that the Council had taken appropriate advice and that a report in the public interest was not appropriate in the circumstances.

# Key messages

<p><b>Value for money conclusion (continued)</b></p>	<p><b>Safeguarding children</b></p> <p>Children's Well-Being was the only directorate overspend in 2014/15 with a £529,000 overspend. In March 2015 the Parliamentary Under Secretary for State for Children and Families wrote to the Council lifting the improvement notice previously in place in Children's services. Ofsted identified areas for improvement and these are reflected in the Council's own improvement plan. The July 2015 Cabinet report showed an overall forecast overspend in Children's and Well-being of £1.3m which was contributing to an overall forecast deficit for 2015/16 for the Council of £595,000. The overspend in Children's was due to additional safeguarding costs and in particular the use of agency staff and higher than expected placement costs.</p>
<p><b>Whole of Government Accounts</b></p>	<p>We reviewed the consolidation pack which the Council prepared to support the production of Whole of Government Accounts. We reported that the Council's pack was consistent with the audited financial statements.</p>
<p><b>Certification of grant claims and returns</b></p>	<p>We have not yet certified any grant claims, however work is in progress on the housing benefit claim, with a certification deadline of the end of November 2015. We will report the findings from the audit of this claim as part of our Grant Certification Report in February 2016</p>
<p><b>Audit fee</b></p>	<p>Our fee for the core audit in 2014/15 was £165,873 excluding VAT. Further detail is included within Appendix B.</p>

# Appendix A: Key issues and recommendations

This appendix summarised the significant recommendations identified during the 2014/15 audit.

No.	Issue and recommendation	Priority	Management response/ responsible officer/ due date
1.	<p><b>Audit closedown process.</b></p> <p><b>Recommendation:</b> The Council should continue to redesign the process for closedown and audit of the accounts to ensure a more efficient approach and the Council is ready for the revision of the audited accounts deadline</p>	Medium	<p>This is underway with earlier closedown planning meetings already scheduled, the revised deadline is considered achievable</p> <p>Responsible officer: Head of Corporate Finance</p> <p>Due date: 31 January 2016</p>
2.	<p><b>Property assets.</b></p> <p><b>Recommendation:</b> Controls should be strengthened on the accounting of all Property Plant and Equipment assets by ensuring that:                      -all valuations in the asset register and accounts agree to most recent valuations carried out                      -all assets are included in the balance sheet.</p>	Medium	<p>A comprehensive review of the fixed asset register including the agreement of entries therein has begun. Improvements have already been identified and completed</p> <p>Responsible officer: Head of Corporate Finance</p> <p>Due date: 31 December 2015</p>



## Appendix B: Reports issued and fees

We confirm below the fee charged for the audit.

### Fees

	Per Audit plan £	Actual fees £
Audit Fee *	164,803	165,873
Grant certification fee **	6,420	TBC
<b>Total fees</b>	<b>173,203</b>	<b>TBC</b>

\*The Audit Commission increased the fee by £1,070 in respect of work on material business rates balances. This additional work was necessary as auditors no longer carry out work to certify NDR3 claims. The additional fee was 50% of the average fee previously charged for NDR3 certifications for unitary councils.

\*\* The final certification fee will be reported in the annual certification report in February 2016.

### Fees for other services

Service	Fees £
Teachers Pension Agency Claim	4,200
Forensic assistance with a contractor	4,000

### Reports issued

Report	Date issued
Audit Plan	March 2015
Audit Findings Report	September 2015
Annual Audit Letter	October 2015

# Appendix C-How we brought you added value this year

## Council leadership

**We:**

- provided assurance on financial reporting and financial resilience by giving a timely audit opinion and value for money conclusion
- shared our thinking on key issues, including issuing members and management with our annual reports on Governance and Financial Health and our reports on Alternative Delivery Models, Pension Fund governance, Welfare Reform, Health and Well-being, Financial Sustainability in Local Government and Devolution.
- review of the development of a solution for waste disposal for Herefordshire and Worcestershire .
- provided an opportunity to network with other Local Government bodies at our workshops covering taxation, building a local authority company, integration with health, Local Government self-sufficiency and 20:20 vision.
- arranged a local workshop to raise awareness on good governance

## Audit committee

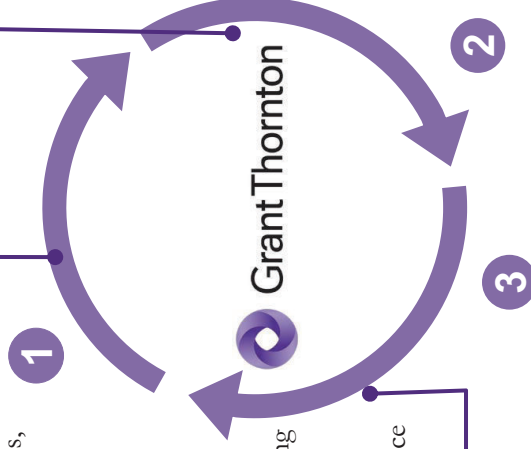
**We:**

- provided independent external audit commentary and insight on your key issues through senior attendance at every audit committee and shared a LG publication to help members of local authority audit committees understand the financial statements and discharge their responsibilities as they review the accounts
- invested in regular dialogue with the audit committee to ensure there were no surprises and to maintain a robust and independent stance throughout our audit
- provided regular, timely and transparent reports from our work and briefing notes on key sector developments.

## Council management

**We:**

- ensured a smooth external audit process through regular dialogue and meetings to promptly discuss financial accounts opinion audit and other issues including WGA and grant certification work to ensure you submit accurate figures to central government.
- presentation of audit requirements at your finance accountants meeting reflecting our engagement and partnership working with finance. Worked with the finance department to improve the accounts process and to strengthen controls and systems
- shared technical knowledge , provided early warning on key risks and provided an opportunity to network with other Local Government bodies at our annual finance seminar
- liaised with internal audit to minimise duplication.
- introduced our Forensics team to the Council who helped in a dispute with contractors
- our Place Analytics team has provided a complimentary summary of the County's performance and position on our growth and dynamism indices covered in our 'Where Growth Happens' report.





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<b>MEETING:</b>	<b>AUDIT &amp; GOVERNANCE COMMITTEE</b>
<b>MEETING DATE:</b>	<b>24th November 2015</b>
<b>TITLE OF REPORT:</b>	<b>PROGRESS REPORT ON 2015/16 INTERNAL AUDIT PLAN</b>
<b>REPORT BY:</b>	<b>INTERNAL AUDIT – SOUTH WEST AUDIT PARTNERSHIP</b>

## Classification

Open

## Wards Affected

County-wide

## Purpose

The purpose of this Internal Audit Report is to update Members on the progress of internal audit work and to bring to their attention any key internal control issues arising from work recently completed.

The attached report (Appendix A) is a summary of the activity completed at 31<sup>st</sup> October 2015 for the 2015/16 audit plan.

## Recommendation

**That subject to any comments the Committee wishes to make the report be noted.**

## Alternative Options

- 1 This report is for information and therefore alternative options are not applicable.

## Reasons for Recommendations

- 2 To ensure compliance with good practice as set out in the Public Sector Internal Audit Standards (PSIAS).

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Further information on the subject of this report is available from  
Jacqui Gooding – Assistant Director (SWAP) on Tel: 01432 260294 or 07872500675

## **Key Considerations**

3 See Appendix A

## **Community Impact**

4 The report does not impact on this area.

## **Equality and Human Rights**

5 The report does not impact on this area.

## **Financial Implications**

6 There are no financial implications.

## **Legal Implications**

7 There are no Legal implications.

## **Risk Management**

8 There is a risk that the level of work required to give an opinion on the Council's systems of Internal Control is not achieved. This is mitigated by the regular active management and monitoring of progress against the agreed internal audit plan.

## **Consultees**

9 The Director of Resources (Section 151 Officer) was consulted in the drafting of this report.

## **Appendices**

Appendix A – SWAP Plan Progress Report 2015/16 (NB this report contains two further appendices referred to within)

## **Background Papers**

- None identified.



## **Herefordshire Council**

Report of Internal Audit Activity  
Plan Progress 2015-16 Quarter 2

# Contents

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## Summary:

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Role of Internal Audit  
Overview of Internal Audit Activity

## Internal Audit Work Plan 2015/16:

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Report on Significant Findings  
Audit Plan Progress  
Future Planned Work }  
Conclusions }

## APPENDICES:

Appendix 'B'  
Appendix 'C'

2015-16 Annual Plan Progress  
Audit Framework Definitions





Our audit activity is split between:

- **Operational Audit**
- **School Themes**
- **Governance Audit**
- **Key Control Audit**
- **IT Audit**
- **Grants**
- **Other Reviews**

## Role of Internal Audit

The Internal Audit service for Herefordshire Council is provided by South West Audit Partnership Limited (SWAP). SWAP is a Local Authority controlled Company. SWAP has adopted and works to the Standards of the Institute of Internal Auditors, further guided by interpretation provided by the Public Sector Internal Audit Standards (PSIAS), and also follows the CIPFA Code of Practice for Internal Audit. The Partnership is also guided by the Internal Audit Charter approved by the Audit and Governance Committee at its meeting on 19 March 2015.

Internal Audit provides an independent and objective opinion on the Authority's control environment by evaluating its effectiveness. Primarily the work includes:

- Operational Audit Reviews
- School Themes
- Cross Cutting Governance Audits
- Annual Review of Key Financial System Controls
- IT Audits
- Grants
- Other Special or Unplanned Reviews

## Overview of Internal Audit Activity

Internal Audit work is largely driven by an Annual Audit Plan. This is approved by the Director of Resources (Section 151 Officer) following consultation with the Senior Management Team. This year's (2015/16) Plan was presented to this Committee on 19 March 2015.

Audit assignments are undertaken in accordance with this Plan to assess current levels of governance, control and risk.



These are actions that we have identified as being high priority or corporate risks that have been assessed as “Very High” or “High” and that we believe should be brought to the attention of the Audit Committee

## Report on Significant Findings/Risk

Appendix B is a summary of the Annual Plan for 2015/16 – a list of all audits as agreed in the Annual Audit Plan 2015/16. It is important that Members are aware of the status of audits as this information helps them place reliance on the work of Internal Audit and its ability to complete the plan as agreed.

Where a review has a status of ‘Completed’ and has been assessed as ‘Partial’ or ‘No Assurance’ or with a ‘High’ or ‘Very High’ corporate risk, I will provide further detail to inform Members of the key issues identified. For the audits completed to date for 2015-16 none have been assessed as ‘Partial’ or ‘No Assurance’ and no ‘High’ or ‘Very High’ corporate risks identified.

One significant finding at service level has been reported and this is covered in the Safer Recruitment audit below.

## Completed Audit Assignments in the Period

### Audit Plan Progress

The summary of the Annual Plan for 2015/16 (Appendix B) highlights progress to date. Based on the findings of each review, an overall control assurance is offered. For a summary of Control Assurance Definitions, Categorisation of Recommendations and Risk Levels, please refer to Appendix 'C'.

As can be seen from Appendix 'B', the following audits have been progressed to date:  
**Operational:**

- Complete, 1 review - (Reasonable)
- Draft Report, 2 reviews
- In Progress, 7 reviews
- Not Started, 16 reviews

#### **Governance, Fraud and Corruption:**

- Complete, 2 reviews (Non-Opinion)
- In Progress, 1 reviews
- Not Started, 1 review
- Contingency, 1 review

#### **Follow Up Reviews: (Non-Opinion)**

- Complete, 1 Reviews
- In Progress, 1 review
- Not Started, 5 Reviews

#### **School Themes –: Pupil Premium**

- Complete, 5 reviews ( 1 Substantial, 4 Reasonable)
- Draft Report, 1 review

Completed Audit Assignments in the Period

## Audit Plan Progress

### Key Control:

- Discussion Document 1 review
- In Progress, 1 review
- Not Started, 3 reviews

### ICT Reviews:

- Complete, 2 review (1 Non-opinion, 1 Reasonable)
- In Progress, 2 reviews
- Not Started, 5 reviews

### Grants:

- Complete, 1 Claim,
- In progress, 1 Claim

### Removed:

- 1 review (Elections)

## Audit Plan Progress

Progress against the plan has improved since my last report. Audits completed to final report since my last update are:

The Buchanan Trust (Non-Opinion) – The auditor was able to provide reasonable assurance that the transfer of the Fund's balance on externalisation was accurate and had been accounted for appropriately in line with the Council's Constitution.



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Delivering Audit Excellence

SWAP work is completed to comply with the International Professional Practices Framework of the Institute of Internal Auditors, further guided by interpretation provided by the PSIAS and the CIPFA Code of Practice for Internal Audit in England and Wales.

Completed Audit Assignments in the Period

## Audit Plan Progress

Local Transport Block Funding/Pothole Fund (Non-opinion) - The auditor concluded that in all significant respects the conditions attached to Local Transport Capital Block Funding (Integrated Transport and Highway Maintenance) Specific Grant Determination 2014/15 No 31/2273, and also the Pothole Fund: Specific Grant Determination Ref: 2014/15 No 31/2391 have been complied with.

Safer Recruitment (Reasonable) - The objective of the audit was to assess the procedures and controls in place to ensure individuals are subject to pre-employment vetting; background checks and continued monitoring where relevant to their role in the Children's Services Directorate. There were four priority 3 recommendations and one priority 4 recommendation.

Generally there were good processes and procedures in place however improvement is needed in record keeping of documentation provided or checked as part of the recruitment process. There was one significant finding in relation to volunteers. There is no known control list of volunteers within the Council or a nominated officer who is in charge of overseeing volunteers. There is a list of volunteers that have been subject to a DBS check but this does not provide a list of all volunteers and as such it is difficult to provide assurance that all volunteers that should have been subject to a DBS check have been identified. The lead auditor is collating information from the SWAP Partners to establish how other Councils manage the use of volunteers.

## Special Reviews

Unplanned work, special reviews or projects carried out on a responsive basis are requested by the Director of Resources (Section 151 Officer).

No reviews have been requested since my last update.

**We keep our audit plans under regular review, so as to ensure we are auditing the right things at the right time.**

## **Future Planned Work**

As new and emerging risks are identified, any changes to the plan will be subject to the agreement of the Director of Resources (Section 151 Officer) with removal or deferral of audits to be formally agreed by the Audit Committee.

There has been two requests for additional work since my last report:

Gypsy and Traveller Site - Openfields Bromyard – annual audit of the Grant Agreement and Affordable Housing Capital Funding

LAC and Fostering FWi Projects – review of the project arrangements

To accommodate the LAC and Fostering FWi Projects review I recommend that the audit reviewing the strategy for resolving incidents and managing problems - Incident and Problem Management is deferred to 2016-17.

This was included as a high level review to ensure that appropriate strategies and policies are in place to ensure incidents and problems are resolved and users suffer no loss or disruption of their ICT service.

## **Conclusion**

I am pleased to report that to date no audits have received Partial or No assurance. Overall assurance has either been substantial or reasonable for the audits completed where an opinion has been assessed. Five audits have been completed as Non-Opinion reviews.

The school themed review of Pupil Premium has been concluded and a summary report issued to all schools via Spotlight on Children identifying areas of good practice.

Directorate/Service	Audit Type	Audit Name	Quarter	Status	Opinion	No. of recs	Recommendations				
							1	2	3	4	5
Economy Communities and Corporate	Deferred/Removed	Elections	1	Removed	-	-	-	-	-	-	
Economy Communities and Corporate	Follow Up	Accounts Payable 2015-16	1	In Progress	0	0	0	0	0	0	
Economy Communities and Corporate	Follow Up	Main Accounting 2015-16	1	Completed	Non-Opinion	-	-	-	-	-	
Economy Communities and Corporate	Governance, Fraud & Corruption	Fraud Reviews	1	Contingency	0	0	0	0	0	0	
Economy Communities and Corporate	Governance, Fraud & Corruption	NFI 2015-16	1	In Progress	This work is ongoing throughout the year	0	0	0	0	0	
Economy Communities and Corporate	ICT	Hardware Asset Management	1	Completed	Reasonable	3	0	0	2	1	
*Information and communication technology	ICT	Public Services Network (PSN) code - assurance compliance	1	Completed	Non-Opinion	-	-	-	-	-	
Economy Communities and Corporate	Key Control	Payroll 2015-16	1	DISCUSSION Document	0	0	0	0	0	0	
Economy Communities and Corporate	Key Control	Pensions - Auto enrolment 2015-16	1	In Progress	0	0	0	0	0	0	
Adults Wellbeing Service	Operational	Peer Challenge Benefits Realisation	1	In Progress	0	0	0	0	0	0	
Children's Wellbeing Service	Operational	Safer Recruitment	1	Completed	Reasonable	5	0	0	4	1	
Children's Wellbeing Service	Operational	Use of Agency Staff 2015-16	1	Draft Report	0	0	0	0	0	0	
Adults Wellbeing Service	Operational	Delivery of Projects funded by the Skills Funding Agency 2015-16	1	In Progress	0	0	0	0	0	0	
Economy Communities and Corporate	Operational	HALO contract	1	Draft Report	0	0	0	0	0	0	
Economy Communities and Corporate	Operational	Home to School Transport	1	Drafting report	0	0	0	0	0	0	
Children's Wellbeing Service	School	Pupil Premium - school theme report	1	Completed	Non-opinion	-	-	-	-	-	
Children's Wellbeing Service	School	Trinity Primary School	1	Completed	Substantial	2	0	0	2	0	
Children's Wellbeing Service	School	The Aconbury Centre	1	Draft Report	Reasonable	0	0	0	0	0	
Children's Wellbeing Service	School	Much Marcle C of E Primary School	1	Completed	Reasonable	8	0	0	8	0	
Children's Wellbeing Service	School	Madley Community Primary School	1	Completed	Reasonable	8	0	0	8	0	
Children's Wellbeing Service	School	St Marys Church of England Primary School	1	Completed	Reasonable	2	0	0	2	0	
Children's Wellbeing Service	School	Blackmarston School	1	Completed	Reasonable	4	0	0	4	0	
Economy Communities and Corporate	Governance, Fraud & Corruption	Buchanan Trust	2	Completed	Non-Opinion	0	0	0	0	0	
Economy Communities and Corporate	Governance, Fraud & Corruption	Fraud and Corruption Survey	2	Completed	Non-Opinion	0	0	0	0	0	
Economy Communities and Corporate	Grant	Local Transport Block Funding/Pothole Fund	2	Completed	Non-Opinion	0	0	0	0	0	
Economy Communities and Corporate	ICT	Incident and Problem Management	2	Request to defer to 2016-17	0	0	0	0	0	0	
Economy Communities and Corporate	ICT	Access Controls - CIVICA and CRM	2	In Progress	0	0	0	0	0	0	
Economy Communities and Corporate	ICT	Council and NHS ICT	2	Not Started	0	0	0	0	0	0	
Economy Communities and Corporate	Operational	Shaw care provider contract	2	Not Started	0	0	0	0	0	0	
Adults Wellbeing Service	Operational	Better Care Fund	2	In progress	0	0	0	0	0	0	
Economy Communities and Corporate	Operational	Registrar and Coroners	2	In Progress	0	0	0	0	0	0	
Economy Communities and Corporate	Operational	Democratic Services 2015 -16	2	In Progress	0	0	0	0	0	0	
Economy Communities and Corporate	Operational	Modern Records	2	In Progress	0	0	0	0	0	0	
Economy Communities and Corporate	Operational	Public Health Investment and Outcomes	2	Not Started	0	0	0	0	0	0	
Economy Communities and Corporate	Operational	Road Maintenance	2	Not Started	0	0	0	0	0	0	
Children's Wellbeing Service	ICT	LAC and Fostering FWI Projects	3	In Progress	0	0	0	0	0	0	

Directorate/Service	Audit Type	Audit Name	Quarter	Status	Opinion	No. of recs	Recommendations							
							1	2	3	4	5			
Economy Communities and Corporate	Grant	Gypsy and Traveller Site - Openfields Bromyard	3	In Progress		0	0	0	0	0	0	0	0	0
Economy Communities and Corporate	Follow Up	Council Tax 2015-16	3	Not Started		0	0	0	0	0	0	0	0	0
Economy Communities and Corporate	Follow Up	Housing and Council Tax Benefit	3	Not Started		0	0	0	0	0	0	0	0	0
Economy Communities and Corporate	Follow Up	Treasury Management 2015-16	3	Not Started		0	0	0	0	0	0	0	0	0
Children's Wellbeing Service	Governance, Fraud & Corruption	Troubled Families	3	Not Started		0	0	0	0	0	0	0	0	0
Economy Communities and Corporate	ICT	PCI Data Security Standard compliance	3	Not Started		0	0	0	0	0	0	0	0	0
Economy Communities and Corporate	ICT	Mobile phone usage and strategy	3	Not Started		0	0	0	0	0	0	0	0	0
Economy Communities and Corporate	Key Control	Accounts Receivable 2015-16	3	Not Started		0	0	0	0	0	0	0	0	0
Economy Communities and Corporate	Key Control	Capital Accounting 2015-16	3	Not Started		0	0	0	0	0	0	0	0	0
Economy Communities and Corporate	Key Control	NNDR	3	Not Started		0	0	0	0	0	0	0	0	0
Adults Wellbeing Service	Operational	Deprivation of Liberty (DOLs)	3	Not Started		0	0	0	0	0	0	0	0	0
Economy Communities and Corporate	Operational	Licensing	3	Not Started		0	0	0	0	0	0	0	0	0
Economy Communities and Corporate	Operational	Fastershire BDUK	3	Not Started		0	0	0	0	0	0	0	0	0
Economy Communities and Corporate	Operational	Waste Collection Contract	3	Not Started		0	0	0	0	0	0	0	0	0
Children's Wellbeing Service	Operational	Education, Health and Care plans	3	Not Started		0	0	0	0	0	0	0	0	0
Children's Wellbeing Service	Follow Up	Schools Prevention of Fraud	4	Not Started		0	0	0	0	0	0	0	0	0
Economy Communities and Corporate	Follow Up	Road Maintenance Follow Up	4	Not Started		0	0	0	0	0	0	0	0	0
Economy Communities and Corporate	ICT	Corporate Services - Digital Channels Project	4	Not Started		0	0	0	0	0	0	0	0	0
Adults Wellbeing Service	Operational	Direct Budgets	4	Not Started		0	0	0	0	0	0	0	0	0
Adults Wellbeing Service	Operational	Purchasing Strategy and Market Management - Care service	4	Not Started		0	0	0	0	0	0	0	0	0
Economy Communities and Corporate	Operational	Commercial Rents	4	Not Started		0	0	0	0	0	0	0	0	0
Economy Communities and Corporate	Operational	Income review - maximising income - income and charging guidance	4	Not Started		0	0	0	0	0	0	0	0	0
Economy Communities and Corporate	Operational	Land Charges 2015-16	4	Not Started		0	0	0	0	0	0	0	0	0
Economy Communities and Corporate	Operational	Planning Applications	4	Not Started		0	0	0	0	0	0	0	0	0
Children's Wellbeing Service	Operational	Contract Management - Children's Wellbeing	4	Not Started		0	0	0	0	0	0	0	0	0
Economy Communities and Corporate	Operational	Energy Supply Contract	4	Not Started		0	0	0	0	0	0	0	0	0



**Audit Framework Definitions**

**Control Assurance Definitions**

<b>Substantial</b>	▲ ★★★ I am able to offer substantial assurance as the areas reviewed were found to be adequately controlled. Internal controls are in place and operating effectively and risks against the achievement of objectives are well managed.
<b>Reasonable</b>	▲ ★★ I am able to offer reasonable assurance as most of the areas reviewed were found to be adequately controlled. Generally risks are well managed but some systems require the introduction or improvement of internal controls to ensure the achievement of objectives.
<b>Partial</b>	▲ ★ I am able to offer Partial assurance in relation to the areas reviewed and the controls found to be in place. Some key risks are not well managed and systems require the introduction or improvement of internal controls to ensure the achievement of objectives.
<b>None</b>	▲ I am not able to offer any assurance. The areas reviewed were found to be inadequately controlled. Risks are not well managed and systems require the introduction or improvement of internal controls to ensure the achievement of objectives.

**Categorisation Of Recommendations**

When making recommendations to Management it is important that they know how important the recommendation is to their service. There should be a clear distinction between how we evaluate the risks identified for the service but scored at a corporate level and the priority assigned to the recommendation. No timeframes have been applied to each Priority as implementation will depend on several factors, however, the definitions imply the importance.

Priority 5: Findings that are fundamental to the integrity of the unit’s business processes and require the immediate attention of management.

Priority 4: Important findings that need to be resolved by management.

Priority 3: The accuracy of records is at risk and requires attention.

Priority 2: Minor control issues have been identified which nevertheless need to be addressed.

Priority 1: Administrative errors identified that should be corrected. Simple, no-cost measures would serve to enhance an existing control.

**Definitions of Risk**

Risk	Reporting Implications
<b>Low</b>	Issues of a minor nature or best practice where some improvement can be made.
<b>Medium</b>	Issues which should be addressed by management in their areas of responsibility.
<b>High</b>	Issues that we consider need to be brought to the attention of senior management.
<b>Very High</b>	Issues that we consider need to be brought to the attention of both senior management and the Audit Committee.





<b>MEETING:</b>	<b>Audit &amp; Governance Committee</b>
<b>MEETING DATE:</b>	<b>24 November 2015</b>
<b>TITLE OF REPORT:</b>	<b>Corporate risk register</b>
<b>REPORT BY:</b>	<b>Directorate Services Team Leader</b>

## Classification

Open

## Key decision

This is not an executive decision.

## Wards affected

County-wide.

## Purpose

To inform the Committee of the risks on the corporate risk register, so as to give assurance that risks are being managed.

## Recommendation(s)

**That the corporate risk register be noted, and any recommendations to improve the robustness of risk management be identified.**

## Alternative options

1. None.

## Reasons for recommendations

2. The corporate risk register is one of the elements that underpin the council's assurance framework and informs the annual governance statement.
3. The committee is responsible for assuring the effectiveness of the council's risk management arrangements. This report offers assurance that risk is being managed.

## Key Considerations

4. The council's risk management framework provides the basis for the effective management of risks and opportunities within the council, informs decision making at all levels, and aids delivery of the corporate plan priorities. The framework also

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Further information on the subject of this report is available from Steve Hodges, directorate services team leader on (01432) 261923

includes the process for monitoring and reporting of strategic risks.

5. Each directorate of the council maintains its own directorate and service risk registers which are reviewed monthly.
6. Significant and strategic risks are escalated to the corporate risk register and considered by management board and cabinet quarterly as part of the performance and budget report.
7. The last audit report on risk management was concluded in January 2015 when the audit opinion was one of Reasonable, where most of the areas reviewed were found to be adequately controlled. The audit found that generally risks are well managed but some systems required the introduction or improvement of internal controls to ensure the achievement of objectives. Since the audit, the corporate risk register is now routinely reviewed by Cabinet and Management Board as part of the quarterly performance and budget report.

## **Community Impact**

8. None.

## **Equality and human rights**

9. The content of the report has no direct impact on equality or human rights.

## **Financial implications**

10. There are no financial implications arising from this report.

## **Legal implications**

11. There are no legal implications arising from this report.

## **Risk management**

12. Corporate risks, and associated mitigation, are as set out in the corporate risk register (Appendix A).

## **Consultees**

13. None.

## **Appendices**

Appendix A – Corporate risk register

## **Background Papers**

None



<b>Meeting:</b>	<b>Audit and governance committee</b>
<b>Meeting date:</b>	<b>24 November 2015</b>
<b>Title of report:</b>	<b>Energy from waste (EfW) loan update</b>
<b>Report by:</b>	<b>Head of corporate finance</b>

## Classification

Open

## Key Decision

This is not an executive decision.

## Wards Affected

Countywide

## Purpose

To provide assurance to the audit and governance committee on the status of the energy from waste (EfW) loan arrangement.

## Recommendation(s)

**THAT:**

- a) the risks to the council, as lender, are confirmed as being reasonable and appropriate having regard to the risks typically assumed by long term senior funders to waste projects in the United Kingdom and best banking practice; and
- b) arrangements for the administration of the loan are reviewed and, having regard to the advice of external advisors, confirmed as satisfactory.

## Alternative options

- 1 None; the loan arrangement was contractually agreed in May 2014, no breaches have taken place during this reporting period.

## Reasons for recommendations

- 2 To fulfil the functions delegated to the committee in relation to governance of the waste loan arrangement.

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Further information on the subject of this report is available from  
Josie Rushgrove, head of corporate finance on Tel (01432) 261867

## Key considerations

### Background

- 3 Following the approval to provide financing of the construction of an energy from waste (EfW) plant, council delegated to the audit and governance committee the responsibility to review the loan arrangements (including waiver terms) and risks to the council as lender and make recommendations as necessary.
- 4 No decisions or courses of action have been identified for recommendation to the committee.

### Key loan features and update

- 5 Herefordshire and Worcestershire councils are funding the EfW plant through the use of prudential borrowing. Drawdowns of funding from Mercia will continue over a 33 month construction period, between 2014 and 2017, before loan repayments fall due. Repayments will commence in February 2017.
- 6 The total loan facility is for £163.5m, with Herefordshire providing 24.2% of the loan value, £40m. The loan facility is split between two tranches being an interest only loan facility and a repayable loan:
  - £9m repayment loan and
  - £31m interest only (bullet) loan
- 7 Total loan interest and fees chargeable to Mercia are fixed and are representative of commercial bank charges. These total £69m (£17m for Herefordshire) during the loan period. These charges are repayable before the PFI contract ends in 2023 and are recharged to the councils by Mercia through the unitary charge for waste disposal.
- 8 Herefordshire will obtain loan finance in line with its treasury management strategy. This will include short term borrowings and longer term finance from the public works loan board where interest rates are aligned to long term gilt prices. Commercial banks rates are based on the London interbank offer rate (LIBOR). The differential between the long term gilt price and LIBOR rates are typically 3% therefore the cost of debt incurred will be less than the cost charged to Mercia resulting in an estimated surplus of approximately £5m for Herefordshire. This surplus has been reflected in council budgets approved by Council in February 2015.
- 9 The outstanding loan balance in 2023 reflects the expected net book value of the plant at that date. There are strict handover and regular testing arrangements in place that escalate when nearing the end of the contract protecting the return condition of the plant.
- 10 The remaining loan balance of £31m will be repaid after the end of the PFI contract period (2023) until the end of the plant's useful life (2042).

### General progress update

- 11 The council's contractual relationship is with Mercia. Mercia has sub-contracted the work to HZI (Hitachi Zosen Inova). HZI had then sub-contracted the civil engineering aspects of the work to a company called Interserve Construction Limited (Interserve). A decision has been made by HZI to terminate their contract with Interserve. HZI

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Further information on the subject of this report is available from  
Josie Rushgrove, head of corporate finance on Tel (01432) 261867

have now taken direct control of the civil engineering contract.

- 12 HZI had expressed concern about the time taken on the civil engineering works and to ensure that the contract remained on time and to budget decided to replace Interserve. The termination was a matter for HZI and Interserve and the risk rested with HZI, not with the councils.
- 13 Mercia have assured that, because the majority of the civil engineering work is complete, there would be no cost impact and there would be no impact on the critical path of the project as a result of the change of sub-contractor.
- 14 Confirmation has been received from the sponsors that they did not consider that there were any financial risks associated with the project at this stage that impacted on them as sponsors. The council, in its role as funder, would only be exposed to risk after the sponsors.
- 15 If the project were to extend beyond the takeover date, then HZI would pay liquidated damages to Mercia who would then reimburse the Council as lender. There is no impact on the take-over date and loan repayments at this stage.
- 17 This committee is tasked with reviewing the risks as a result of the funding provided by the council to Mercia. This includes ensuring the risks are considered reasonable and appropriate. Attached is a risk register (at appendix d) detailing the unmitigated and mitigated risks arising as a result of the council being lender to Mercia. All risks are typical of a long term senior funder to waste projects and are aligned to best banking practice.

#### **Financial advisor update**

- 18 The latest progress update from the financial advisors show that Mercia have met all senior term loan facility agreement (STLFA) requirements during this reporting period. Cover ratios and cash flow test requirements that ensure Mercia have equity and cash balances sufficient to cover loan repayments have been complied with.
- 19 Part of the loan conditions is the actual construction period cash flow test (ACPCFT) which confirms Mercia have sufficient cash flows in relation to Mercia's equity contribution to the EfW. The ACPCFT is prepared by Mercia on a quarterly basis and reviewed by Deloitte acting in the capacity as financial advisors to the councils in relation to the STLFA to determine whether:  
  
*“actual operating cash generated during that period plus the brought forward cash balance attributable to operations is equal to, or exceeds... the amounts of operating cash projected to be generated during that period plus the brought forward cash balance attributable to operations as shown in the base case financial model.”*
- 20 The ACPCFT performed by Deloitte is attached at appendix a and reports a result of an excess cash flow amount £1m. This means that overall operations have produced £1m more than forecast in the base case financial model. This reflects the impact of additional waste going to Mercia as the economy improves and means the mandatory test was satisfied.
- 21 Mercia is able to use existing business as equity for cash flow purposes. The cashflow Mercia sets aside during the construction phase qualifies as Mercia's contribution of equity capital. Mercia has achieved its required contribution of equity capital to the project that takes risk ahead of the councils STLFA. A higher cash flow

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Further information on the subject of this report is available from  
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offsets the need for Mercia to draw down funds and the council has the ability to lock up Mercia's equity if Mercia fails to achieve an adequate level of excess cash. At present Mercia has the right level of equity to satisfy the tests required under the loan agreement. The ACPCFT test is satisfied.

### **Technical advisor update**

- 22 The lenders' technical advisor has confirmed that the expected takeover date is now the planned takeover date plus one month, March 2017. There is still a possibility that this date could be brought forward, in any case the takeover date does not impact on the loan arrangement, loan repayments will commence in February 2017. Funding of the loan repayments will come from liquidated damages if required.
- 23 Fichtner Consulting Engineers are technical advisors to the lenders during the construction phase of the plant. A copy of the latest progress summary report is attached at appendix b. No significant issues have arisen during the period and the construction completion date is not deemed to be at risk.
- 24 The main elements of the civil engineering works are complete with the evacuation of the bunker largely delivered on budget, although slightly behind forecast timescales. There has been some re-ordering of the remaining civil engineering programme to allow the mechanical and engineering programme to commence to keep the construction timetable on track.
- 25 The construction focus is now on building the superstructure of the plant, including the concrete based bunker and tipping hall and the steel superstructure that houses the boiler hall and administrative buildings.
- 26 Fichtner had indicated that HZI had a good health and safety record on site and had concluded that it was a well-run site with good control processes.
- 27 At takeover the council will be in receipt of a fully operational facility that had passed all relevant tests. Operating tests would be undertaken for an approximate six month period in advance of the takeover date to ensure that it was in full working order. Waste would be treated during this period without any cost to the councils.
- 28 Attached at appendix c is a letter from Fichtner confirming that there are no concerns about the quality of the work as a result of the termination of the Interserve contract.

### **Waivers and consents**

- 29 The committee are asked to note that since the previous update the following waivers and consents have been requested and approved under clause 18.4(b)(ii)(G) of the loan agreement:
- The appointment of ARUP and Royal Haskoning as major subcontractors for the fire design prevention.
  - The appointment of either Compco or Agus as major subcontractors to replace a number of subcontracts that require re-procurement.
  - The appointment of Orona Elevators for the lift contract.
- 30 All of these follow the HZI termination of Interserve and the completion of due

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diligence checks by officers and advisors.

- 31 Sponsors confirmed that the remaining civil packages to be let by HZI following the termination of Interserve total £14m of which 70% relates to building services. HZI are permitted to let the remainder of the contracts (£5m) without consent from the lenders.

## **Community impact**

- 32 There is no additional community impact as a result of this progress update report. The loan arrangement will contribute to the following council corporate objectives:
- Managing our finances effectively to secure value for money and deliver a balanced budget
  - Making best use of the resources available to us in order to meet the council's priorities (includes money, buildings, IT, information).

## **Equality duty**

- 33 This update and its recommendations do not have an impact on equality or human rights.

## **Financial implications**

- 34 The loan arrangement is progressing to plan with the financial implications being reflected in the medium term financial strategy and treasury management strategy approved by Council in February 2015.
- 35 Actual loan drawdowns are approximately two months behind the base case financial model which is consistent with the delay on civil engineering works. Accelerated drawdowns are expected. The impact on budgets are immaterial at this stage, the delay will not affect the loan repayment date, 28 February 2017. If delays continue the financial impact will be reflected in the updated treasury management strategy presented to cabinet in January 2016.
- 36 All costs incurred by advisors are recharged to Mercia.

## **Legal implications**

- 37 The terms and arrangements for this loan agreement are set out in the Senior Term Loan Facilities Agreement. There are no specific legal comments arising from this report.

## **Risk management**

- 38 The councils have undertaken an assessment of risk in its role as lender working with legal advisors (Ashurst), finance advisors (Deloitte) and technical advisors (Fichtner) to understand the basis on which commercial banks reserve elements of their margin against risks. The review considered:
- Counterparty risk

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- Security package
- Key income generation assumptions in the financial model
- Specific project risks
- Interest and foreign exchange rate risk

- 39 The councils negotiated a security package that has left minimal risk that costs would be borne by the councils should issues occur during the construction phase. The loan arrangement security package mirrors that expected in a commercial bank arrangement. Advisors completed a risk fall away analysis and in recognition of this during the construction phase Herefordshire will retain 50% of its loan surplus in its waste disposal reserve should any construction period risk materialise. This reserve balance is included in the council's medium term financial strategy approved by Council in February 2015.
- 40 Risks are retained where they resided in the original 1998 waste disposal contract and any new risks have been transferred to Mercia and its supply chain. There are actions that can be taken if a default situation were to arise, for example taking shares or assets in Mercia in lieu of loan repayment. No indications of default are currently present.
- 41 Existing compensation on termination contract clauses ensure that the lender is repaid the majority (90%) of any outstanding debt balance if any termination event should occur during the PFI contract period.
- 42 Attached at appendix d is the risk register detailing the controls in place safeguarding the council's position in the lending arrangement. The committee is asked to note and consider the risks which are considered to be reasonable and appropriate having regard to the risks typically assumed by long term senior funders to waste projects in the UK and best banking practice.
- 43 Although the expected takeover date had been deferred until 31 March 2017, the repayment of the loan from 28 February 2017 is not at risk. Due diligence tests have been undertaken to establish the financial strength of HZI to continue with the contract. These highlighted no concerns therefore there are no changes to the residual risk. The council is not facing any more risks as a result of the waivers and consents issued. The security packages in place are therefore working effectively.

## Consultees

- 44 None.

## Appendices

- Appendix a Financial advisor update (ACPCFT)  
 Appendix b General technical advisor update  
 Appendix c Specific technical advisor update (installation quality)  
 Appendix d Risk register

## Background papers

None identified.

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Further information on the subject of this report is available from  
 Josie Rushgrove, head of corporate finance on Tel (01432) 261867



# Senior Term Loan Facility Agreement

## Actual Construction Period Cash Flow Test



For the period:  
1 April 2015 to 30 June 2015



# Important notice

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# Actual Construction Period Cash Flow Test

## Background

Mercia has a Waste Management Services Contract (“WMSC”) with the Councils. Mercia secured planning consent for a new facility and re-negotiated the WMSC for the design, construction and operation of a Waste to Energy (“WtE”) plant over the remainder of the WMSC, due to expire in 2023. Financial close was reached in May 2014.

In order to ensure the funding solution demonstrated VfM, the Councils used their prudential borrowing powers to debt fund Mercia’s WtE Plant.

53 Based on a capital structure of 85% debt and 15% equity, the Councils issued a senior loan facility.

Within the Senior Term Loan Facility Agreement (“STLFA”), the Councils included an Actual Construction Period Cash Flow Test (“ACPCFT”). This test is carried out on a quarterly basis following financial close (the first quarter ending 30 September 2014) and is used to determine whether:

*“Actual Operating Cash generated during that period plus the brought forward cash balance attributable to operations is equal to, or exceeds... the amount of Operating Cash projected to be generated during that period plus the brought forward cash balance attributable to operations as shown in the Base Case Financial Model.”*

Should a shortfall occur, Mercia will be required to remedy this shortfall by means of an equity injection equal to the amount of the shortfall in accordance with the contractual documentation.

## Scope of review

Deloitte has reviewed the calculation provided by Mercia for the ACPCFT. In doing so Deloitte has:

- Agreed the terms of the calculation to the STLFA;
- Agreed the “model” Operating Cash generated during the period to the Base Case Financial Model;
- Agreed the actual Operating Cash generated during the period to management information;
- Re-performed the calculation of the ACPCFT;
- Compared the senior term loan facility draw downs against those forecast in the Base Case Financial Model.
- Reviewed the technical reports that we received for the period to 30 June 2015.

## Summary of results

The result of the ACPCFT performed by Mercia for the period under review is an Excess Cash Flow amount as at 30 June 2015 is £1,087k.

This shows that in the period from 1 May 2014 to 30 June 2015, the operations have produced £1,087k more than was forecast for this period in the Base Case Financial Model.

Based on the above, the ACPCFT for the period under review would be satisfied. In completing our work set out above, we have not identified any inconsistencies between Mercia’s calculation and the underlying information.

# Calculation

## Actual Construction Period Cash Flow Test

Metric (£000)	May – Sep 14	Oct – Dec 14	Jan - Mar 15	Apr - Jun 15
<b>Base case financial model</b> <i>b/f cash attributable to Ops</i>	4,254	4,793	7,051	9,123
Gross revenue	18,603	10,448	10,847	11,813
Operating costs	(14,893)	(8,111)	(8,320)	(8,961)
Changes in working capital	(1,212)	320	(18)	(252)
Cell preparation assets	(612)	0	0	0
Corporation tax	(1,346)	(400)	(437)	(477)
<b>Total change</b>	<b>539</b>	<b>2,258</b>	<b>2,072</b>	<b>2,122</b>
<b>Actuals</b>				
<i>b/f cash attributable to Ops</i>	4,637	6,480	11,674	10,423
Gross revenue	19,688	13,341	10,578	11,929
Operating costs	(15,557)	(8,588)	(8,509)	(9,372)
Changes in working capital	(1,392)	1,363	(3,018)	(171)
Cell preparation assets	(333)	(286)	0	0
Corporation tax	(563)	(636)	(302)	(476)
<b>Total change</b>	<b>1,843</b>	<b>5,194</b>	<b>(1,252)</b>	<b>1,910</b>
<b>Variance</b>	<b>1,304</b>	<b>2,936</b>	<b>(3,324)</b>	<b>(212)</b>
Excess cash flow a/c b/f	383	1,687	4,624	1,299
<b>Excess cash flow a/c c/f</b>	<b>1,687</b>	<b>4,624</b>	<b>1,299</b>	<b>1,087</b>

Source: Mercia; Financial Model; Senior Term Loan Facility Agreement.

# Commentary

## Commentary

- The calculation is the result of a methodology agreed between parties (the Councils and Mercia) which accords with the STLFA signed on 21 May 2014.
- The result of the ACPCFE performed by Mercia for the period under review is an Excess Cash Flow amount as at 30 June 2015 is £1,087k.
- This shows that in the period from 1 May 2014 to 30 June 2015, the operations have produced £1,087k more than was forecast for this period in the Base Case Financial Model.
- Based on the above, the ACPCFE for the period under review would be satisfied. In completing our work set out above, we have not identified any inconsistencies between Mercia's calculation and the underlying information.
- We reviewed the technical report "*Mercia LTA Construction Progress Summary – July 2015*", which covers relevant activities and progress based on review of latest available reports from the Owner's Engineer (covering 1st – 30th April 2015) and Mercia (covering 1st – 31st May 2015), and on the monthly progress meeting held on site on 9th July 2015. From the report, we highlight the following aspects:
  - HZI have confirmed that procurement and manufacturing is "progressing as expected and is not currently on the critical path".
  - Construction progress on site during May has "remained good".
  - The key risk to the project remains the 3 month delay in the civil works.
- In July 2015, HZI made the decision to terminate Interserve due to the risks associated with their previous performance on the project. HZI will need to confirm how they intend to continue the civil works which were within Interserve's scope and how they will avoid additional delays. Mercia will be issuing a document providing more information on the reasons for termination and an initial view on HZI's plans to complete the project.
- Having discussed the technical reports with Mercia, we are told that there has been no change to model assumptions to date, nor are any envisaged at this time. However, a Contract Variation Instruction has been received regarding the relocation of a Household Waste Site (Tenbury) –the model will have to be updated for this change (a contractual requirement). This change should be cash neutral to the project.
- Mercia are also working on some changes to the model structure to enable them to update it for the above change and once the process has been agreed with the Council, the model will be updated.
- The Councils will have to clarify that they are happy for the updated model to be used for future ACPCFE.

# Senior Term Facility Loan draw downs

## Actuals vs Forecast in the Financial Model

The table below shows the actual Senior Term Facility Loan draw downs against those forecast in the financial model.

Model	May - Sep 14	Oct - Dec 14	Jan - Mar 15	Apr - Jun 15
<b>Model</b>				
Facility A	5,241	2,341	1,725	5,633
Facility B	18,898	8,426	6,190	20,288
<b>Total</b>	<b>24,139</b>	<b>10,767</b>	<b>7,916</b>	<b>25,921</b>
<b>Actual</b>				
Facility A	4,576	0	1,713	2,375
Facility B	16,532	0	6,187	8,581
<b>Total</b>	<b>21,108</b>	<b>0</b>	<b>7,900</b>	<b>10,957</b>
<b>Difference</b>	<b>(3,031)</b>	<b>(10,767)</b>	<b>(16)</b>	<b>(14,965)</b>

Facility A is the amortising loan. Capital repayment begins in the quarter ended 30 June 2017 following the end of the construction period.

Facility B is the bullet loan which is forecast to be repaid in the quarter ended 31 December 2023.

From discussion with Mercia management, the lack of draw down in October 2014 to December 2014 period reflects both a delay in the WtE build (meaning less cash was required for the WtE build) and the lower than expected capital expenditure in non-WtE build (meaning that more cash can be used on the WtE build).

We note that actual draw downs have been significantly below the draw downs that were forecast in the financial model. From discussion with Mercia management, this is due to the fact that, in general, there have been delays in the timing of some of the EPC milestone payments and the asset replacement programme has been a little behind due to the lead times for delivery / installation. These are delays in the timing of capital expenditure payments, and Mercia anticipate catching up with the model drawdowns later this year.

Source: Mercia; Financial Model



# Appendix 1

## Mercia's calculation (£000)

### Cash Flow Test Calculation

	1 Apr 15 to 30 Jun 15 ACTUAL	1 Apr 15 to 30 Jun 15 MODEL
<b>Profit Before Depreciation and Tax</b>	2,557	2,852
<b>Working Capital Movement (Operating)</b>	-171	-252
Cell Preparation Assets	-	-
Corporation Tax (Cash)	-476	-477
<b>Operating Cash Flow</b>	<b>1,910</b>	<b>2,122</b>

## Mercia's cash flow notice

Excess Cash – Opening Balance (Mar 2015)	1,299
Gross Revenue	+116
Operating Costs	-410
Changes in Working Capital	+81
Corporation Tax	+1
Total	-212
Excess Cash – Closing Balance (Jun 2015)	1,087

	1 April to 30 June 2015		
	Actual	Model	Var
Operating Cash Opening Balance	10,423	9,123	1,299
Operating Cash Flow (as above)	1,910	2,122	(212)
<b>Operating Cash Closing Balance</b>	<b>12,333</b>	<b>11,246</b>	<b>1,087</b>

### Excess Cash Flow

Source: Mercia; Mercia also provided the workings behind this calculation so that the calculation could be reconciled to the company's trial balance and so it could be presented in a manner mapping to the description in the Senior Term Loan Facilities Agreement (see page 4).

# Appendix 2

## Extracts from Senior Term Loan Facility Agreement

**"Actual Construction Period Cashflow Test"** means the quarterly test to be carried out on each Actual Construction Period Cashflow Testing Date, in relation to the preceding quarter period to determine whether:

- (a) actual Operating Cash generated during that period plus the brought forward cash balance attributable to operations is equal to, or exceeds;
- (b) the amount of Operating Cash projected to be generated during that period plus the brought forward cash balance attributable to operations as shown in the Base Case Financial Model;

**"Actual Construction Period Cashflow Testing Date"** means each Quarter Date following Financial Close, up to and including Completion;

**"Actual Construction Period Cashflow Shortfall"** has the meaning given to it in clause 15.9 (Actual Construction Period Cashflow Test);

**"Actual Construction Period Cashflow Remedy Amount"** means the minimum amount necessary following a failure by the Borrower of the Actual Construction Period Cashflow Test, to pass such test;

**"Actual Construction Period Excess Cashflow Amount"** means the amount of Operating Cash generated in any quarter during the Construction Period which is greater than the amount required to satisfy the Actual Construction Period Cashflow Test;

**"Base Case Financial Model"** means the computer model, agreed between the Lenders and the Borrower at Financial Close, as amended from time to time by agreement between the Lenders and the Borrower and delivered pursuant to paragraph 11.1 (Part I – Initial Conditions Precedent) of schedule 3;

**"Current Assets"** means:

- (a) cash held by the Borrower;
- (b) any balance on the Debt Service Reserve Account;
- (c) any balance on the Maintenance Reserve Account;
- (d) any prepayments received;
- (e) amounts owed to the Borrower and/or the amounts of any accounts receivable (in each case from trade debtors or HMRC in respect of VAT);
- (f) amounts in respect of deferred taxes;
- (g) inventory; and
- (h) any cell preparation assets;

**"Current Liabilities"** means:

- (a) amounts owed by the Borrower and/or the amounts of any accounts payable (in each case to trade creditors or HMRC in respect of National Insurance and VAT);
- (b) the amount of any accruals or provisions made;
- (c) the amount of any deferred tax liability;
- (d) any cell restoration liabilities;
- (e) any aftercare liabilities; and
- (f) liabilities in respect of Corporation Tax;

# Appendix 2 (continued)

## Extracts from Senior Term Loan Facility Agreement

**"Gross Revenue"** means, at any Ratio Testing Date and without double counting, the sum of:

- (a) operating revenue including the Unitary Payment, any interim service payments (if applicable) and any actual or guaranteed third party income, but excluding, for the avoidance of doubt, the Bullet Payment; plus
- (b) interest earned on all cash accounts (other than the Distribution Account); plus
- (c) Damages;
- (d) Insurance Proceeds to the extent received as compensation for loss of revenue;
- (e) income earned on Authorised Investments (other than any Authorised Investments in respect of the Distribution Account (if any));
- (f) rebates of Tax actually received or projected to be received in the latest Approved Budget; and
- (g) all other income or proceeds of a revenue nature from whatever source; assumed in the Approved Financial Model to be receivable by the Borrower in the period commencing with such Ratio Testing Date and terminating on the Final Repayment Date or, in respect of any Ratio Testing Period ended on that Ratio Testing Date, all such revenues actually received during such Ratio Testing Period;

**"Operating Cash"** means:

- (a) Gross Revenue; less
- (b) Operating Costs; plus or minus
- (c) changes in Working Capital; less
- (d) Corporation Tax.

in each case, in respect of that Financial Year, as reflected in the operating cashflow calculation in the Approved Financial Model;

**"Working Capital"** means Current Assets minus Current Liabilities.

Source: Senior Term Loan Facility Agreement

**"Operating Costs"** means, without double counting any of those costs, and including any VAT thereon, costs identified as, or as the case may be, falling within the category of:

- (a) costs and expenses of administering, maintaining and operating the Borrower, SWSL and BWL and the Project including, without limitation, all operating costs accrued prior to, or arising after Financial Close relating to the Borrower's, SWSL's and BWL's existing operations under, or related to, the Waste Management Services Contract all costs relating to Environmental Matters and the costs of complying with the requirements of Environmental Laws and the terms and conditions of Environmental Authorisations (together in all cases with any applicable VAT thereon which is irrecoverable VAT);
- (b) the cost of insurance premia (other than in relation to insurances covering the construction and commissioning of the Plant) and all property and occupation charges and rates to which the Project may be subject (together in each case with any applicable VAT thereon which is irrecoverable VAT);
- (c) sums payable by the Borrower under the terms of the Project Documents to which it is a party, other than in relation to construction and commissioning of the Plant (together with any applicable VAT thereon which is irrecoverable VAT);
- (d) Taxes payable (excluding VAT other than "output tax" within the meaning of Section 24(2) of the Value Added Tax Act 1994) other than in relation to the construction and commissioning of the Plant; and
- (e) development costs,

and in all cases, the equivalent lines thereafter in each Approved Budget and each Approved Financial Model;

- (b) The Borrower may only withdraw sums from the Excess Cash Flow Account:
  - (i) to meet Project Costs at any time on or after the Take-Over Date, but prior to Completion; or
  - (ii) to transfer any amount standing to the credit of Excess Cash Flow Account on Completion to the Distribution Account, provided that no Event of Default is continuing.



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# MEMORANDUM

<b>To:</b>	Mark Forrester	<b>Organisation:</b>	Worcestershire County Council
<b>cc:</b>	Simon Lewis	<b>Organisation:</b>	Worcestershire County Council
<b>From:</b>	Kerry Booth	<b>Our Ref:</b>	S1291-2300-0004KSB
<b>Date:</b>	2 <sup>nd</sup> October 2015	<b>No. of Pages:</b>	3
<b>Subject:</b>	Mercia LTA Construction Progress Summary – October 2015		

## 1 INTRODUCTION

Mercia Waste Management Limited ("Mercia") is constructing the 200,000 tonnes/year, 18 MWe Mercia EnviRecover EfW Plant in Kidderminster, Worcestershire. Fichtner Consulting Engineers Ltd (Fichtner) has been appointed as lender's technical advisor (LTA) for the construction phase of the plant. This summary memo covers relevant activities and progress based on review of latest available reports from the Owner's Engineer (OE) (covering 1<sup>st</sup> – 31<sup>st</sup> August 2015) and Mercia (covering 1<sup>st</sup> – 31<sup>st</sup> July 2015). Fichtner has not been made aware of any issues during the month of September which need to be drawn to the Council's attention. Fichtner will attend the November progress meeting to confirm the civil engineering activities scheduled for October have been completed.

## 2 PROJECT PROGRESS

Construction of process steelwork, boiler construction and civil works on the turbine hall area have progressed well in this period, and has generally been in line with the revised Approved Programme. However, due to the termination of the contract with Interserve and delays in appointing replacement civil contractors, the critical path is now shown to go through the administration block construction and installation of building services. The latest programme shows a target Take Over date of 31<sup>st</sup> March 2017, one month after the contractual Take Over date of 28<sup>th</sup> February 2017.

The status of activities on site are summarised below.

- Site wide and temporary works – Drainage installation has progressed when access permits.
- Perimeter retaining wall and access ramps – Concrete pouring of the east access ramp is ongoing.
- Tipping hall and bunker area – Preparation works for pouring of the south crane beam has commenced. Installation of steelwork and precast concrete planks to the west and east cores and hopper shelf sections continues.
- Boiler and Flue Gas Treatment (FGT) hall area – Installation of the economiser and boiler membrane walls is ongoing. Erection of the FGT structural steel cube 101 is due to commence in September.
- Administration building area – Installation of fire wall cladding has commenced. Installation of phase 3 of the administration building steelwork is due to commence in September.
- Turbine hall – Structural steelwork is ongoing with installation of cladding due to commence in September. Lifting in of process equipment is ongoing.
- Air Cooled Condenser (ACC) – All pad foundations are complete. This area is now being used as laydown for the bag filter sections therefore no works on the ACC are progressing.
- Substation and 66kV transformer area – Installation of the earthing grid and the 66kV equipment plinths has commenced and is due to be completed in the September. The transformer blast walls and bund are complete. Structural steelwork for the DNO control room is also complete.

- Perimeter retaining wall and access ramps – Removal of the temporary earth ramp is complete and cleaning of the perimeter retaining wall continues in preparation for pouring of the permanent reinforced concrete east ramp.

### 3 KEY PROJECT RISKS AND OBSERVATIONS

The appointment of replacement subcontractors following the termination of Interserve's contract and the progress of the civil works, particularly building services design, remains the key risk to the project. Delays in appointing replacement subcontractors has resulted in poor civil construction progress. HZI are now predicting a Take Over date of 31<sup>st</sup> March 2017, one month after the contractual Take Over date. The critical path in the programme now runs through construction of the administration building.

It is critical that the building services and fire detection/suppression contracts are placed by the dates shown in the latest programme. The timing of awarding these contracts, and the commencement date for installation of the admin block phase 3 structural steel will determine if the projected Take Over date is likely to slip further.

HZI have advised that the late shift (19:00 to 02:00) and Sunday working (which has been agreed with Worcestershire Regulatory Services) is available for acceleration of specific works. These time periods will be used by:

- individual contractors to meet their contractual deadlines;
- by HZI to fit in activities (such as the drainage at the -8m level) which conflict with other works; and
- to progress critical path items such as the administration block steelwork.

Provided the key contract award dates are met, additional working hours means there is still potential for the Take Over date to be earlier than currently forecast. Fichtner will continue to monitor the situation and provide updates accordingly.

### 4 FINANCIAL AND COMMERCIAL

Payments have now been made for thirteen milestone events. These include four process milestones and nine civil milestones and amount to 64.5% of the total payment. The cumulative amount which has been certified to date is £39,364,723.16. The LTA has issued four payment certificates to allow drawdown on the senior loan.

No milestone payments were applied for in July or August. An application for milestone 18 - Flue gas treatment reactor in position, is expected in September.

To date twenty seven Variation Orders have been issued, of these three have involved a reduction to the contract price, and one an addition. To date the net reduction to the contract price is £89,463. There has been no extension of time for any Variation Orders issued to date.

Cost proposals are outstanding for 5 additional items requested by Mercia. It was agreed that these costs will be offset against the saving from not providing a concrete lining wall to the perimeter secant piles, which has been requested by HZI. Once prices have been agreed Variation Orders will be issued wherever there is a change to the contractual requirements.

### 5 HEALTH AND SAFETY

There were no injuries reported in July or August. However, there was a significant increase in disciplinary action with thirteen yellow cards and three red cards issued in July and seven yellow cards and one red card issued in August. Eight of the yellow cards related to incorrect use of personal protective equipment (PPE), two in relation to poor supervision and ten to working at height. Two of the red cards related to failure of an alcohol test at the induction and two to working at height. HZI have stated that, in line with the current phase of construction, they are focussing on working at height practices and that this is reflected by the increased number of SSORs raised in this category in August. Any transgressions are also being dealt with through the disciplinary system to make sure that high standards are maintained.

Despite the increase in disciplinary action, Fichtner consider that there remains a good health and safety culture on site, and that the organisation of the site and the level of attention given to health and safety continues to be good. The fact that disciplinary action is being taken where appropriate, shows that HZI are remaining firm when dealing with any transgressions of the site rules, which should help to maintain the current high standards.

## 6 PLANNED ACTIVITIES NEXT PERIOD

At present the following activities are planned for September 2015:

- Detailed engineering of remaining packages (including boiler piping, turbine control, electrical engineering, instrumentation, various civil packages, etc);
- Placement of purchase orders for a number of process and civil items, including weighbridges, waste bunker excavation and construction, external doors and blockwork and request for quotations on a number of additional civil packages;
- Continued manufacture of items currently in work, including intermediate and final inspections where required;
- Continued work on civil packages including drainage (as access permits), perimeter retaining wall and access ramp, waste bunker, admin building, demineralised water building, turbine hall, high voltage transformer compound, high voltage substation, and DNO control room; and
- Continued work on process packages including boiler pre-assembly and assembly, boiler hall ductwork and grate installation, installation of FGT steelwork and installation of ducting and fabric filters, and installation of the turbine to ACC steam duct.

Yours sincerely  
FICHTNER Consulting Engineers Limited

**Kerry Booth**  
Consultant

**Phin Eddy**  
Commercial Director





5<sup>th</sup> October 2015

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Gillian Sinclair  
Mercia Waste Management Limited  
C/O FCC Environment  
Ground Floor West  
900 Pavilion Drive  
Northampton  
NN4 7RG

**Ref: HZI Installation Quality to Date**

Dear Gillian,

We can confirm that in general the quality of construction on the EnviRecover project is good.

HZI have a site inspection procedure, which is outlined in the attached document, in order to monitor quality. There is a good relationship between our Site Representative, Paul Draffan and HZI's quality manager Georgios Apostolidis, and we are invited to all HZI site intermediate inspections (IIS), so that components can be inspected prior to insulation. We will also be invited to final site inspections (FIS). These inspections present the opportunity to check quality documentation and pick up any snags prior to the final Mechanical Erection Completion (MEC) inspection for the system. The MEC is the final inspection for each system to ensure that it meets the contractual and good industry practice requirements.

We are also able to review HZI's quality monitoring documentation, including weld maps, at any time, through arrangement with the HZI Quality Manager.

In addition to the HZI organised inspections, we carry out our own independent plant walk downs and inspections daily. Any issues we encounter are raised through the observations system. To date, 39 civil observations have been raised (with 12 closed) and 4 process observations have been raised. Compared to other projects, this is a relatively low number, and none of the observations raised to date give any particular cause for concern.

The quality of material and equipment delivered to site is good. In particular we have been impressed with the professionalism and diligence of Carey's, Refako and Mostostal Pulawy. Equipment has also been inspected prior to shipment from the factory during Factory Inspection Workshops (FIWs). As part of these inspections, the quality system of the boiler supplier Refako was audited and found to be robust. The turbine rotor was inspected and confirmed that the balancing requirements had been met. Our electrical engineer has also been impressed with the build quality and specification of the electrical panels inspected to date, with only minor issues raised.

In conclusion, the quality of site installation is good and we currently have no major concerns. There has been no reduction in quality of the civil works since the termination of the Interserve contract. The key Interserve subcontractors such as Arup, Royal Haskoning and Adstone have been retained. Where there has been a replacement of a subcontractor e.g. Bemac for Carey's the level of quality has been maintained.

Yours sincerely  
FICHTNER Consulting Engineers Limited

**Mark Shatwell**  
Project Manager

**Stuart Wilson**  
Fichtner Project Director

Risk Reference	Description of risk	Gross Impact	Gross Probability	Gross Risk Score	Risk control approach	Mitigating Actions	Residual Impact	Residual Probability	Residual Risk Score	Assigned to (Risk Owners)
a	Default of loan repayments by borrower to lenders due to SPV (Mercia) or HZI falling into administration.	Critical	Medium	15	Risk transferred	Due to the security package negotiated by the Councils a fall away analysis indicated that Mercia, its Shareholders and HZI would need to enter administration at the same time to put repayment at risk during the construction phase. The maximum exposure to the Councils has been calculated and included within the sufficiency assessment of the Council's reserves. All press articles are scanned regularly for indications of financial strength issues and followed up to ensure counterparty risk is not increased.	Substantial	Very low	6	The risk owners are the Section 151 Officers of each Council supported by Ashurst as advisors in case of contract default and Deloitte to monitor Mercia's actual quarterly cash flow tests and cover ratios that have to be maintained by Mercia.
67 b	Construction completion date of EfW is delayed and delays repayment of loan to lenders.	Substantial	Medium	11	Risk transferred	Under the contract terms agreed with Mercia, Mercia take all material risk on EfW construction delay and repayment of loan will commence around February 2017, as set out in the SLFLA and agreed final financial model. Repayments are not tied to the actual construction completion date, rather the planned date. The Council as lender has the right to call the loan into default if construction is not completed by a long stop date, 18 months after the loan repayment date. The lenders technical advisor has confirmed that the expected takeover date is now the planned take over date plus one month, 31.03.15	Substantial	Very low	6	The risk owners are the Section 151 Officers of each Council supported by Ashurst as advisors in case of contract default.
c	PWLB borrowing rates increase more than estimated in the Councils' prudential borrowing model. Higher rates would reduce the surplus generated on the loan arrangements with Mercia.	Substantial	Low	10	Risk treated	The cost of purchasing a financial product to remove this risk (a swaption) from an investment bank was quoted at £20m. The Councils decided to manage the risk through forecasting the forward price for its debt draw downs over the construction period and hold in reserve monies to mitigate this risk where required. Currently the rates accessible by the Councils are lower than this estimate as the continued low gilt rate environment pervades.	Substantial	Very low	6	The risk owners are the Section 151 Officers supported by Treasury and Financing Teams.

d	Loan drawdowns are slower than set out in the STFLA. Delayed drawdowns would result in reduced interest payments to the Councils and potentially reduced surplus if PWLB loan rates increase between the expected draw date and actual.	Negligible	Medium	4	Risk treated	The Councils plan to borrow in line with its Treasury Management Policy. Therefore the Councils would receive reduced interest receipts but less interest would also be payable. The Councils are monitoring market gilt rates actively and have the option to borrow from PWLB up to a year in advance of expected drawdown requests. Regular progress reports are being reviewed to ensure the construction programme and the loan drawdowns are requested in line with the plan.	Negligible	Very low	2	The risk owners are the Section 151 Officers supported by Treasury and Financing Teams.
e	Drawdown requests from Mercia are not actioned by the Councils or not actioned within the required contracted time period.	Substantial	Low	10	Risk treated	The Councils treasury teams have been fully briefed on the actions required to fulfil drawdown requests, checks required and the contracted timeline by the Section 151 Officer and their teams. Drawdowns to date have been actioned in line with requirements.	Substantial	Very low	6	The risk owners are the Section 151 Officers supported by Treasury and Financing Teams.
8	Mercia loan principal and / or interest repayments are below the required values as per the rates agreed in the STFLA .	Substantial	Very Low	6	Risk treated	The Councils treasury team maintain a spreadsheet detailing drawdowns to date and expected future principal and interest payments. This is reconciled to Mercia's repayment spreadsheet and will be matched to principal and interest repayments received from Mercia during the post construction period.	Substantial	Almost impossible	5	The risk owners are the Section 151 Officers supported by Treasury and Financing Teams.
9	Default of repayments by borrower to lenders due to HZI termination of Interserve Construction Limited (ICL) delaying project completion to after long stop date.	Critical	Medium	15	Risk treated	Sponsors have provided assurance that they believe HZI are undertaking the right processes to replace ICL work packages and that there is no financial risk to the Sponsors from the work underway. Sponsors confirmed that their due diligence on HZI had not raised any concerns around the company's viability or going concern. The Councils as lenders have the right to call the loan into default if construction is not completed by the long stop date, at which point the negotiated security package, set out in section a above, would take effect.	Substantial	Very low	6	The risk owners are the Section 151 Officers of each Council supported by Ashurst as advisors in case of contract default.

h	<p>HZI termination of ICL may weaken the negotiated security package due to no single new supplier exceeding £10m contract value and therefore triggering EPC Contract Schedule 7 requirements for Collateral Warranty and professional indemnity insurance requirements. The risk is that the Council as lender does not receive the same security package as it had when ICL was in place.</p>	Substantial	High	12	Risk treated	<p>In terms of Collateral Warranty, the HZI Collateral Warranty is in place and remains in place. Due diligence has been undertaken by Sponsors and the Councils as lenders (with the Financial Advisor) to confirm the financial strength of HZI in light of events. There are no issues arising from these reviews. Sponsors have agreed to review on a case by case basis the requirement for additional security protections and will advise the Councils as to its rational for its decision. The Councils as lenders has sign off rights and requests have and will continue to be made to the Councils prospectively for Schedule 7 services and retrospectively (based on Sponsor assurance) for non-Schedule 7 services. Planned meetings have been held and will continue to be arranged for sign off and Council advisors have been retained to provide advice. The Councils have clearly articulated to Sponsors that there should not be any weakening on the Security Package in place with regard to the Civil Engineering Work. There is no financial impact on Sponsors from events to date and therefore no financial</p>	Substantial	Low	10	<p>The risk owners are the Section 151 Officers of each Council supported by Ashurst as advisors in case of contract default.</p>
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Key	Score	Risk judgement
1-7	Low	Acceptable risk: need periodic review, low cost control improvements sought if possible
8-18	Medium	Acceptable risk: close monitoring and cost effective control improvements sought
19-24	High	Unacceptable risk: immediate control / improvement required

**Scoring Matrix**

Very High	9	19	21	21
High	8	12	20	23
Medium	4	11	15	24
Low	3	10	14	18
Very Low	2	6	13	17
Almost impossible	1	5	7	16

Negligible    Substantial    Critical    Extreme  
**Impact**

**Likelihood**





<b>Meeting:</b>	<b>Audit and governance committee</b>
<b>Meeting date:</b>	<b>24 November 2015</b>
<b>Title of report:</b>	<b>Annual report of the monitoring officer</b>
<b>Report by:</b>	<b>Monitoring officer</b>

## Classification

Open

## Key decision

This is not an executive decision.

## Wards affected

Countywide

## Purpose

To inform the committee of performance in the areas within the remit of the monitoring officer for the municipal year 2014/15.

## Recommendation(s)

**THAT:**

- (a) **the annual report of the monitoring officer be reviewed and any areas for further work identified for inclusion in the work programme.**

## Alternative options

- 1 There are no alternative options as the report provides a factual summary of performance.

## Reasons for recommendations

- 2 To enable the committee to be assured that high standards of conduct continue to be promoted and maintained and the council is adhering to the principles of openness and transparency.

## Key considerations

- 3 The role of the monitoring officer is a statutory office whose duties are set out in the Local Government and Housing Act 1989 and the Local Government Act 2000.
- 4 The main responsibilities of the monitoring officer are to ensure that the council, its elected councillors and its staff act with probity and that all the council's activities are in accordance with the law and the council's constitution. The monitoring officer has responsibility for ensuring that the council avoids findings of maladministration and that it responds appropriately to the local government ombudsman in that regard.
- 5 The monitoring officer is also responsible for dealing with allegations that councillors have failed to comply with the members' code of conduct, and for administering the local standards framework. The monitoring officer's responsibilities dovetail with those of the other statutory officers: the head of paid service (chief executive) and the section 151 officer (director of resources).

## Standards

- 6 In accordance with the provisions of the Localism Act 2011 the council has adopted a code of conduct, and this has been made available to all parish councils in the county to inform the adoption of their own code. Council has appointed a number of independent people to serve on a panel to consider complaints that cannot be resolved informally and to provide a sounding board for the monitoring officer regarding complaints received. The monitoring officer is grateful for the time and commitment these independent panel members give. Following resignations from two independent persons recruitment is underway to appoint additional people to this role.
- 7 The council maintains a register of interests for members of Herefordshire Council and parish councillors; these declarations are published on the 'your councillors' pages of the council's website. An annual reminder is sent to members and parish councillors to ensure that declarations are kept up to date. The monitoring officer provides periodic briefing sessions for Herefordshire councillors and parish councillors on the code of conduct, including induction training for members following elections. Under the powers delegated to the monitoring officer by Council in September 2012 the monitoring officer granted one general dispensation to enable members to vote on appointments at the annual meeting of Council in May 2014.
- 8 Between May 2014 and April 2015 a total of 11 complaints alleging a breach of the code of conduct were received. The table below shows the outcome of those complaints. This figure is a significant reduction on that for 2013/14. This is most likely explained by the fact that the changes to the standards regime brought about by the Localism Act 2011 lead to a number of complaints under the previous regime being heard in 2013. As the new standards regime has noticeably less 'teeth' than the previous system it is also possible that individuals are less likely to pursue complaints if they feel the outcome will have little impact.



Complaints received			No breach identified		Resolved informally		Formal panel recommendation	
Year	13/14	14/15	13/14	14/15	13/14	14/15	13/14	14/15
Herefordshire councillor	16	3	6	2	5	1	5	0
Town and parish councillor	20	8	8	6	10	2	2	0
<b>Total</b>	<b>36</b>	<b>11</b>	<b>14</b>	<b>8</b>	<b>15</b>	<b>3</b>	<b>7</b>	<b>0</b>

9 Members are required to register offers (whether accepted or declined) of gifts and hospitality with an estimated value in excess of £25.00; any declarations received are published on the 'your councillors' pages of the council website.

10 The council's information access team, manages:

- All formal complaints (note that with effect from 1 June 2014 the statutory children's social care (CSC) complaints process has been administered and managed by the quality assurance team in the children's wellbeing directorate)
- Freedom of information (FOI) requests
- Subject access requests (SAR)
- Environmental regulation requests (EIR)
- Potential data breaches
- Police requests including proof of life requests
- Requests from other authorities to share information
- Community trigger alerts (since October 2014)

11 Complaints performance and trends are regularly monitored and reviewed by the council's management board. The table below provides a high level summary of the number of issues the team dealt with during the year and the previous year to provide comparison.

	Complaint	FOI	EIR	SAR	Data incident	Police request	LA request	Community trigger
2013/14	880	1280	153	56	64	34	8	N/A
2014/15	78 (CSC) 867 (other) 945 (total)	1165	76	76	63	101	72	0

12 Data incidents are incidents (potential breaches) reported internally to be investigated – they are not full-blown data breaches. However, all incidents are investigated so that we can improve practice and learn from any mistakes. Mandatory training is provided for all employees and for elected members on information governance issues, and the rate of reporting indicate a high level of awareness among staff of the

processes to be followed if a potential data breach has occurred. During 2014/15 three data breaches were reported to the information commissioner's office (ICO). The ICO has closed all of those cases finding the council's response to them satisfactory.

- 13 During 2014/15 three FOI/EIR referrals were made to the ICO. The ICO have upheld the council's decision in all three cases.
- 14 The number of police and other local authority requests for information appears to have risen significantly over the two years; this is due to a change in the governing legislation, and subsequent change in local recording processes, which ensure that such requests are logged and monitored centrally.
- 15 The community trigger gives individuals and communities the right to request a review of their case of anti-social behaviour or hate crime, if they are not happy with the response from the relevant authorities.
- 16 A community trigger can be applied for if:
- an individual has reported three or more incidents of anti-social behaviour in the past six months to the local authority, the police or their housing association
  - an individual and four or more further individuals have complained separately about similar incidents of anti-social behaviour in the past six months to the local authority, the police or their housing association.
- 17 During 2014/15 a total of 47 enquires were reviewed by the Local Government Ombudsman (LGO) compared to 63 in 2013/14. Of these 17 were up-held, compared to two in 2013/14. The LGO investigations that were upheld are listed as follows:
- Adults and wellbeing had four LGO decisions upheld, concluding maladministration and injustice, three of these were adult social care cases where compensation was paid totalling £6,950 and one was housing related with a payment of £150. A further housing related case was upheld concluding maladministration but no injustice.
  - Economy communities corporate had six LGO decisions upheld, concluding maladministration but no injustice, of which five were due to "The Council failing to consider the National Planning Policy Framework when considering a planning application."
  - Children's Wellbeing had three LGO decisions upheld, two concluding maladministration and injustice, but no compensation paid and one concluding maladministration but no injustice.
  - Balfour Beatty Living Places had two LGO decisions upheld, one with no further action and one concluding maladministration but no injustice.
  - Hoople had one LGO decision upheld with no further action.
- 18 The monitoring officer is responsible for ensuring that concerns raised by whistleblowers are investigated in accordance with the council's policy. During 2014/15 one disclosure was made, one was also made in 2013/14. As the matter related to a staffing issue it was more appropriate to deal with under the staff grievance process. In addition, one public interest declaration was made to an external body; the outcome of their investigation was reported to the committee in September 2014.

## Corporate Governance

- 19 In line with the council's agreed values, one of the key elements of good corporate governance is open and transparent decision making. It is therefore appropriate to note any occasions when closed sessions of public meetings have taken place, when less than 28 days' notice of intention to take a key executive decision has been given, and the number of scrutiny call-ins conducted.
- 20 The public can be excluded from the whole or part of a meeting if the meeting is to discuss confidential or exempt information (as defined in schedule 12a of the Local Government Act 1972 as amended). During 2014/15 there were two occasions when this took place (once relating to regulatory sub-committee and once to the employment panel).
- 21 Key decisions to be taken by the executive are notified on the council's website generally giving the required 28 days' notice. It is not always possible to provide this amount of notice and during 2014/15 there were eighteen occasions when a key decision was taken with more than five days but less than 28 days' notice being given; in all cases the chairman of the relevant overview and scrutiny committee was informed of this and of the reason in each case. This is a significant increase over the 2013/14 figure of nine. Whilst the reduction in notice period was in most cases due to matters beyond the council's control (e.g. to respond to government deadlines or to respond in a timely way to rapidly changing circumstances) there were a number of instances which related to contract awards. The governance team is working closely with the commercial team and directorate commissioners to improve forward planning. There were no cases of 'special urgency' where key decisions were taken with less than five days' notice.
- 22 General overview and scrutiny committee called-in two decisions of the executive during 2014/15, compared to one the previous year. The first was in relation to the South Wye transport package; two recommendations were made to cabinet requesting that further consideration be given to the robustness of the financial appraisal and the selection of SC2 given the costs related to environmental mitigation work. Cabinet considered these matters further and reaffirmed their decision. The second was in relation to a decision taken by the Marches local enterprise partnership joint committee regarding the Marches enterprise zone and, the committee endorsed the decision making no further recommendations.
- 23 During the year 2014/15 the general overview and scrutiny committees made a total of 50 recommendations to the executive. Of these 35 were accepted in full, ten accepted in part, and five rejected.
- 24 The monitoring officer is responsible for ensuring that any investigation using discreet surveillance or similar evidence gathering techniques is appropriately authorised in accordance with the provisions of the Regulation of Investigatory Powers Act 2000 (RIPA). During 2014/15 no such authorisations were requested. In addition during the municipal year 2014/15 the Office of Surveillance Commissioners undertook an inspection of the council's exercise and performance in relation to the powers available under RIPA. The inspector found that whilst the council had not made use of the powers for some time, the council maintained "... an enduring commitment to, and an understanding of, the responsibilities which the legislation places upon the organisation." Three recommendations were made to ensure that the council's policies remained in line with changing legislation and there is an action plan in place to implement these recommendations.

## **Community impact**

- 25 This report provides information about the council's performance in relation to being open, transparent and accountable.

## **Equality duty**

- 26 There are no equality duty implications arising directly from this report, which is for information.

## **Financial implications**

- 27 There are no financial implications arising directly from this report, which is for information.

## **Legal implications**

- 28 As set out in the report.

## **Risk management**

- 29 There are no risks arising directly from the report which is for information. Effective governance processes mitigate the risk of legal change to decision-making and maintaining high standards of conduct mitigates risks to the reputation of the authority.

## **Consultees**

- 30 Not applicable.

## **Appendices**

- None.

## **Background papers**

- None identified.



<b>Meeting:</b>	<b>Audit &amp; Governance Committee</b>
<b>Meeting date:</b>	<b>24 November 2015</b>
<b>Title of report:</b>	<b>Governance improvement working group update</b>
<b>Report by:</b>	<b>Governance manager</b>

## Classification

Open

## Key Decision

This is not an executive decision.

## Wards Affected

Countywide

## Purpose

To note the work of the governance improvement working group to date and agree the draft design principles to inform the further work of the group

## Recommendation(s)

**With reference to the outcomes to date of the governance improvement working group (as set out in the report and at appendix a) the draft design principles set out in appendix b be considered and approved.**

## Alternative options

- 1 To not complete a review of the current governance arrangements. In July 2015 the committee approved the next steps for the working group and work has already commenced. This approval recognised agreement reached between group leaders in October 2014 and a resolution passed by Council in December 2014 reflecting some perceptions that the current governance arrangements were not sufficiently transparent and limited the extent of member and stakeholder involvement in decision making.

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Further information on the subject of this report is available from  
Annie Brookes, Governance Manager on Tel (01432) 260605

## Reasons for recommendations

- 2 To facilitate the continuing work of this group. This will ensure that the review of governance arrangements can be completed and recommendations made for suitable governance arrangements to be in place for the council. This exercise would in turn inform a detailed review of the current constitution.

## Key considerations

- 3 Following fact-finding work that commenced in early 2015, the committee approved on 16 July 2015 revised membership of a governance improvement working group and a timetable for work.
- 4 As agreed, the group has completed the first 'fact finding' stage and, in light of the information gathered has drafted a set of design principles to shape possible future governance arrangements.
- 5 The work of the group is progressing ahead of the timescales agreed by the committee in July and is reporting earlier than planned on the identification of design principles (November rather than January).
- 6 The draft design principles are based on the findings and a group of SWOT analyses undertaken by the working group (attached at appendix A). The design principles are described in full in appendix B, but in summary are:
  - Members and officers perform effectively in clearly defined functions and roles
  - Maximise member engagement and participation, including the involvement of all members in the development of key policies
  - Decision making is informed, transparent and efficient
  - The council welcomes public engagement and makes accountability real
7. In defining these design principles a number of action points were identified which would need to be addressed as the next stage of the process if the principles were to be realised. These actions have impact on the constitution and also on other areas as illustrated and would form the basis of any further recommendations arising which would be reported to the committee in March 2016. NB - The outcome of this stage was originally due to be reported to committee in April 2016 as agreed by committee in July.

## Community impact

- 8 Having clear and shared design principles to guide the review of the constitutional arrangements supports the council achieve its aim to be open transparent and accountable.

## Equality duty

9. The report does not impact on this area.

## **Financial implications**

10. There are no financial implications.

## **Legal implications**

11. There are no legal implications.

## **Risk management**

12. If governance arrangements are not transparent or robust there are the risks that the council's reputation may suffer; that it will be more difficult to encourage candidates to stand for election and that decision-making is less sound. By undertaking a review of governance arrangements in line with good practice these risks can be mitigated.

## **Consultees**

None at this stage.

## **Appendices**

Appendix A – SWOT analysis

Appendix B - Design principles

## **Background papers**

None identified.





Governance Improvement Working Group – SWOT Analysis

1. Members' involvement in the policy-making / decision-making process (see also Scrutiny below)	
STRENGTHS	WEAKNESSES
<ul style="list-style-type: none"> <li>• "Known" system</li> <li>• People with sound grasp of issues</li> <li>• Understanding Herefordshire</li> <li>• Clearly defined chain of command</li> <li>• Speed of decision-making</li> <li>• Forward Plan now more interactive</li> </ul>	<ul style="list-style-type: none"> <li>• Don't feel involved</li> <li>• Understanding roles</li> <li>• Too reactive</li> <li>• Resources: people (limited), and use of</li> <li>• Limited involvement</li> <li>• Appointment to roles (but legal requirement)</li> <li>• Perception of "back room" deals</li> <li>• Concern re. workloads / spread</li> <li>• Lack of clarity on how to feed into decision-making process</li> <li>• Balance between council and executive functions</li> <li>• Members' training not member-focused in design and delivery and timing</li> </ul>
OPPORTUNITIES	THREATS
<ul style="list-style-type: none"> <li>• Understand and build on members' skills and experience</li> <li>• Be more proactive and have closer relationship with scrutiny</li> <li>• Improve communication</li> <li>• Effective use of Groups</li> <li>• Understand and make better use of corporate plan</li> <li>• Use Understanding Herefordshire</li> <li>• Use of resources in different ways</li> <li>• Cross-party executive functions</li> <li>• Support members to make more use of council systems e.g. intranet</li> </ul>	<ul style="list-style-type: none"> <li>• Break in continuity</li> <li>• Poor communication</li> <li>• Resources</li> <li>• Public disengagement and perception / knowledge of issues</li> <li>• Call-in process - hard to track history</li> <li>• Officers' skills gaps re training delivery and design, presentations and report writing</li> </ul>

2. How the public / stakeholders are involved	
STRENGTHS	WEAKNESSES
<ul style="list-style-type: none"> <li>• Public meetings and media /web etc.</li> <li>• Very few "exempt" reports</li> <li>• Open meetings</li> <li>• Questions from the public and propose items for future work plan <ul style="list-style-type: none"> <li>• Earlier release of draft minutes</li> </ul> </li> </ul>	<ul style="list-style-type: none"> <li>• Low response-rates</li> <li>• Over-dependence on on-line methods</li> <li>• Lack of public knowledge of politics / council business</li> <li>• Misunderstood open-ness</li> <li>• Limited focus of where questions are directed</li> <li>• Number of clicks to web-site topics</li> </ul>
OPPORTUNITIES	THREATS
<ul style="list-style-type: none"> <li>• Use IT to increase accessibility (beyond Planning Cttee) – webcasting and use of social media and Modern.gov (for audio webcasting)</li> <li>• Transparency Code</li> </ul>	<ul style="list-style-type: none"> <li>• Perception of level of members' knowledge about specific issues – engagement without undue influence</li> <li>• Ward members spend most of evenings</li> </ul>

<ul style="list-style-type: none"> <li>• Varied ways of involving public</li> <li>• Formats for presentation – creativity</li> <li>• Timing of meetings and locations – consider adjusting some meetings within the day (evening meetings not considered sustainable) at discretion of the chair (only council mtgs are set times)</li> <li>• Webcasting and social media</li> <li>• Transparency statement at start of website</li> <li>• Group leaders to ask members’ views on timing of meetings</li> </ul>	<p>tending to local matters with public, therefore conflict with meeting timings</p> <ul style="list-style-type: none"> <li>• Public transport issues and people travelling to meetings in winter time</li> <li>• Members’ existing commitments (personal and professional)</li> </ul>
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3. Having a clear scheme of delegation at member, officer and partnership level

<b>STRENGTHS</b>	<b>WEAKNESSES</b>
<ul style="list-style-type: none"> <li>• Timely decisions</li> <li>• It works</li> </ul>	<ul style="list-style-type: none"> <li>• Misunderstood!</li> <li>• Misunderstanding of how partnerships work</li> <li>• How training is provided for Members eg ref constitution</li> <li>• Understanding of the Forward Plan</li> <li>• Fear of asking “silly” questions about how decisions are/were made</li> </ul>
<b>OPPORTUNITIES</b>	<b>THREATS</b>
<ul style="list-style-type: none"> <li>• Improve understanding of and clear escalation of processes / way of managing flow</li> <li>• Clarify officer decision call-in</li> <li>• Expand call-ins</li> <li>• Format / accessibility of constitution</li> <li>• To develop members’ knowledge of the SOD.</li> <li>• Have individual officer mentors for Members (or in groups)/ people who can be cross-referenced</li> <li>• Make more use of Members’ handbook</li> <li>• Group leaders to make more use of their meetings by involving officers or relevant cabinet member</li> </ul>	

4. How members are involved in performance management and improvement

<b>STRENGTHS</b>	<b>WEAKNESSES</b>
<ul style="list-style-type: none"> <li>• Understanding Herefordshire and amount of data</li> </ul>	<ul style="list-style-type: none"> <li>• Poor understanding and use of data</li> </ul>
<b>OPPORTUNITIES</b>	<b>THREATS</b>
<ul style="list-style-type: none"> <li>• Better use and understanding of data</li> <li>• Improve outcomes in relation to use of resources</li> </ul>	<ul style="list-style-type: none"> <li>• Decreasing resources</li> <li>• Overwhelming data</li> </ul>

<ul style="list-style-type: none"> <li>• Understanding Herefordshire</li> <li>• Linking outcomes to data</li> <li>• Greater role for scrutiny</li> </ul>	
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5. Scrutiny	
<b>STRENGTHS</b>	<b>WEAKNESSES</b>
<ul style="list-style-type: none"> <li>• Can guide, advise and forewarn</li> </ul>	<ul style="list-style-type: none"> <li>• Understanding Herefordshire - lots of data and presentational issues, overwhelming, lack of understanding of significance of data</li> <li>• not understanding what Members' roles are and lack of knowledge of what scrutiny does</li> <li>• isn't reactive to here and now but works to programme of work</li> <li>• has no executive power/ final say</li> <li>• lack of positive challenge</li> <li>• seen as oppositional rather than part of process</li> </ul>
<b>OPPORTUNITIES</b>	<b>THREATS</b>
<ul style="list-style-type: none"> <li>• to be more forward looking</li> <li>• to be more challenging</li> <li>• to engage Members in scrutiny process</li> <li>• to have a better balance in the process/membership</li> <li>• to focus on performance / outcomes and what is better for the community</li> <li>• to strengthen the role of scrutiny to resolve other weaknesses identified in the SWOTs (pose as question)</li> <li>• more efficient scrutiny to make services more efficient e.g. responding to peer reviews etc.</li> </ul>	<ul style="list-style-type: none"> <li>• potential disengagement of Members</li> <li>• fear of constructive criticism (officer and Members)</li> <li>• over emphasis on policy rather than performance</li> </ul>



<b>Governance Improvement Working Group / Constitutional Review 2015</b>			
	<b>Governance design principle</b>	<b>Constitution</b>	<b>Other</b>
1.	Members and officers perform effectively in clearly defined functions and roles	<ul style="list-style-type: none"> <li>Review functions scheme</li> <li>Review scheme of delegation</li> <li>Focus for member decision making on strategy and policy, with officer decision-making focussed on operations/implementation</li> <li>Clear purpose and vision for the organisation focussed on outcomes</li> <li>Partnership roles and responsibilities clear</li> </ul>	<ul style="list-style-type: none"> <li>Training and development for members and officers</li> <li>Communications/website – ensure people know the information and support available and can find it</li> <li>Plain English/easy guides</li> </ul>
2.	Maximise member engagement and participation, including the involvement of all members in the development of key policies	<ul style="list-style-type: none"> <li>Clarify/strengthen role of members in performance management and improvement</li> <li>Confirm budget and policy framework items</li> <li>Scrutiny structure reviewed and/or policy panels supporting cabinet members</li> </ul>	<ul style="list-style-type: none"> <li>With regard to policy development - clear process flow / timescales to ensure all stakeholders included and at the right point, e.g. unions, partners etc.</li> <li>Ensure feedback is given to those contributing</li> </ul>
3.	Decision making is informed, transparent and efficient	<ul style="list-style-type: none"> <li>Clear scheme of delegation</li> <li>Presumption of openness</li> <li>Set threshold below which officer decisions do not need to be recorded</li> <li>Review key decision threshold</li> </ul>	<ul style="list-style-type: none"> <li>Forward plan robust and clearly understood and identifies type of decision /strategy, policy</li> <li>Decision reports proportionate to scale of decision</li> <li>Training for report authors</li> <li>Identify evidence sources and demonstrate how they are being used</li> <li>Maximise use of technology to minimise bureaucracy and cost</li> </ul>

<b>Governance Improvement Working Group / Constitutional Review 2015</b>		
<b>Governance design principle</b>	<b>Constitution</b>	<b>Other</b>
4. The council welcomes public engagement and makes accountability real.	<ul style="list-style-type: none"> <li>• Public involvement at meetings (questions at all meetings/questions without notice)</li> <li>• Forward plan publication arrangements</li> <li>• Scrutiny arrangements robust and resourced</li> <li>• Standards of behaviour (members and officers) clearly articulated</li> <li>• Locality arrangements</li> </ul>	<ul style="list-style-type: none"> <li>• Use of webcasting/technology to improve public access</li> <li>• Timing/location of scrutiny and Cabinet meetings flexible at Chairman's discretion</li> <li>• Website and communications make information easy to access</li> <li>• Forward plan understood and accessible</li> <li>• Improved customer feedback and use of information held to inform improvement</li> </ul>



<b>Meeting:</b>	<b>Audit &amp; Governance Committee</b>
<b>Meeting date:</b>	<b>24 November 2015</b>
<b>Title of report:</b>	<b>A&amp;G committee work programme update</b>
<b>Report by:</b>	<b>Governance Manager</b>

## Classification

Open

## Key Decision

This is not an executive decision.

## Wards Affected

Countywide

## Purpose

To provide an update on the Committee's work programme for 2015-16.

## Recommendation

**THAT:**

**subject to any updates made by the committee, the updated work programme for 2015-16 for the Audit and Governance Committee be agreed.**

## Alternative options

There are no alternative options as regards whether or not to have a work programme as the committee will require such a programme in order to set out its objectives for the coming year.

The programme was discussed and finalised by the committee in March 2015. However, following discussion, adjustments to timescales and content may be required and amended from time to time.

## Reasons for recommendations

- 1 The work programme is recommended as the committee is required to define and make known its work for the coming year. This will ensure that matters pertaining to audit and governance are tracked and progressed in order to provide sound

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Further information on the subject of this report is available from  
Annie Brookes, Governance Manager on Tel (01432) 260605

governance for the council.

- 2 The Committee is asked to note the updates to the work programme and consider any further adjustments.

## **Key considerations**

- 3 A number of items considered by the committee will be ongoing and updates are programmed in to the year. Included in this updated programme are an update from the governance improvement working group (constitution review) and revisions to the financial procedure rules for January 2016. A further addition for March is the setting of the committee's work programme for 2016-17.
- 4 The routine business of the committee has been reflected as far as is known, including the regular reporting from internal and external auditors.

## **Community impact**

- 5 The work of the committee supports the council in demonstrating its values, and in particular the commitment to being open, transparent and accountable.

## **Equality duty**

- 6 This report does not impact on this area.

## **Financial implications**

- 7 There are no financial implications.

## **Legal implications**

- 8 There are no legal implications.

## **Risk management**

- 9 The programme can be adjusted in year to respond as necessary to risks as they are identified; the committee also provides assurance that risk management processes are robust and effective.

## **Consultees**

- 10 Internal and external auditors, head of corporate finance, monitoring officer and governance manager have contributed to content of the work programme.

## **Appendices**

Appendix A – A&G Work Programme 2015-16

## **Background papers**

None identified.



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Further information on the subject of this report is available from  
Annie Brookes, Governance Manager on Tel (01432) 260605



Audit & Governance Work Programme 2015-16		
Meeting	Items	Comment
November 2015	<ul style="list-style-type: none"> <li>• Annual Audit letter <b>TT/PR</b>)</li> <li>• Internal Audit Plan Progress Report <b>(JG/PR)</b></li> <li>• Risk Register <b>(PR)</b></li> <li>• Waste Loan Update <b>(JR)</b></li> <li>• Monitoring Officer's Annual Report <b>(AB)</b></li> <li>• Update from Governance Improvement Working Group – constitution <b>(CW)</b></li> <li>• Work plan update <b>(RG)</b></li> <li>•</li> </ul>	
January 2016	<ul style="list-style-type: none"> <li>• Staff Survey Report <b>(TJP/PR)</b></li> <li>• Internal Audit Plan Progress Report <b>(JG/PR)</b></li> <li>• SWAP training and development Update <b>(JG/PR)</b></li> <li>• Update on Annual Governance Statement <b>(PR/AB)</b></li> <li>• Performance Appraisals for Elected Members <b>(CW/RG)</b></li> <li>• Update from Governance Improvement Working Group – constitution <b>(CW)</b></li> <li>• Revisions to financial procedure rules <b>(JR)</b></li> <li>• Work plan update <b>(RG)</b></li> </ul>	
March 2016	<ul style="list-style-type: none"> <li>• External Audit update <b>(TT/PR)</b></li> <li>• Internal Audit Plan update <b>(JG/PR)</b></li> <li>• Internal Audit Plan Progress Report <b>(JG/PR)</b></li> <li>• Internal Audit Charter <b>(JG/PR)</b></li> <li>• Internal Audit Plan 2016-17 <b>(JG/PR)</b></li> <li>• Biannual forecast of revenue and capital outturn <b>(JR/AH)</b></li> <li>• Update from Governance Improvement Working Group – constitution <b>(CW)</b></li> <li>• Future work programme for 2016-17 <b>(RG)</b></li> </ul>	
Audit & Governance Work Programme 2016-17 (carry to new sheet)		
May 2016	<ul style="list-style-type: none"> <li>•</li> </ul>	
July 2016	<ul style="list-style-type: none"> <li>• AGS final outturn 2015-16 <b>(AB/PR)</b></li> <li>• AGS action plan 2016-17 <b>(AB/PR)</b></li> </ul>	
September 2016	<ul style="list-style-type: none"> <li>• Signing of Accounts <b>(JR/PR)</b></li> </ul>	
November 2016	<ul style="list-style-type: none"> <li>•</li> </ul>	

