ARUN
DISTRICT COUNCIL

Arun District Council
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Committee Manager : Jane Fulton (Ext 37611)

08 February 2017

AUDIT AND GOVERNANCE COMMITTEE

A meeting of the Audit and Governance Committee will be held in Committee Room 1 (the Pink Room) at the Arun Civic Centre, Maltravers Road, Littlehampton, BN17 5LF on **Thursday, 23 February 2017 at 9.30am** and you are requested to attend.

Members: Councillors Clayden (Chairman), Mrs Oakley (Vice-Chairman), Brooks, L Brown, Edwards, D Maconachie, Mrs Maconachie, Mrs Porter, Miss Rhodes, and Wheal

A G E N D A

1. APOLOGIES FOR ABSENCE

2. DECLARATIONS OF INTEREST

Members and Officers are reminded to make any declarations of personal and/or prejudicial interests that they may have in relation to items on this Agenda.

You should declare your interest by stating :
a) the item you have the interest in
b) whether it is a personal interest and the nature of the interest
c) whether it is also a prejudicial interest

You then need to re-declare your interest and the nature of the interest at the commencement of the item or when the interest becomes apparent.

3. MINUTES

To approve as a correct record the Minutes of the meeting held on 8 December 2017 (previously circulated).

4. ITEMS NOT ON THE AGENDA THAT THE CHAIRMAN OF THE MEETING IS OF THE OPINION SHOULD BE CONSIDERED AS A MATTER OF URGENCY BY REASON OF SPECIAL CIRCUMSTANCES.

5. *ERNST & YOUNG - CERTIFICATION OF CLAIMS AND RETURNS - ANNUAL REPORT 2015/16

Ernst & Young's Certification of Claims and Returns - Annual Report 2015/16 is *attached.*

6. *ERNST & YOUNG - AUDIT PLAN, PROGRESS REPORT AND SECTOR UPDATE

Ernst & Young's Audit Plan, Progress Report and Sector Update are *attached*.

7. *TREASURY MANAGEMENT STRATEGY STATEMENT & ANNUAL INVESTMENT STRATEGY - 2017/18

This report presents the Treasury Management Strategy Statement and Annual Investment Strategy 2017/2018. The Committee is asked to scrutinise the report prior to making recommendation to Full Council.

8. *ANNUAL INTERNAL AUDIT PLAN - 2017/18

Each year Internal Audit is required to develop an annual internal audit plan for the following financial year for agreement by the Committee.

9. *PROGRESS AGAINST THE AUDIT PLAN

Each year Internal Audit is undertakes its work against an annual audit plan, as approved by the Audit & Governance Committee at the beginning of the financial year.

The Committee is required to oversee the provision of an adequate and effective internal audit service.

The Committee is requested to note the contents of the reports attached.

10. INFFORMATION/ADVISORY DOCUMENTS RECEIVED

The Audit Committee Update [Issue 21] covering December 2016 is attached.

The TEICCAF has issued its fraud survey report “Protecting the English Public Purse 2016”. A copy can be downloaded from their website by clicking on or accessing http://www.teiccaf.com/protecting-the-english-public-purse-2016/. This document has not been attached due to its size.

(Note: Members are also reminded that if they have any detailed questions, would they please inform the Chairman and/or relevant Lead Officer in advance of the meeting in order that the appropriate Officer/ Cabinet Member can attend the meeting.)

Certification of claims and returns annual report 2015-16

Arun District Council

December 2016

Ernst & Young LLP

Building a better working world

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December 2016

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Dear Members

Certification of claims and returns annual report 2015-16 for Arun District Council

We are pleased to report on our certification and other assurance work. This report summarises the results of our work on Arun District Council's 2015-16 claims.

Scope of work

Local authorities claim large sums of public money in grants and subsidies from central government and other grant-paying bodies and must complete returns providing financial information to government departments. In some cases these grant-paying bodies and government departments require appropriately qualified auditors to certify the claims and returns submitted to them.

From 1 April 2015, the duty to make arrangements for the certification of relevant claims and returns and to prescribe scales of fees for this work was delegated to the Public Sector Audit Appointments Ltd (PSAA) by the Secretary of State for Communities and Local Government.

For 2015-16, these arrangements required only the certification of the housing benefits subsidy claim. In certifying this we followed a methodology determined by the Department for Work and Pensions and did not undertake an audit of the claim.

Summary

Section 1 of this report outlines the results of our 2015-16 certification work and highlights the significant issues.

We checked and certified the housing benefits subsidy claim with a total value of £52,223,733. We met the submission deadline. As in previous periods the claim was prepared and supported to a high standard and our initial work identified no errors. We did identify an arithmetic error within the claim form, which was subsequently amended. No qualification letter was issued. As most authorities have a qualification letter, this is a very positive reflection on the Authority's performance.

Fees for certification and other returns work are summarised in section 2. The housing benefits subsidy claim fees for 2015-16 were published by PSAA in March 2015 and are now available on the PSAA's website (www.psaa.co.uk).

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We welcome the opportunity to discuss the contents of this report with you at the Audit & Governance Committee meeting on 23 February 2017.

Yours faithfully

Paul King
Executive Director
Ernst & Young LLP
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Contents

1. Housing benefits subsidy claim

Scope of work	Results
Value of claim presented for certification	£52,223,733
Amended/Not amended	Amended – with no impact on overall subsidy claimed.
Qualification letter	No
Fee – 2015-16 Fee – 2014-15	£8,330 £12,070

Recommendations from 2014-15	Findings in 2015-16
None	None

Local Government administers the Government's housing benefits scheme for tenants and can claim subsidies from the Department for Work and Pensions (DWP) towards the cost of benefits paid.

2. 2015-16 certification fees

The PSAA determine a scale fee each year for the audit of claims and returns. For 2015-16, these scale fees were published by the Public Sector Audit Appointments Ltd (PSAA's) in March 2015 and are now available on the PSAA's website (www.psaa.co.uk).

Claim or return	2015-16	2015-16	2014-15
	Actual fee £	Indicative fee £	Actual fee £
Housing benefits subsidy claim	8,330	8,330	12,070

3. Looking forward

From 1 April 2015, the duty to make arrangements for the certification of relevant claims and returns and to prescribe scales of fees for this work was delegated to (PSAA) by the Secretary of State for Communities and Local Government.

The Council's indicative certification fee for 2016-17 is £9,053. This was prescribed by PSAA in March 2016, based on no changes to the work programme for 2015-16. Indicative fees for 2016/17 housing benefit subsidy certification work are based on final 2014/15 certification fees. PSAA reduced scale audit fees and indicative certification fees for most audited bodies by 25 per cent based on the fees applicable for 2014-15.

Details of individual indicative fees are available at the following web address: http://www.psaa.co.uk/audit-and-certification-fees/201617-work-programme-and-scales-of-fees/individual-indicative-certification-fees/

We must seek the agreement of PSAA to any proposed variations to these indicative certification fees. We will inform the Head of Finance and Property before seeking any such variation.

PSAA is currently consulting on the 2017-18 work programme. There are no changes planned to the work required and the arrangements for certification of housing benefit subsidy claims remain in the work programme. However, this is the final year in which these certification arrangements will apply. From 2018-19, the Council will be responsible for appointing their own auditor and this is likely to include making their own arrangements for the certification of the housing benefit subsidy claim in accordance with the requirements that will be established by the DWP.

EY | Assurance | Tax | Transactions | Advisory

Ernst & Young LLP

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Arun District Council

Year ending 31 March 2017

Audit Plan

February 2017

Ernst & Young LLP

Building a better working world

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February 2017

Ref: ADC/PK/Audit Plan

Email: PKing1@uk.ey.com

Dear Committee Members

Audit Plan

We are pleased to attach our Audit Plan which sets out how we intend to carry out our responsibilities as auditor. Its purpose is to provide the Audit & Governance Committee with a basis to review our proposed audit approach and scope for the 2016/17 audit in accordance with the requirements of the Local Audit and Accountability Act 2014, the National Audit Office's 2015 Code of Audit Practice, the Statement of Responsibilities issued by Public Sector Audit Appointments (PSAA) Ltd, auditing standards and other professional requirements. It is also to ensure that our audit is aligned with the Committee's service expectations.

This plan summarises our initial assessment of the key risks driving the development of an effective audit for the Council, and outlines our planned audit strategy in response to those risks.

We welcome the opportunity to discuss this Audit Plan with you at your meeting on 23 February 2017 and to understand whether there are other matters which you consider may influence our audit.

Yours faithfully

Paul King
Executive Director
For and behalf of Ernst & Young LLP

Contents

In April 2015 Public Sector Audit Appointments Ltd (PSAA) issued ''Statement of responsibilities of auditors and audited bodies '. It is available from the Chief Executive of each audited body and via the PSAA website (www.psaa.co.uk).

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

The 'Terms of Appointment from 1 April 2015' issued by PSAA sets out additional requirements that auditors must comply with, over and above those set out in the National Audit Office Code of Audit Practice (the Code) and statute, and covers matters of practice and procedure which are of a recurring nature.

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

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

1. Overview

This Audit Plan covers the work that we plan to perform to provide you with:

- ► Our audit opinion on whether the financial statements of Arun District Council give a true and fair view of the financial position as at 31 March 2017 and of the income and expenditure for the year then ended;
- ► Our conclusion on the Council's arrangements to secure economy, efficiency and effectiveness;

We will also review and report to the National Audit Office (NAO), to the extent and in the form required by them, on the Council's Whole of Government Accounts return.

Our audit will also include the mandatory procedures that we are required to perform in accordance with applicable laws and auditing standards.

When planning the audit we take into account several key inputs:

- ► Strategic, operational and financial risks relevant to the financial statements;
- ► Developments in financial reporting and auditing standards;
- ► The quality of systems and processes;
- ► Changes in the business and regulatory environment; and,
- ► Management's views on all of the above.

By considering these inputs, our audit is focused on the areas that matter and our feedback is more likely to be relevant to the Council. Our audit will also include the mandatory procedures that we are required to perform in accordance with applicable laws and auditing standards.

Our process and strategy

Financial statement audit

We consider materiality in terms of the possible impact of an error or omission on the financial statements and set an overall planning materiality level. We then set a tolerable error to reduce the probability that the aggregate of uncorrected and undetected misstatements exceeds planning materiality to an appropriately low level. We also assess each disclosure and consider qualitative issues affecting materiality as well as quantitative issues.

We assess the controls in operation in each process affecting the financial statements and consider whether we will rely on internal controls.

To the fullest extent permissible by auditing standards, we intend to consider internal audit's work in documenting your financial systems and controls. We have liaised with internal audit and considered their work, where we considered it appropriate to do so in aiding our understanding of your control environment.

Arrangements for securing economy, efficiency and effectiveness

We are required to satisfy ourselves that the Council has made proper arrangements for securing economy, efficiency and effectiveness in its use of resources. We carry out the procedures in line with the guidance included in the National Audit Office’s 2015 Code of Audit Practice.

We expect to be able to adopt an integrated audit approach, so our work in the financial statement audit feeds into our conclusion of the arrangements in place for securing economy, efficiency and effectiveness.

Further detail is included in section 3 of this Audit Plan.

We will provide an update to the Audit & Governance Committee on the results of our work in these areas in our report to those charged with governance scheduled for delivery in September 2017.

2. Financial statement risks

We outline below our current assessment of the financial statement risks facing the Council, identified through our knowledge of the Council's operations and discussion with those charged with governance and officers.

At our meeting, we will seek to validate these with you.

Significant risks (including fraud risks)	Our audit approach
Risk of management override	
As identified in ISA (UK and Ireland) 240, management is in a unique position to perpetrate fraud because of its ability to manipulate accounting records directly or indirectly and prepare fraudulent financial statements by overriding controls that otherwise appear to be operating effectively. We identify and respond to this fraud risk on every audit engagement.	Our approach will focus on: ► Testing the appropriateness of journal entries recorded in the general ledger and other adjustments made in the preparation of the financial statements ► Reviewing accounting estimates for evidence of management bias, and ► Evaluating the business rationale for significant unusual transactions

2.1 Responsibilities in respect of fraud and error

We would like to take this opportunity to remind you that management has the primary responsibility to prevent and detect fraud. It is important that management, with the oversight of those charged with governance, has a culture of ethical behaviour and a strong control environment that both deters and prevents fraud.

Our responsibility is to plan and perform audits to obtain reasonable assurance about whether the financial statements as a whole are free of material misstatements whether caused by error or fraud. As auditors, we approach each engagement with a questioning mind that accepts the possibility that a material misstatement due to fraud could occur, and design the appropriate procedures to consider such risk.

Based on the requirements of auditing standards our approach will focus on:

- Identifying fraud risks during the planning stages;
- Enquiry of management about risks of fraud and the controls to address those risks;
- Understanding the oversight given by those charged with governance of management's processes over fraud;
- Consideration of the effectiveness of management's controls designed to address the risk of fraud;
- Determining an appropriate strategy to address any identified risks of fraud, and,
- Performing mandatory procedures regardless of specifically identified risks.

3. Value for money risks

We are required to consider whether the Council has put in place ‘proper arrangements’ to secure economy, efficiency and effectiveness on its use of resources.
For 2016-17 this is based on the overall evaluation criterion:

“In all significant respects, the audited body had proper arrangements to ensure it took properly informed decisions and deployed resources to achieve planned and sustainable outcomes for taxpayers and local people”

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

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

In considering your proper arrangements, we will draw on the requirements of the CIPFA/SOLACE framework for local government to ensure that our assessment is made against a framework that you are already required to have in place and to report on through documents such as your annual governance statement.

We are only required to determine whether there are any risks that we consider significant, which the Code of Audit Practice which defines as:

“A matter is significant if, in the auditor’s professional view, it is reasonable to conclude that the matter would be of interest to the audited body or the wider public”

Our risk assessment supports the planning of sufficient work to enable us to deliver a safe conclusion on arrangements to secure value for money and enables us to determine the nature and extent of further work that may be required. If we do not identify any significant risks there is no requirement to carry out further work.

Our risk assessment has therefore considered both the potential financial impact of the issues we have identified, and also the likelihood that the issue will be of interest to local taxpayers, the Government and other stakeholders. Our initial planning and discussions with officers has not identified any risks which we view as relevant to our value for money conclusion at this stage.

We will keep our risk assessment under review throughout our audit and communicate to the Audit & Governance Committee any revisions to our assessment and any additional local risk-based work we may need to undertake as a result. This will include updating our understanding of the Council’s financial planning arrangements.

4. Our audit process and strategy

4.1 Objective and scope of our audit

Under the Code of Audit Practice our principal objectives are to review and report on the Council's:

- Financial statements
- Arrangements for securing economy, efficiency and effectiveness in its use of resources to the extent required by the relevant legislation and the requirements of the Code.

We issue an audit report that covers:

1. **Financial statement audit**

Our objective is to form an opinion on the financial statements under International Standards on Auditing (UK and Ireland).

Alongside our audit report, we also review and report to the NAO on the Whole of Government Accounts return to the extent and in the form they require;

2. **Arrangements for securing economy, efficiency and effectiveness (value for money)**

We are required to consider whether the Council has put in place 'proper arrangements' to secure economy, efficiency and effectiveness on its use of resources.

4.2 Audit process overview

Processes

Our initial assessment of the key processes across the Council has identified the following key processes where we will seek to test key controls:

- Accounts Receivable;
- Accounts Payable;
- Cash & Bank;
- Payroll;
- Business Rates;
- Council Tax;
- Housing Benefits; and
- Housing Rents.

To the fullest extent permissible by auditing standards, we will seek to place reliance on the work of Internal Audit to test controls in its annual programme of work. Areas that we anticipate being able to use the work of internal audit are Accounts Receivable, Accounts Payable, Cash and Bank, Payroll, Business Rates, Council Tax and Housing Benefits,

We have also identified the following key processes that we will test substantively post year-end:

- ► Treasury Management; and
- ► Property, Plant and Equipment.

Analytics

We will use our computer-based analytics tools to enable us to capture whole populations of your financial data, in particular journal entries. These tools:

- ► Help identify specific exceptions and anomalies which can then be subject to more traditional substantive audit tests
- ► Give greater likelihood of identifying errors than random sampling techniques.

We will report the findings from our process and analytics work, including any significant weaknesses or inefficiencies identified and recommendations for improvement, to management and the Audit & Governance Committee through our usual processes.

Internal audit

As in prior years, we will review internal audit plans and the results of their work. We will reflect the findings from these reports, together with reports from any other work completed in the year, in our detailed audit plan, where we raise issues that could have an impact on the year-end financial statements.

In implementing our controls strategy, we intend to place reliance on the work of internal audit as much as possible, while complying with the requirements of auditing standards. The intended pieces of internal audits work identified as directly relevant to our audit include their review of and controls testing on those systems noted above.

Use of specialists

When auditing key judgements, we are often required to rely on the input and advice provided by specialists who have qualifications and expertise not possessed by the core audit team. We will use specialist EY resource as necessary to help us to form a view on judgments made in the financial statements .The areas where either EY or third party specialists provide input for the current year audit are:

Area	Specialists
IAS19 Pensions	EY pensions specialists Hymans Robertson - Actuary
Property, Plant and Equipment valuations	Wilks, Head and Eve – RICS Registered Valuers

In accordance with Auditing Standards, we will evaluate each specialist's professional competence and objectivity, considering their qualifications, experience and available resources, together with the independence of the individuals performing the work.

We also consider the work performed by the specialist in light of our knowledge of the Council's environment and processes and our assessment of audit risk in the particular area. For example, we would typically perform the following procedures:

- ► Analyse source data and make inquiries as to the procedures used by the expert to establish whether the source date is relevant and reliable;
- ► Assess the reasonableness of the assumptions and methods used;

- Consider the appropriateness of the timing of when the specialist carried out the work; and
- Assess whether the substance of the specialist's findings are properly reflected in the financial statements.

4.3 Mandatory audit procedures required by auditing standards and the Code

As well as the financial statement risks (section two) and value for money risks (section three), we must perform other procedures as required by auditing, ethical and independence standards, the Code and other regulations. We outline below the procedures we will undertake during the course of our audit.

Procedures required by standards

- Addressing the risk of fraud and error;
- Significant disclosures included in the financial statements;
- Entity-wide controls;
- Reading other information contained in the financial statements and reporting whether it is inconsistent with our understanding and the financial statements;
- Auditor independence.

Procedures required by the Code

- Reviewing, and reporting on as appropriate, other information published with the financial statements, including the Annual Governance Statement and the Remuneration Report
- Reviewing and reporting on the Whole of Government Accounts return, in line with the instructions issued by the NAO

Finally, we are also required to discharge our statutory duties and responsibilities as established by the Local Audit and Accountability Act 2014.

4.4 Materiality

For the purposes of determining whether the financial statements are free from material error, we define materiality as the magnitude of an omission or misstatement that, individually or in aggregate, could reasonably be expected to influence the users of the financial statements. Our evaluation requires professional judgement and so takes into account qualitative as well as quantitative considerations implied in the definition.

We have determined that overall materiality for the financial statements of the Council is £1.758 million based on 2% of gross revenue expenditure. We will communicate uncorrected audit misstatements greater than £88 thousand to you.

The amount we consider material at the end of the audit may differ from our initial determination. At this stage, however, it is not feasible to anticipate all the circumstances that might ultimately influence our judgement. At the end of the audit we will form our final opinion by reference to all matters that could be significant to users of the financial statements, including the total effect of any audit misstatements, and our evaluation of materiality at that date.

4.5 Fees

The duty to prescribe fees is a statutory function delegated to Public Sector Audit Appointments Ltd (PSAA) by the Secretary of State for Communities and Local Government. PSAA has published a scale fee for all relevant bodies. This is defined as the fee required by auditors to meet statutory responsibilities under the Local Audit and Accountability Act 2014 in accordance with the NAO Code. The indicative fee scale for the audit of Arun District Council is £57,103.

4.6 Your audit team

The engagement team is led by Paul King, who has significant experience on Arun District Council. Paul is supported by Jason Jones, who is responsible for the day-to-day direction of audit work and James Stuttaford who is the key point of contact for the finance team.

4.7 Timetable of communication, deliverables and insights

We have set out below a timetable showing the key stages of the audit, including the value for money work and the Whole of Government Accounts. The timetable includes the deliverables we have agreed to provide to the Council through the Audit & Governance Committee's cycle in 2016/17. These dates are determined to ensure our alignment with PSAA's rolling calendar of deadlines.

From time to time matters may arise that require immediate communication with the Audit & Governance Committee and we will discuss them with the Chair as appropriate.

Following the conclusion of our audit we will prepare an Annual Audit Letter to communicate the key issues arising from our work to the Council and external stakeholders, including members of the public.

Audit phase	Timetable	Audit & Governance Committee timetable	Deliverables
High level planning	**December 2016**	**February 2017**	Audit Plan
Risk assessment and setting of scopes and testing routine processes and controls	**March 2017**	**June 2017**	Progress Report
Year-end audit and completion of audit	**July/August 2017**	**September 2017**	Report to those charged with governance via the Audit Results Report Audit report (including our opinion on the financial statements and overall value for money conclusion). Audit completion certificate Reporting to the NAO on the Whole of Government Accounts return.
Conclusion of reporting	**August 2017**	**September 2017**	Annual Audit Letter

In addition to the above formal reporting and deliverables we will seek to provide practical business insights and updates on regulatory matters.

5. Independence

5.1 Introduction

The APB Ethical Standards and ISA (UK and Ireland) 260 'Communication of audit matters with those charged with governance', requires us to communicate with you on a timely basis on all significant facts and matters that bear on our independence and objectivity. The Ethical Standards, as revised in December 2010, require that we do this formally both at the planning stage and at the conclusion of the audit, as well as during the audit if appropriate. The aim of these communications is to ensure full and fair disclosure by us to those charged with your governance on matters in which you have an interest.

Required communications

Planning stage	Final stage
▸ The principal threats, if any, to objectivity and independence identified by EY including consideration of all relationships between you, your affiliates and directors and us; ▸ The safeguards adopted and the reasons why they are considered to be effective, including any Engagement Quality Review; ▸ The overall assessment of threats and safeguards; ▸ Information about the general policies and process within EY to maintain objectivity and independence.	▸ A written disclosure of relationships (including the provision of non-audit services) that bear on our objectivity and independence, the threats to our independence that these create, any safeguards that we have put in place and why they address such threats, together with any other information necessary to enable our objectivity and independence to be assessed; ▸ Details of non-audit services provided and the fees charged in relation thereto; ▸ Written confirmation that we are independent; ▸ Details of any inconsistencies between APB Ethical Standards, the PSAA Terms of Appointment and your policy for the supply of non-audit services by EY and any apparent breach of that policy; and ▸ An opportunity to discuss auditor independence issues.

During the course of the audit we must also communicate with you whenever any significant judgements are made about threats to objectivity and independence and the appropriateness of our safeguards, for example when accepting an engagement to provide non-audit services.

We also provide information on any contingent fee arrangements, the amounts of any future contracted services, and details of any written proposal to provide non-audit services;

We ensure that the total amount of fees that EY and our network firms have charged to you and your affiliates for the provision of services during the reporting period are disclosed, analysed in appropriate categories.

5.2 Relationships, services and related threats and safeguards

We highlight the following significant facts and matters that may be reasonably considered to bear upon our objectivity and independence, including any principal threats. However we have adopted the safeguards below to mitigate these threats along with the reasons why they are considered to be effective.

Self-interest threats

A self-interest threat arises when EY has financial or other interests in your entity. Examples include where we have an investment in your entity; where we receive significant fees in respect of non-audit services; where we need to recover long outstanding fees; or where we enter into a business relationship with the Council.

At the time of writing, there are no long outstanding fees.

We believe that it is appropriate for us to undertake permissible non-audit services, and we will comply with the policies that the Council has approved and that are in compliance with PSAA Terms of Appointment.

At the time of writing, there are no planned non-audit fees.

A self-interest threat may also arise if members of our audit engagement team have objectives or are rewarded in relation to sales of non-audit services to the Council. We confirm that no member of our audit engagement team, including those from other service lines, is in this position, in compliance with Ethical Standard 4.

There are no other self-interest threats at the date of this report.

Self-review threats

Self-review threats arise when the results of a non-audit service performed by EY or others within the EY network are reflected in the amounts included or disclosed in the financial statements.

There are no other self-review threats at the date of this report.

Management threats

Partners and employees of EY are prohibited from taking decisions on behalf of management of your entity. Management threats may also arise during the provision of a non-audit service where management is required to make judgements or decisions based on that work.

There are no management threats at the date of this report.

Other threats

Other threats, such as advocacy, familiarity or intimidation, may arise.

There are no other threats at the date of this report.

Overall Assessment

Overall we consider that the adopted safeguards appropriately mitigate the principal threats identified, and we therefore confirm that EY is independent and the objectivity and independence of Paul King, the audit engagement Director and the audit engagement team have not been compromised.

5.3 Other required communications

EY has policies and procedures that instil professional values as part of firm culture and ensure that the highest standards of objectivity, independence and integrity are maintained.

Details of the key policies and processes within EY for maintaining objectivity and independence can be found in our annual Transparency Report, which the firm is required to publish by law. The most recent version of this report is for the year ended June 2016 and can be found here:

http://www.ey.com/uk/en/about-us/ey-uk-transparency-report-2016

Appendix A Fees

A breakdown of our agreed fee is shown below.

	Planned Fee 2016/17 £	Scale fee 2016/17 £	Outturn fee 2015/16 £
Opinion Audit and VFM Conclusion	57,103	57,103	57,103
Total Audit Fee – Code work	**57,103**	**57,103**	**57,103**
Certification of claims and returns [1]	9,053	9,053	8,330
Total	**66,156**	**66,156**	**65,433**

All fees exclude VAT.

The agreed fee presented above is based on the following assumptions:

- Officers meeting the agreed timetable of deliverables;
- The operating effectiveness of the internal controls for the key processes outlined in section 4.2 above;
- We can rely on the work of internal audit as planned;
- Our accounts opinion and value for money conclusion being unqualified;
- Appropriate quality of documentation is provided by the Council; and
- The Council has an effective control environment.

If any of the above assumptions prove to be unfounded, we will seek a variation to the agreed fee. This will be discussed with the Council in advance.

Fees for the auditor's consideration of correspondence from the public and formal objections will be charged in addition to the scale fee.

[1] Our fee for the certification of grant claims is based on the indicative scale fee set by the PSAA.

Appendix B UK required communications with those charged with governance

There are certain communications that we must provide to the Audit Committee. These are detailed here:

Required communication	Reference
Planning and audit approach Communication of the planned scope and timing of the audit including any limitations.	► Audit Plan
Significant findings from the audit ► Our view about the significant qualitative aspects of accounting practices including accounting policies, accounting estimates and financial statement disclosures ► Significant difficulties, if any, encountered during the audit ► Significant matters, if any, arising from the audit that were discussed with management ► Written representations that we are seeking ► Expected modifications to the audit report ► Other matters if any, significant to the oversight of the financial reporting process	► Audit Results Report
Misstatements ► Uncorrected misstatements and their effect on our audit opinion ► The effect of uncorrected misstatements related to prior periods ► A request that any uncorrected misstatement be corrected ► In writing, corrected misstatements that are significant	► Audit Results Report
Fraud ► Enquiries of the Audit Committee to determine whether they have knowledge of any actual, suspected or alleged fraud affecting the entity ► Any fraud that we have identified or information we have obtained that indicates that a fraud may exist ► A discussion of any other matters related to fraud	► Audit Results Report
Related parties Significant matters arising during the audit in connection with the entity's related parties including, when applicable: ► Non-disclosure by management ► Inappropriate authorisation and approval of transactions ► Disagreement over disclosures ► Non-compliance with laws and regulations ► Difficulty in identifying the party that ultimately controls the entity	► Audit Results Report
External confirmations ► Management's refusal for us to request confirmations ► Inability to obtain relevant and reliable audit evidence from other procedures	► Audit Results Report
Consideration of laws and regulations ► Audit findings regarding non-compliance where the non-compliance is material and believed to be intentional. This communication is subject to compliance with legislation on tipping off ► Enquiry of the Audit Committee into possible instances of non-compliance with laws and regulations that may have a material effect on the financial statements and that the Audit Committee may be aware of	► Audit Results Report

Required communication	Reference
Independence Communication of all significant facts and matters that bear on EY's objectivity and independence Communication of key elements of the audit engagement director's consideration of independence and objectivity such as: ► The principal threats ► Safeguards adopted and their effectiveness ► An overall assessment of threats and safeguards ► Information about the general policies and process within the firm to maintain objectivity and independence	► Audit Plan ► Audit Results Report
Going concern Events or conditions identified that may cast significant doubt on the entity's ability to continue as a going concern, including: ► Whether the events or conditions constitute a material uncertainty ► Whether the use of the going concern assumption is appropriate in the preparation and presentation of the financial statements ► The adequacy of related disclosures in the financial statements	► Audit Results Report
Significant deficiencies in internal controls identified during the audit	► Audit Results Report
Fee Information ► Breakdown of fee information at the agreement of the initial audit plan ► Breakdown of fee information at the completion of the audit	► Audit Plan ► Audit Results Report ► Annual Audit Letter if considered necessary

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Ernst & Young LLP

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Arun District Council

Audit & Governance Committee

Progress Report

February 2017

Building a better working world

Building a better
working world

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INVESTOR IN PEOPLE

Audit & Governance Committee
Arun District Council
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BN17 5LF

23 Febuary 2017

Dear Committee Member

Audit Progress Report

We are pleased to attach our Audit Progress Report.

The purpose of this report is to provide the Committee with an overview of the final position on the 2015/16 audit, and our initial plans for the 2016/17 audit. This report is a key mechanism in ensuring that our audit is aligned with the Committee's service expectations.

Our audit is undertaken in accordance with the requirements of the Local Audit and Accountability Act 2014, the National Audit Office's 2015 Code of Audit Practice, the Statement of Responsibilities issued by Public Sector Audit Appointments (PSAA) Ltd, auditing standards and other professional requirements.

We welcome the opportunity to discuss this report with you as well as understand whether there are other matters which you consider may influence our audit.

Yours faithfully

Paul King
Executive Director
For and behalf of Ernst & Young LLP

Contents

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

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

The ‘Terms of Appointment’ (updated September 2015) issued by PSAA sets out additional requirements that auditors must comply with, over and above those set out in the National Audit Office Code of Audit Practice (the Code) and statute, and covers matters of practice and procedure which are of a recurring nature.

This progress update is prepared in the context of the Statement of responsibilities. It is addressed to the Governance Committee, and is prepared for the sole use of the audited body. We, as appointed auditor, take no responsibility to any third party.

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

2015/16 work programme

Our 2015/16 Annual Audit Letter was presented to the November 2016 Audit & Governance Committee.

This letter communicated to Members and external stakeholders, including members of the public, the key issues arising from our audit work. We had already reported the detailed findings from our audit work in our 2015/16 Audit Results Report to the September 2016 Committee.

Our progress report accompanying the 2015/16 Annual Audit Letter in the December 2016 Committee informed Members that our work on the certification of the Council's claims and returns was completed in November 2016.

We are presenting our annual report on the certification of claims and returns to the Audit & Governance Committee today. This completes our work programme in relation to the 2015/16 financial year.

2016/17 audit

Fee letter

We issued our 2016/17 fee letter to the Council on 19 April 2016. This was reported to the June 2016 meeting of the Audit & Governance Committee.

Financial Statements

We adopt a risk based approach to the audit and, as part of our continuous planning we have held a number of meetings with key officers and other stakeholders to ensure the 2016/17 audit runs as smoothly as possible and to identify any risks and technical accounting issues that require our early consideration. Recent meetings include:

- November 2016 – attendance at the Audit & Governance Committee; and
- January 2017 – meeting with the Chief Executive, Deputy Chief Executive and the Head of Finance and Property to update our understanding of the challenges and risks you are facing.

Planning and interim visit

We are scheduled to complete our initial planning work, including the walkthrough of the key financial systems in March 2017.

There are no significant matters arising from our initial planning work or meetings that we need to bring to your attention at this stage.

We will update the Committee when the testing of controls and early substantive testing has been completed. This work is also scheduled for March 2017.

Internal Audit

Internal Audit is a key part of the Council's internal control environment that we review during our assessment process. This process helps us to assess the level of risk of material errors occurring in the financial statements and informs the level of testing that we are required to complete in support of the audit opinion. We consider Internal Audit's progress with their annual audit plan and the results of their testing of financial systems and, where it is appropriate to do so, we will undertake procedures to enable us to place reliance upon this testing.

Post statements visit

We are currently finalising our resource planning for our post statements work in the summer in discussion with the Head of Finance and Property. We have communicated the proposed timings of our visit accordingly.

We will continue to use our computer-based analytics tools to enable us to capture whole populations of your financial data, in particular payroll and journal entries. These tools facilitate our analysis of these data sets and allow us to focus our testing in areas of highest risk.

Our detailed audit plan, setting out the risks we have identified and the work we will undertake in response, will be presented to the Audit & Governance Committee in February 2017.

Value for money

Our initial risk assessment is ongoing. At this stage we have not identified any significant risks per our audit plan to be presented to the February 2017 meeting of the Audit & Governance Committee.

Other issues of interest

Expenditure funding analysis

The 2016/17 Code of Practice on Local Authority Accounting in the United Kingdom contains a new format and reporting requirements for the Comprehensive Income and Expenditure Statement (CIES) and the Movement in Reserves Statement as a result of the 'Telling the Story' review of local authority financial statements. The main changes are:

- reformatting the CIES to report on the same basis as the local authority is organised by; and
- the introduction of the new Expenditure and Funding Analysis.

CIPFA have published a briefing note "Understanding Local Authority Financial Statements in 2016" which provides further information. This is available on the CIPFA website at

http://www.cipfa.org/policy-and-guidance/technical-panels-and-boards/cipfa-lasaac-local-authority-code-board/simplification-and-streamlining-the-presentation-of-local-authority-financial-statements

As part of our audit planning, we will seek to understand the preparation that the Council is making for these changes. This early engagement should help to ensure a smooth transition to the new reporting format.

Sector briefings

In addition to our formal reporting and deliverables we provide practical business insights and updates on regulatory matters through our Sector Briefings.

Timetable

We set out below a timetable showing the key stages of the audit, including the value for money work, and the deliverables we will provide to you through the 2016/17 Audit & Governance Committee cycle.

Audit phase	EY Timetable	Deliverable	Reported	Status
High level planning	**Ongoing**	Audit Fee Letter	Issued 19th April 2016 Reported June 2016	Completed
Risk assessment and setting of scope of audit	**Dec 2016 - February 2017**	Audit Plan	February 2017	Completed
Testing of routine processes and controls	**February 2017**	Progress Report	February 2017	Work is planned to start in March 2017.
Year-end audit	**Summer 2017**	Audit results report to those charged with governance. Audit report (including our opinion on the financial statements and a conclusion on your arrangements for securing economy, efficiency and effectiveness in your use of resources) Whole of Government Accounts Submission to NAO based on their group audit instructions. Audit Completion certificate	September 2017	Work is planned to start during July 2017. Audit & Governance Committee date to be confirmed.

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AGENDA ITEM NO. 7

ARUN DISTRICT COUNCIL

AUDIT AND GOVERNANCE COMMITTEE
23 FEBRUARY 2017

Decision Paper

Subject : Treasury Management Strategy Statement and Annual Investment Strategy 2017/18

Report by : Sian Southerton - Senior Accountant (Treasury)

Report date : January 2017

EXECUTIVE SUMMARY

The purpose of this report is to present the Treasury Management Strategy Statement and Annual Investment Strategy 2017/2018 and to enable the Audit and Governance Committee to scrutinise the report prior to making comment to Full Council.

RECOMMENDATIONS

The Committee is requested to recommend Full Council to:

(i) approve the Treasury Management Strategy for 2017/18;
(ii) approve the Annual Investment Strategy for 2017/18; and
(iii) approve the Prudential Indicators for 2017/18, 2018/2019 and 2019/20 as contained in appendix 1 and the body of the report.

1.0 Introduction

1.1 Background

The Council is required to operate a balanced budget, which broadly means that cash raised during the year will meet cash expenditure. Part of the treasury management operation is to ensure that this cash flow is adequately planned, with cash being available when it is needed. Surplus monies are invested in low risk counterparties or instruments commensurate with the Council's risk appetite, providing adequate liquidity initially before considering investment return.

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

CIPFA defines treasury management as:

"The management of the local authority's investments and cash flows, its banking, money market and capital market transactions; the effective control of the risks associated with those activities; and the pursuit of optimum performance consistent with those risks."

1.2 Reporting Arrangements

The Council is required to receive and approve, as a minimum, three main reports each year, which incorporate a variety of polices, estimates and actuals. These reports are required to be adequately scrutinised by committee before being recommended to the Council. This role is undertaken by the Audit and Governance Committee.

1.2.1 **Prudential and Treasury Indicators and Treasury Strategy** (this report) - The first and most important report covers:

- the capital plans (including prudential indicators) (2.0);
- a minimum revenue provision (MRP) policy (how residual capital expenditure is charged to revenue over time) (2.3);
- the treasury management strategy (how the investments and borrowings are to be organised) including treasury indicators (3.0); and
- an investment strategy (the parameters on how investments are to be managed) (4.0).

1.2.2 **A Mid Year Treasury Management Report** – This will update Members with the progress of the capital position, amending prudential indicators as necessary, and whether any policies require revision. The Audit and Governance Committee will also receive update reports at its September and December meetings prior to approval by Full Council.

1.2.3 **An Annual Treasury Report** – This provides details of a selection of actual prudential and treasury indicators and actual treasury operations compared to the estimates within the strategy.

1.3 Treasury Management Strategy for 2017/18

The strategy for 2017/18 covers two main areas:

1.3.1 **Capital issues**

- the capital plans and the prudential indicators;
- the minimum revenue provision (MRP) policy.

1.3.2 **Treasury management Issues**

- the current treasury position;
- treasury indicators which will limit the treasury risk and activities of the Council;
- prospects for interest rates;
- the borrowing strategy;
- policy on borrowing in advance of need;
- debt rescheduling;
- the investment strategy;
- creditworthiness policy; and
- policy on use of external service providers.

These elements cover the requirements of the Local Government Act 2003, the CIPFA Prudential Code, the CIPFA Treasury Management Code and the CLG Investment Guidance. CLG Minimum Revenue Provision (MRP) Guidance was also reviewed to confirm that in Arun's circumstances a MRP was not currently necessary and a Voluntary Repayment Provision (VRP) is sufficient as Arun's debt is all HRA. However there is a possibility that the Council may wish to borrow for General Fund purposes at some point in the future and the MRP policy written as part of the 2016/17 Strategy is still in place with no revisions at this time. The policy will need to be reviewed at such time as the need to borrow has been agreed. There may also be further HRA borrowing relating to the current acquisition/new build programme.

1.4 Training

The CIPFA Code requires the responsible officer to ensure that members with responsibility for treasury management receive adequate training. (This especially applies to members responsible for scrutiny). Members of the Audit and Governance Committee, Cabinet and Overview Select Committee were invited to attended a workshop presented by Capita Asset Services (Treasury advisors) explaining the roles and responsibilities of elected members and giving them an economic update. The latest session was held on 8th December 2016.

The training needs of treasury management officers are reviewed periodically and senior officers attend seminars at least once a year.

1.5 Treasury management consultants

The Council uses Capita Asset Services, Treasury solutions as its external treasury management advisors.

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

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

2.0 The Capital Prudential Indicators 2017/18 to 2019/20 (Appendix 1)

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

2.1 Capital Expenditure.

This prudential Indicator is a summary of the Council's capital expenditure plans, both those agreed previously, and those forming part of this budget cycle. The Council's capital expenditure is considered as part of the budget setting process and a report for approval is going to Full Council on 22nd February 2017.

The strategy assumes that there will be a need to borrow varying amounts over the 3 years from 2017/18 to 2019/20 to finance capital expenditure, however the source has not yet been identified. The projected net annual financing requirement is therefore shown in the table below. The need to borrow is reviewed annually as part of the Treasury Management Strategy and budget setting process and will be dependent on the HRA Business Plan and the Capital programme.

The table below summarises the capital expenditure plans and how these plans are being financed by capital or revenue resources. Any shortfall of resources results in a funding need (borrowing). Although borrowing may need to be taken out in addition to the use of capital receipts for the Littlehampton Leisure Centre new build, at the time of writing, no plans or decisions have been made to the value or timing of this borrowing and have therefore not been included.

Capital Expenditure	Actual 2015/16 £,000	Current Estimate 2016/17 £,000	Estimate 2017/18 £,000	Estimate 2018/19 £,000	Estimate 2019/20 £,000
Non HRA	1,950	1,327	17,306	2,096	2,700
HRA	2,096	4,628	5,778	2,942	2,282
HRA settlement	-	-	-	-	-
Total	**4,046**	**5,955**	**23,084**	**5,038**	**4,982**
Financed by:					
Capital receipts	0	1,233	10,166	216	18
Capital grants	1,521	600	1,000	1,000	1,000
Capital reserves	2,096	3,028	2,207	2,207	2,207
Revenue	429	44	3,126	1,111	1,715
	4,046	**4,905**	**16,499**	**4,534**	**4,940**
Net financing need for the year	**0**	**1,050**	**6,585**	**504**	**42**

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

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

The CFR does not increase indefinitely, as the minimum revenue provision (MRP) is a statutory annual revenue charge which broadly reduces the borrowing need in line with each assets life.

The CFR includes any other long term liabilities (e.g. PFI schemes, finance leases). Whilst these increase the CFR, and therefore the Council's borrowing requirement, these types of scheme include a borrowing facility and so the Council is not required to separately borrow for these schemes. The Council currently has no such schemes within the CFR.

The Council is asked to approve the CFR projections in Appendix 1 also shown below:

CFR at 31 March	**Actual 2015/16 £,000**	**Current Estimate 2016/17 £,000**	**Estimate 2017/18 £,000**	**Estimate 2018/19 £,000**	**Estimate 2019/20 £,000**
Capital Financing Requirement					
CFR – General Fund	(4,978)	(4,978)	(1,293)	(1,703)	(2,113)
CFR – housing	2,342	2,342	2,342	2,342	2,342
HRA Settlement	56,724	53,180	49,636	46,092	42,548
HRA - Acquisition / new build	0	1,015	3,387	3,756	3,662
Total CFR	**54,088**	**51,559**	**54,072**	**50,487**	**46,439**
Movement in CFR	**(3,544)**	**(2,529)**	**2,513**	**(3,585)**	**(4,048)**

Movement in CFR represented by					
Net financing need for the year (above)	0	1050	6,585	504	42
Less MRP/**VRP**	(3,544)	(3,579)	(4,072)	(4,089)	(4,090)
Movement in CFR	**(3,544)**	**(2,529)**	**2,513**	**(3,585)**	**(4,048)**

2.3 Minimum revenue provision (MRP) policy statement

Councils are required to pay off an element of the accumulated General Fund capital spend each year (the CFR) through a revenue charge (the minimum revenue provision - MRP), although it is also allowed to undertake additional voluntary payments if required (voluntary revenue provision - VRP).

CLG regulations have been issued which require the full Council to approve an MRP Statement in advance of each year (Appendix 2). A variety of options are provided to councils, so long as there is a prudent provision. Four options for prudent MRP provision are set out in the CLG Guidance.

Where the CFR (as calculated for the normal purposes of the prudential Code) is nil or negative on the last day of a financial year, this indicates that the authority's provision for debt is equal to or greater than the debt incurred.

The Council does not currently have any General Fund debt and therefore is not statutorily required to make Minimum Revenue Provision (MRP) in respect of its CFR, however, it is considered prudent to make VRP in respect of the PWLB maturity loans funding the HRA self-financing settlement payment. The table shows the VRP reducing the CFR. The VRP is incorporated in the HRA Business Plan and in the 2017/18 HRA budget. If borrowing is taken out for general fund in 2017/18, the MRP policy will need to be reviewed.

2.4 Core funds and expected investment balances

The application of resources (capital receipts, reserves etc.) to either finance capital expenditure or other budget decisions to support the revenue budget will have an ongoing impact on investments unless resources are supplemented each year from new sources (asset sales etc.). Detailed below are estimates of the year end balances for each resource and anticipated day to day cash flow balances.

Year End Resources £m	2015/16 Actual £m	2016/17 Estimate £m	2017/18 Estimate £m	2018/19 Estimate £m	2019/20 Estimate £m
Fund balances	18.1	15.8	16.2	16.0	14.3
Earmarked Reserves	13.2	9.7	5.0	4.0	3.0
Capital Receipts	11.8	12.4	4.1	5.9	5.9
Other	2.1	0	0	0	0
Total core funds	**45.2**	**37.9**	**25.30**	**25.9**	**23.2**
Under/over borrowing	10.9	12.1	10.7	10.1	5.8
Expected investments	**56.1**	**50.0**	**36.0**	**36.0**	**29.0**

2.5 Affordability Prudential Indicators

The report covers the overall capital and control of borrowing prudential indicators, but within this framework prudential indicators are required to assess the affordability of the capital investment plans. These provide an indication of the impact of the capital investment plans on the Council's overall finances. The Council is asked to approve the following indicators contained in Appendix 1

a. Ratio of financing costs to net revenue stream.

This indicator identifies the trend in the cost of capital (borrowing and other long term obligation costs net of investment income) against the net revenue stream.

	Actual 2015/16 %	Current Estimate 2016/17 %	Estimate 2017/18 %	Estimate 2018/19 %	Estimate 2019/20 %
Non-HRA	-2.34	-2.42	-1.91	-1.91	-1.91
HRA	32.30	34.71	32.79	33.44	33.34

b. Incremental impact of capital investment decisions on council tax.

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

c. Incremental impact of capital investment decisions on the band D council tax

	Actual 2015/16 £	Current Estimate 2016/17 £	Estimate 2017/18 £	Estimate 2018/19 £	Estimate 2019/20 £
Council tax - band D	2.6	5.45	26.37	-33.49	9.98

d. Estimate of Incremental impact of capital investment decisions on housing rent levels

Similar to the council tax calculation, this indicator identifies the trend in the cost of proposed changes in the housing capital programme recommended in the budget report compared to the Council's existing commitments and current plans, expressed as a discrete impact on weekly rent levels.

e. Incremental impact of capital investment decisions on housing rent levels

	2015/16 Actual £	2016/17 Estimate £	2017/18 Estimate £	2018/19 Estimate £	2019/20 Estimate £
Weekly housing rent levels	20.26*	-0.95	0.10	0.37	0.05

** Increase due to HRA aquision / new build*

This indicator shows the revenue impact on any newly proposed changes, although any discrete impact will be constrained by rent controls.

3 Borrowing Strategy

The capital expenditure plans set out in Section 2 provide details of the service activity of the Council. The treasury management function ensures that the Council's cash is organised in accordance with the relevant professional codes, so that sufficient cash is available to meet this service activity. This will involve both the organisation of the cash flow and, where capital plans require, the organisation of approporiate borrowing facilities. The strategy covers the relevant treasury / prudential indicators, the current and projected debt positions and the annual investment strategy.

3.1 Current Portfolio Position

The Council's Treasury Investment and debt portfolio position at 31 March 2016 and 31 December 2016 summarised below;

	2015/16 Actual £'000	2016/17 Actual at 31/12/16 £'000
Total Investments	56,113	74,471
Total Debt	62,040	62,040

The investments held at 31st December 2016 are shown in Appendix 3.

Within the prudential indicators there are a number of key indicators to ensure that the Council operates its activities within well defined limits. One of these is that the Council needs to ensure that its gross debt does not, except in the short term, exceed the total of the CFR in the preceding year plus the estimates of any additional CFR for 2017/18 and the following two financial years. This allows some flexibility for limited early borrowing for future years, but ensures that borrowing is not undertaken for revenue purposes.

The Council is technically in an over borrowed position as the only borrowing relates to the HRA Self-Financing settlement (£70.9m). Prior to this borrowing being undertaken, the Council had a negative CFR of £2.6m which has arisen over a number of years and was due more to changes in the capital accounting regulations rather than to any specific policy decision. As a consequence of these factors, the Council's gross debt exceeds its CFR and is likely to continue to do so in the short term.

The Head of Finance and Property reports that the Council complied with the prudential indicators in the current year and does not envisage difficulties for the future. This view takes into account current commitments, existing plans, and the proposals in the budget report.

3.2 Treasury Indicators: Limits to Borrowing Activity

3.2.1 The Operational Boundary.

This is the limit beyond which external debt is not normally expected to exceed. The Council is requested to approve an operational boundary of £63M in Appendix 1 (2017/18).

3.2.2 **The Authorised Limit for external debt.**

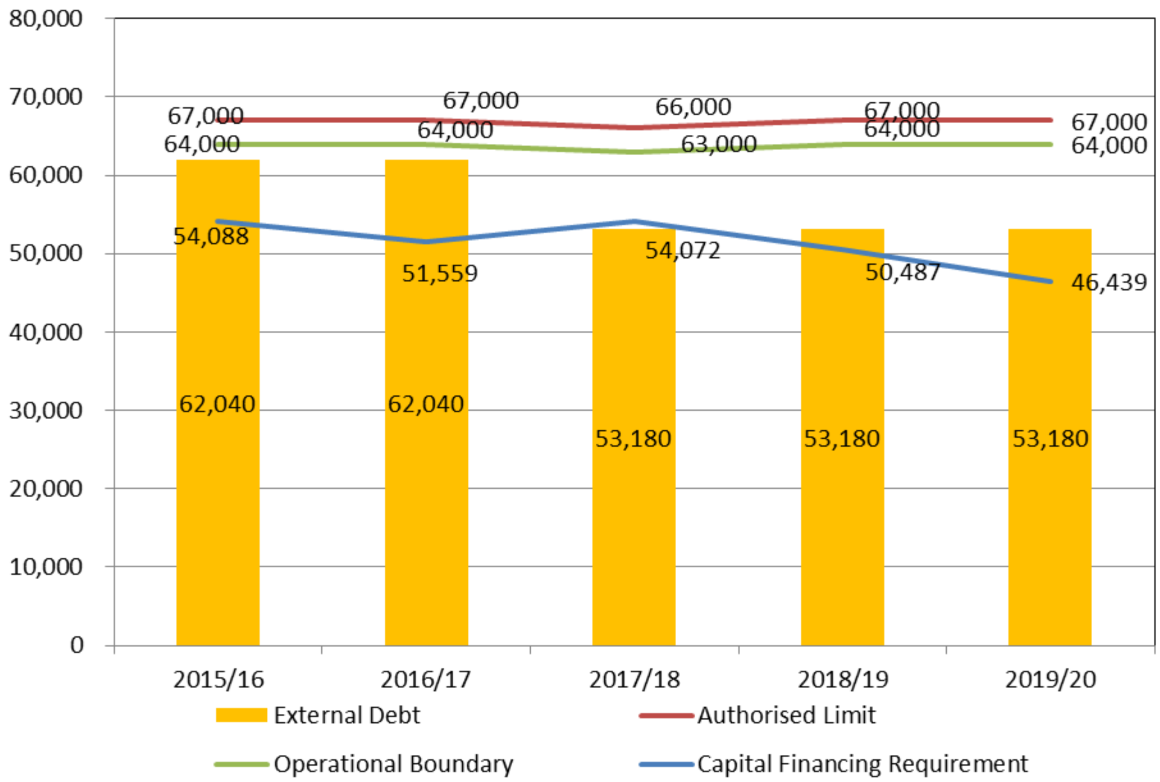
A further key prudential indicator represents a control on the maximum level of borrowing. This represents a limit beyond which external debt is prohibited, and this limit needs to be set or revised by the full Council. It reflects the level of external debt which, while not desired, could be afforded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

(i) This is the statutory limit determined under section 3 (1) of the Local Government Act 2003. The Government retains an option to control either the total of all councils' plans, or those of a specific council, although this power has not yet been exercised.

(ii) The Council is asked to approve an Authorised Limit of £66M (appendix 1 2017/18).

3.2.3 Separately, the Council is also limited to a maximum HRA CFR through the HRA self-financing regime of £81.63M.

3.2.4 The chart below shows the Councils projection of CFR and borrowing.



3.3 Prospects for Interest Rates

3.3.1 The Council has appointed Capita Asset Services as its treasury advisor and part of their service is to assist the Council to formulate a view on interest rates. Appendix 4 draws together two views of the forecasts for short term (Bank Rate) and longer fixed interest rates. The following table gives the Capita Asset Services central view. This forecast suggests the first increase in Bank Rate to be in June 2019.

	Dec-16	Mar-17	Jun-17	Sep-17	Dec-17	Mar-18	Jun-18	Sep-18	Dec-18	Mar-19	Jun-19	Sep-19	Dec-19	Mar-20
Bank rate	0.25%	0.25%	0.25%	0.25%	0.25%	0.25%	0.25%	0.25%	0.25%	0.25%	0.50%	0.50%	0.75%	0.75%
5yr PWLB rate	1.60%	1.60%	1.60%	1.60%	1.60%	1.70%	1.70%	1.70%	1.80%	1.80%	1.90%	1.90%	2.00%	2.00%
10yr PWLB rate	2.30%	2.30%	2.30%	2.30%	2.30%	2.30%	2.40%	2.40%	2.40%	2.50%	2.50%	2.60%	2.60%	2.70%
25yr PWLB rate	2.90%	2.90%	2.90%	2.90%	3.00%	3.00%	3.00%	3.10%	3.10%	3.20%	3.20%	3.30%	3.30%	3.40%
50yr PWLB rate	2.70%	2.70%	2.70%	2.70%	2.80%	2.80%	2.80%	2.90%	2.90%	3.00%	3.00%	3.10%	3.10%	3.20%

3.3.2 The Monetary Policy Committee, (MPC), cut Bank Rate from 0.50% to 0.25% on 4th August in order to counteract what it forecast was going to be a sharp slowdown in growth in the second half of 2016. A first increase to 0.50% is not tentatively pencilled in, as in the table above, until quarter 2 2019, after those negotiations have been concluded, (though the period for negotiations could be extended). However, if strong domestically generated inflation, (e.g. from wage increases within the UK), were to emerge, then the pace and timing of increases in Bank Rate could be brought forward.

Economic and interest rate forecasting remains difficult with so many external influences weighing on the UK. The above forecasts, (and MPC decisions), will be liable to further amendment depending on how economic data and developments in financial markets transpire over the next year. Geopolitical developments, especially in the EU, could also have a major impact. Forecasts for average investment earnings beyond the three-year time horizon will be heavily dependent on economic and political developments.

The overall longer run trend is for gilt yields and PWLB rates to rise, albeit gently. It has long been expected that at some point, there would be a start to a switch back from bonds to equities after a historic long term trend over about the last twenty five years of falling bond yields. The action of central banks since the financial crash of 2008, in implementing substantial quantitative easing purchases of bonds, added further impetus to this downward trend in bond yields and rising prices of bonds.

PWLB rates and gilt yields have been experiencing exceptional levels of volatility that have been highly correlated to geo-political, sovereign debt crisis and emerging market developments. It is likely that these exceptional levels of volatility could continue to occur for the foreseeable future.

The overall balance of risks to economic recovery in the UK is to the downside, particularly in view of the current uncertainty over the final terms of Brexit and the timetable for its implementation.

The potential for **upside risks to current forecasts** for UK gilt yields and PWLB rates, especially for longer term PWLB rates, include: -

- UK inflation rising to significantly higher levels than in the wider EU and in the US, causing an increase in the inflation premium in gilt yields.
- A rise in US Treasury yields as a result of Fed. funds rate increases and rising inflation expectations in the USA, dragging UK gilt yields upwards.
- The pace and timing of increases in the Fed. funds rate causing a fundamental reassessment by investors of the relative risks of holding bonds as opposed to equities and leading to a major flight from bonds to equities.
- A downward revision to the UK's sovereign credit rating undermining investor confidence in holding sovereign debt (gilts).

Investment and borrowing rates

- Investment returns are likely to remain low during 2017/18 and beyond;
- Borrowing interest rates have been on a generally downward trend during most of 2016 up to mid-August; they fell sharply to historically phenomenally low levels after the referendum and then even further after the MPC meeting of 4th August when a new package of quantitative easing purchasing of gilts was announced. Gilt yields have since risen sharply due to a rise in concerns around a 'hard Brexit', the fall in the value of sterling, and an increase in inflation expectations. The policy of avoiding new borrowing by running down spare cash balances, has served well over the last few years. However, this needs to be carefully reviewed to avoid incurring higher borrowing costs in later times when authorities will not be able to avoid new borrowing to finance capital expenditure and/or to refinance maturing debt;
- There will remain a cost of carry to any new long-term borrowing that causes a temporary increase in cash balances as this position will, most likely, incur a revenue cost – the difference between borrowing costs and investment returns.

A more detailed economic commentary is set out at appendix 5 if required.

3.4 Borrowing Strategy

3.4.1 The Council has an increased capital programme and may look to borrow for general fund in 2017/18 onwards. The level of expenditure and reduction in rental income within the HRA will almost certainly require additional borrowing, and this will be reflected in the HRA 10 year financial model which will form an integral part of the Business Plan. The HRA business plan will include a programme of new build/stock acquisition, in addition to ongoing maintenance and decent homes programme.

There may also be a requirement to borrow for other new projects / opportunities but this would need to be dependent on a viable business case which fully justifies the investment.

The Council's borrowing strategy will give consideration to new borrowing in the following order or priority;

1) Internal borrowing, by running down cash balances and foregoing interest earned at historically low rates, as this is the cheapest form of borrowing, however, in view of the overall forecast for long term borrowing rates to increase over the next few years, consideration will also be given to weighing the short term advantage of internal borrowing against potential long term costs if the opportunity is missed for taking market loans at long term rates which will be higher in future years;
2) PWLB borrowing – the Certainty Rate is available to the Council at 0.2% below the normal terms;
3) Short dated borrowing from the money markets, most probably other local authorities;

There may however, be occasional need to borrow for liquidity purposes. The Council has a £100,000 overdraft facility which will increase to £1,000,000 from 1 April 2017 for this purpose, plus access to the money markets.

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

3.4.2 **Treasury Management Limits on Activity**

There are three debt related treasury activity limits. The purpose of these are to restrain the activity of the treasury function within certain limits, thereby managing risk and reducing the impact of any adverse movement in interest rates. However, if these are set to be too restrictive they will impair the opportunities to reduce costs / improve performance. The indicators are:

- Upper limits on variable interest rate exposure. This identifies a maximum limit for variable interest rates based upon the debt position net of investments;
- Upper limits on fixed interest rate exposure. This is similar to the previous indicator and covers a maximum limit on fixed interest rates;
- Maturity structure of borrowing. These gross limits are set to reduce the Council's exposure to large fixed rate sums falling due for refinancing, and are required for upper and lower limits.

The Council is asked to approve the treasury indicators and limits in Appendix 1 also shown below:

£m	2017/18	2018/19	2019/20
Interest rate exposures			
	Upper	**Upper**	**Upper**
Limits on fixed interest rates based on net debt	100%	100%	100%
Limits on variable interest rates based on net debt	40%	40%	40%

Maturity structure of fixed interest rate borrowing 2017/18			
	Actual at 31/03/17	**Lower**	**Upper**
Under 12 months	0%	0%	40%
12 months and within 24 months	0%	0%	40%
24 months and within 5 years	33.32%	0%	50%
5 years and within 10 years	0%	0%	60%
10 years and above	66.68%	0%	100%

3.5 Policy of Borrowing in Advance of Need

The Council will not borrow more than or in advance of its needs, purely in order to profit from the investment of the extra sums borrowed. Any decision to borrow in advance will be within forward approved Capital Financing Requirement estimates, and will be considered carefully to ensure that value for money can be demonstrated and that the Council can ensure the security of such funds.

3.6 Debt Rescheduling

The only loans that the Council currently hold are those taken to fund the housing reform payment. As short term borrowing rates will be considerably cheaper than longer term fixed interest rates there may be potential opportunities to generate savings by repaying long term debt prematurely, however any savings in future years will need to be considered in the light of the current treasury position and the size of the cost of debt repayment (premiums or discounts incurred).

The reasons for any rescheduling to take place will include:

- the generation of cash savings and / or discounted cash flow savings;
- helping to fulfil the treasury strategy;
- enhance the balance of the portfolio (amend the maturity profile and/or the balance of volatility).

Consideration will also be given to identify if there is any residual potential for making savings by running down investment balances to repay debt prematurely as short term rates on investments are likely to be lower than rates paid on current debt.

All rescheduling will be reported to the Council at the earliest meeting following its action.

4 <u>Annual Investment Strategy</u>

4.1 Investment Policy

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

In accordance with the above, and in order to minimise the risk to investments, the Council has below clearly stipulated the minimum acceptable credit quality of counterparties for inclusion on the lending list which also enables diversification and thus avoidance of concentration risk. The key ratings used to monitor counterparties are the Short Term and Long Term ratings

Ratings will not be the sole determinant of the quality of an institution and it is important to continually assess and monitor the financial sector on both a micro and macro basis and in relation to the economic and political environments in which institutions operate. The assessment will also take account of information that reflects the opinion of the markets. To this end the Council will engage with its advisors to maintain a monitor on market pricing such as “credit default swaps” and overlay that information on top of the credit ratings.

Other information sources used will include the financial press, share price and other such information pertaining to the banking sector in order to establish the most robust scrutiny process on the suitability of potential investment counterparties.

The Council does not strictly adhere to the advisor’s suggested lending list and durations, but does take account of the advice offered before making any investment decisions. The Council will take advantage of attractive rates available from counterparties of high creditworthiness for longer periods while interest rates remain low and the forecast for a rate hike is in the distant future.

Investment instruments identified for use in the financial year are listed in Appendix 6 under the ‘Specified’ and ‘Non-Specified’ Investments categories. Counterparty limits will be as set through the Council’s Treasury Management Practices – Schedules.

4.2 Creditworthiness policy

The primary principle governing the Council’s investment criteria is the security of its investments, although the yield or return on the investment is also a key consideration. After this main principle, the Council will ensure that:

- It maintains a policy covering both the categories of investment types it will invest in, criteria for choosing investment counterparties with adequate security, and monitoring their security. This is set out in the specified and non-specified investment sections below; and
- It has sufficient liquidity in its investments. For this purpose it will set out procedures for determining the maximum periods for which funds may prudently be committed. These procedures also apply to the Council’s prudential indicators covering the maximum principal sums invested.

The Council achieves a high credit quality by using a minimum rating criteria (where rated). It does not use the approach suggested by CIPFA of using the lowest common denominator method of selecting counterparties as some rating agencies are more aggressive in giving low ratings than others. The Council applies a majority rule where a counterparty would be removed immediately from the lending list if 2 or more rating agencies downgrade the counterparty below the minimum criteria. The Council's minimum criteria can be seen in Appendix 7.

This Council supplements credit ratings using the creditworthiness service provided by Capita Asset Services. The credit ratings of counterparties are supplemented with the following overlays:

- credit watches and credit outlooks from credit rating agencies;
- CDS (Credit Default Swaps) against the iTraxx benchmark to give early warning of likely changes in credit ratings;
- sovereign ratings to select counterparties from only the most creditworthy countries.

All credit ratings are monitored weekly and the Council is alerted to changes to ratings of all three agencies through its use of the Capita Asset Services creditworthiness service.

Sole reliance will not be placed on the use of this external service. In addition this Council will also use market data and market information, information on government support for banks and the credit ratings of that government support.

The current list of approved counterparties is included in Appendix 7. The Council is currently changing banks from HSBC to Lloyds and therefore the limits associated with these counterparties have changed as shown in appendix 7. HSBC is shown in category 1 and Lloyds in category 5. Lloyds being the incumbent bank from 1st April 2017 has no limit however the Council will only invest £11M in term deposits with them.

4.3 Country and sector limits

The Council has determined that it will only use approved counterparties from countries with a minimum sovereign credit rating of AA from Fitch (or equivalent). The list of countries that qualify using this credit criteria as at the date of this report are shown in Appendix 7. This list will be added to, or deducted from by officers should ratings change in accordance with this policy.

The exception to this policy is the UK, which is currently rated AA by two rating agencies and AA+ by the other one. If the UK's credit rating should fall below the minimum criteria set above, investment will continue to be made in UK financial institutions if after careful consideration it is deemed appropriate to do so.

The code recommends that Councils take country limits into consideration in order to spread risk. In practice most investments tend to be made in the UK due to the restricted number of quality counterparties available to the Council and it is not proposed to set country limits at this time.

The Council does not currently use sector limits e.g. banks v. building societies due to the limited number of quality counterparties available. The Council has a limit of between £4M and £12M (see Appendix 6 and 7 for investment categories) which can be invested with a single counterparty (or group) depending on the credit quality of the counterparty.

Every effort will be made to spread the maturity profile of investments to compensate for the lack of sector or country spreads (due to limited counterparties).

4.4 Investment Strategy

The Council does not utilise external fund managers, but reserves the option to do so in the future should this be deemed to be appropriate. Should consideration be given to exercising this option in the future, the relevant Committee will be advised of the reason for doing so.

The Council's funds are therefore all managed in-house although £4M is invested in a property fund run by CCLA (Churches, Charities and Local Authorities). The average level of funds available for investment purposes is currently £66M. These funds are partially cash-flow derived and there is a core balance of approximately £52M which is available for investments over a year (maximum 5 years or 25 years for property funds). The core balance is comprised of funds that are available due a number of factors including the setting aside of funds to repay the HRA loans (£3.5M) for when they become repayable, the Earmarked Reserves, Capital Receipt, General Fund and HRA balances which were £13.2M, £11.8M, £12.3M and £7.9M at 31 March 2016 respectively.

The Council currently has the following investments which span the financial year:

	Amount £	Start Date	Maturity Date	Rate %
Royal Bank of Scotland (RBS)	2,000,000	29/05/15	31/05/18	1/1.35/1.70
Close Brothers	2,000,000	24/08/16	24/08/18	1.21
Royal Bank of Scotland (RBS)	2,000,000	31/03/16	18/02/19	1.20/1.35
Royal Bank of Scotland (RBS)	2,000,000	19/08/16	19/08/19	0.80/0.95/ 1.10
Close Brothers	1,000,000	26/01/16	04/01/19	1.05
CCLA Property Fund	4,000,000			Between 4% & 5%
	13,000,000			

There are no forward commitments (deals) for the financial year.

Investment returns expectations. . Bank Rate is forecast to stay flat at 0.25% until quarter 2 2019 and not to rise above 0.75% by quarter 1 2020. Bank Rate forecasts for financial year ends (March) are:

- 2016/17 0.25%
- 2017/18 0.25%
- 2018/19 0.25%
- 2019/20 0.50%

The suggested budgeted investment earnings rates for returns on investments placed for periods up to 100 days during each financial year are as follows:

	Now
2016/17	0.25%
2017/18	0.25%
2018/19	0.25%
2019/20	0.50%
2020/21	0.75%
2021/22	1.00%
2022/23	1.50%
2023/24	1.75%
Later years	2.75%

The overall balance of risks to these forecasts is currently probably slightly skewed to the downside in view of the uncertainty over the final terms of Brexit. If growth expectations disappoint and inflationary pressures are minimal, the start of increases in Bank Rate could be pushed back. On the other hand, should the pace of growth quicken and / or forecasts for increases in inflation rise, there could be an upside risk i.e. Bank Rate increases occur earlier and / or at a quicker pace.

The Council's budgeted rate of return for 2017/18 is 1.02% based on 1.83% on funds that are already invested; 0.65% for the remaining core balances; and 0.30% for short term cash flow derived balances. The total investment income budget for 2017/18 is £530,000. The budget is based on some investments of up to one year particularly in category 4 and longer investments in Category 1, 2, 3 and 6. (Category 1 being the highest rated banks and 6 being part nationalised banks). This strategy has resulted in higher returns for the Council over the last few years whilst interest rates have been low.

The Council currently uses two types of Pooled Funds, Property Funds and Money Market Funds (MMFs). Pooled funds enable the Council to diversify the assets and the underlying risk in the investment portfolio and provide the potential for enhanced returns. MMFs are used for short term investments of daily surplus cash as they provide instant liquidity with high quality counterparties at a return comparable to (if not better than) other fixed deposits of short term duration, however these rates are at a very low level now (0.18 – 0.29%) . The MMFs are "triple A" rated, liquid and have a constant net asset value (CNAV) – the latter of which means that typically for every pound of principal invested you will get a pound back. It is not guaranteed, but offers better protection than using the VNAV (Variable net asset value) MMFs. The Money Market Reform is still being dicussed and the EU is working on developing proposals which may require these funds to move from CNAV to VNAV. These reforms are still unlikely to be ready for implementation in 2017/18 and could be a further 2 years for full implementation.

As well as the Money Market Reform, the Markets in Financial Instruments Directive II (MiFID) is set to commence on 3rd January 2018. MiFID is the EU legislation that regulates firms who provide services to clients linked to 'financial instruments' (shares, bonds, units in collective investment schemes and derivatives), and the venues those instruments are traded. Under the new regime, Local Authorities will be deemed "Retail" clients by default. They will have the option to "opt-up" to "Professional" client status, or remain as "Retail". In order to opt-up, the Council will need to meet qualitative and quantitative test criteria.

It is important to note that the option to opt-up is not a one off exercise. It will need to be undertaken with each counterparty and the decision to maintain "Retail" status will significantly limit the investment options available, compared to "Professional" status.
The decision may rest on what options are available under each status, and which is most appropriate and there may be instances where the Council is deemed "Professional" by some counterparties, but "Retail by others.

Investment treasury indicator and limit - total principal funds invested for greater than 364 days. These limits are set with regard to the Council's liquidity requirements and to reduce the need for early sale of an investment, and are based on the availability of funds after each year-end.

The Council is asked to approve the treasury indicators and limits in appendix 1 (shown below):

Maximum principal sums invested > 364 days			
£m	**2017/18**	**2018/19**	**2019/20**
Principal sums invested > 364 days	26	24	22

For its cash flow generated balances, the Council will seek to utilise notice accounts, money market funds and short-dated deposits in order to benefit from the compounding of interest.

4.5 Investment risk benchmarking

This Council will use an investment benchmark to assess the investment performance of its investment portfolio of 7 day LIBID uncompounded.

4.6 End of year investment report

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

4.7 Scheme of delegation

Please see Appendix 9.

4.8 Role of the section 151 officer

Please see Appendix 10.

Background Papers:

CIPFA'S Treasury Management in the Public Services: Code of Practice (2011) *(Link not available as copyright)*

The Prudential Code for Capital Finance in Local Authorities (2011) Guidance notes (2013) *(Link not available as copyright)*

The Local Government Act 2003 (www.legislation.gov.uk/ukpga/2003/26/content)

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Prudential and treasury indicators

APPENDIX 1

1. PRUDENTIAL INDICATORS	2015/16	2016/17	2017/18	2018/19	2019/20
Extract from budget and rent setting report	**Actual**	**Probable outturn**	**Original**	**Original**	**Original**
	£'000	**£'000**	**£'000**	**£'000**	**£'000**
Capital Expenditure					
Non – HRA	1,950	1,327	17,306	2,096	2,700
HRA	2,096	4,628	5,778	2,942	2,282
TOTAL	**4,046**	**5,955**	**23,084**	**5,038**	**4,982**
Ratio of financing costs to net revenue stream					
Non – HRA	-2.34%	-1.77%	-1.91%	-1.91%	-1.91%
HRA	32.30%	32.70%	32.79%	33.44%	33.34%
Capital Financing Requirement as at 31 March					
Non – HRA	-4,978	-4,978	-1,293	-1,703	-2,113
HRA	59,066	56,537	55,365	52,190	48,552
TOTAL	**54,088**	**51,559**	**54,072**	**50,487**	**46,439**
Annual change in Cap. Financing Requirement					
Non – HRA	0	0	3,685	-410	-410
HRA	-3,544	-2,529	-1,172	-3,175	-3,638
TOTAL	**-3,544**	**-2,529**	**2,513**	**-3,585**	**-4,048**
Incremental impact of capital investment decisions					
Increase in council tax (band D) per annum	2.60	5.45	26.37**	-33.49	9.98
Increase in average housing rent per week	20.26*	-0.95	0.10	0.37	0.05

*Increase due to £3.3m for HRA acquisition/new build
**Increase due to L'ton L Centre build

2. TREASURY MANAGEMENT INDICATORS	2015/16	2016/17	2017/18	2018/19	2019/20
	Actual	Probable outturn	Original	Original	Original
	£'000	£'000	£'000	£'000	£'000
Authorised Limit for external debt					
Borrowing	67,000	67,000	66,000	67,000	67,000
Other long term liabilities	0	0	0	0	0
TOTAL	**67,000**	**67,000**	**66,000**	**67,000**	**67,000**
Operational Boundary for external debt					
Borrowing	64,000	64,000	63,000	64,000	64,000
other long term liabilities	0	0	0	0	0
TOTAL	**64,000**	**64,000**	**63,000**	**64,000**	**64,000**
Actual external debt	62,040	62,040	53,180	53,180	53,180
Maximum HRA Debt Limit	81,630	81,630	81,630	81,630	81,630
Upper limit for fixed and variable interest rate exposure (£m):					
Fixed interest rate exposure	100%	100%	100%	100%	100%
Variable interest rate exposure	40%	40%	40%	40%	40%
Upper limit for total principal sums invested for over 364 days (£m)	**26**	**26**	**26**	**24**	**22**

Maturity structure of fixed rate borrowing - upper & Lower limits	**Actual at 31/03/17**	lower limit	upper limit
under 12 months	0%	0%	40%
12 months and within 24 months	0%	0%	40%
24 months and within 5 years	33.32%	0%	50%
5 years and within 10 years	0%	0%	60%
10 years and above	66.68%	0%	100%

APPENDIX 2

Minimum Revenue Provision Policy for 2016/17

1. Introduction

1.1 CLG's Guidance on Minimum Revenue Provision (issued in 2010) places a duty on local authorities to make a prudent provision for debt redemption. Where the Council finances capital expenditure by debt it must set aside resources to repay that debt in later years. The amount charged to revenue for the repayment of this debt is known as the Minimum Revenue Provision (MRP). The MRP charge is the means by which capital expenditure which has been funded by borrowing is paid for by council tax payers.

1.2. From 2007/08 onwards there has been no statutory minimum and the requirement is simply for local authorities to make a prudent level of provision, and the government has instead issued statutory guidance, which local authorities are required to 'have regard to' when setting a prudent level of MRP. The guidance gives local authorities more freedom to determine what would be a prudent level of MRP.

1.3. The CLG guidance requires the authority to approve an annual MRP statement, and recommends 4 options for calculating a prudent amount of MRP, for approval by Full Council in advance of the year to which it applies. Any subsequent revisions to that policy should also be approved by Full Council.

2. Details of DCLG Guidance on MRP

2.1. The statutory guidance issued by DCLG sets out the broad aims of a prudent MRP Policy as being "to ensure that debt is repaid over a period that is either reasonably commensurate with that over which the capital expenditure provides benefits, or, in the case of borrowing supported by Government Revenue Support Grant, reasonably commensurate with the period implicit in the determination of the grant." It then identifies four options for calculating MRP and recommends the circumstances in which each option should be used, but states that other approaches are not ruled out.

2.2. The four MRP options available are:

- **Option 1**: Regulatory Method - is the previous statutory method, which is calculated as 4% of the Council's General Fund Capital Financing Requirement, adjusted for smoothing factors from the transition to the prudential capital financing regime in 2003.

- **Option 2**: CFR Method - Option 2 differs from Option 1 only in that the smoothing factors are removed. Option 2 has been included by DCLG to provide a simpler calculation for those councils for whom it would have a minimal impact, but the draft guidance does not expect it to be used by councils for whom it would significantly increase MRP.

- **Option 3**: Asset Life Method – MRP is charged over the expected useful life of the asset either in equal instalments or using an annuity method whereby the MRP increases in later years.

- **Option 4**: Depreciation Method - MRP is charged over the expected life of the asset in accordance with depreciation accounting. This would mean that the rate at which the MRP is charged could increase (or, more rarely, decrease) from year to year.

  The guidance clearly states this does not preclude other prudent methods to provide for the repayment of debt principal.

2.3 Under the statutory guidance, it is recommended that local authorities use Options 3 or 4 for all prudential borrowing and for all borrowing to fund capitalised expenditure (such as capital grants to other bodies and capital expenditure on IT developments). Authorities may use any of the four options for MRP for their remaining borrowing to fund capital expenditure.

2.4. For balance sheet liabilities relating to finance leases and PFI schemes, the guidance recommends that one prudent approach would be for local authorities to make an MRP charge equal to the element of the annual rental which goes to write down the balance sheet liability. This would have the effect that the total impact on the bottom line would be equal to the actual rentals paid for the year. However the guidance also mentions that Option 3 could be used for this type of debt.

2.5 The guidance also allows authorities to take a MRP Holiday where assets do not become operational for perhaps 2 or 3 years or longer. It proposes that MRP would not be charged until the year following the one in which the asset became operational.

3. Details of Statute - Part 4 Section 23 b of the Local Authorities (Capital Finance and Accounting) (England) Regulations 2003

3.1 In deciding on the appropriate level of MRP to charge and the most appropriate method of financing the capital programme, the Council needs to have regard to the wider legislation regarding the use of capital receipts.

3.2 Statute gives local authorities the option to apply capital receipts to fund the payment of any liabilities relating to finance leases and PFI schemes. This is a reflection of the fact that such schemes are being treated in accounting terms as the acquisition of fixed assets, and the liability represents the amount being paid towards the purchase of the asset itself, rather than interest or service charges payable.

3.3 Local authorities may also use capital receipts to repay any borrowing that was incurred to fund capital expenditure in previous years.

4. 2016/17 MRP Policy

For 2016/17 it is recommended the Council adopt the following MRP policy:

- MRP will be charged utilising **option 3** for assets which have been funded from prudential borrowing.
- MRP will only be charged in the year following the asset becoming operational.
- If capital receipts are utilised to repay debt in year, the value of MRP chargeable will be reduced by the value of the receipts utilised.

- Whether an annuity or equal instalment method is adopted for option 3 will be dependent on the most financially beneficial method as determined by the Chief Financial Officer
- For PFI and Finance lease liabilities an MRP charge will be made to match the value of any liabilities that have not been funded from capital receipts.
- The Chief Finance Officer will determine annually the most prudent use of Capital Receipts, taking into account forecasts for future expenditure and the generation of further receipts.
- There is no requirement for the HRA to make debt repayments but it has opted to make voluntary repayments relating to debt inherited due to HRA self-financing settlement and provision has been made within the business plan to show that it can pay down the remaining debt over the life of the business plan.
- Any major revisions to this policy will be presented to Full Council for approval.

INVESTMENTS at 31st December 2016

Appendix 3

Type of Investment/Deposit	Reference no.	Counterparty	Issue Date	Maturity Date	Nominal	Current Interest Rate
Fixed Term Deposit	536	Royal Bank of Scotland	21/01/2014	23/01/2017	£2,000,000.00	1.5000**
Fixed Term Deposit	618	Goldman Sachs International	22/07/2016	23/01/2017	£2,000,000.00	0.62
Fixed Term Deposit	585	Close Brothers Ltd	24/07/2015	26/01/2017	£1,000,000.00	1.51
Fixed Term Deposit	587	Close Brothers Ltd	07/08/2015	10/02/2017	£1,000,000.00	1.53
Fixed Term Deposit	598	Nationwide Building Society	16/02/2016	14/02/2017	£1,000,000.00	0.95
Fixed Term Deposit	623	Goldman Sachs International	14/09/2016	14/03/2017	£2,000,000.00	0.635
Fixed Term Deposit	591	Close Brothers Ltd	17/09/2015	17/03/2017	£1,000,000.00	1.53
Fixed Term Deposit	625	Goldman Sachs International	06/10/2016	28/03/2017	£2,000,000.00	0.70
Fixed Term Deposit	626	Lloyds Bank PLC	26/10/2016	28/03/2017	£3,000,000.00	0.60
Fixed Term Deposit	619	Barclays Commercial Bank	22/07/2016	28/03/2017	£2,000,000.00	0.637
Fixed Term Deposit	627	Barclays Commercial Bank	02/11/2016	13/04/2017	£2,000,000.00	0.42
Fixed Term Deposit	600	Lloyds Bank PLC	18/04/2016	13/04/2017	£1,000,000.00	1.05
Fixed Term Deposit	601	Close Brothers Ltd	18/04/2016	18/04/2017	£1,000,000.00	1.00
Fixed Term Deposit	602	Skipton Building Society	29/04/2016	28/04/2017	£1,000,000.00	1.02
Fixed Term Deposit	603	Lloyds Bank PLC	12/05/2016	11/05/2017	£1,000,000.00	1.05
Fixed Term Deposit	605	Skipton Building Society	25/05/2016	24/05/2017	£1,000,000.00	1.02
Fixed Term Deposit	606	Goldman Sachs International	24/05/2016	24/05/2017	£2,000,000.00	1.045
Fixed Term Deposit	607	Santander	25/05/2016	24/05/2017	£1,000,000.00	1.00
Fixed Term Deposit	608	Santander	25/05/2016	24/05/2017	£2,000,000.00	1.00
Fixed Term Deposit	579	Svenska Handelsbanken	05/06/2015	05/06/2017	£2,000,000.00	1.15
Fixed Term Deposit	553	Lloyds Bank PLC	06/06/2014	06/06/2017	£2,000,000.00	1.55
Fixed Term Deposit	611	Santander	16/06/2016	15/06/2017	£2,000,000.00	1.00
Fixed Term Deposit	612	Nationwide Building Society	06/07/2016	05/07/2017	£1,000,000.00	0.75
Fixed Term Deposit	613	Leeds Building Society	06/07/2016	05/07/2017	£1,000,000.00	0.75
Fixed Term Deposit	614	Qatar National Bank	06/07/2016	05/07/2017	£2,000,000.00	0.82
Fixed Term Deposit	615	Barclays Commercial Bank	06/07/2016	05/07/2017	£2,000,000.00	0.78
Fixed Term Deposit	616	Lloyds Bank PLC	08/07/2016	07/07/2017	£1,000,000.00	1.05
Fixed Term Deposit	617	Santander	08/07/2016	07/07/2017	£2,000,000.00	1.00
Fixed Term Deposit	609	Qatar National Bank	06/06/2016	07/08/2017	£2,000,000.00	1.16
Fixed Term Deposit	589	RBS	21/08/2015	21/08/2017	£1,000,000.00	1.42****
Fixed Term Deposit	622	Lloyds Bank PLC	09/09/2016	08/09/2017	£1,000,000.00	1.00
Fixed Term Deposit	624	Lloyds Bank PLC	05/10/2016	04/10/2017	£1,000,000.00	1.00
Fixed Term Deposit	572	Royal Bank of Scotland	29/05/2015	31/05/2018	£2,000,000.00	1.35*
Fixed Term Deposit	621	Close Brothers Ltd	24/08/2016	24/08/2018	£2,000,000.00	1.210
Fixed Term Deposit	599	Royal Bank of Scotland	31/03/2016	18/02/2019	£2,000,000.00	1.2***
Fixed Term Deposit	620	Royal Bank of Scotland	19/08/2016	19/08/2019	£2,000,000.00	0.8*****
Property Fund	140000	CCLA (Churches, Charities and LA's)			£4,000,000.00	4.40^
Money Market Fund	110000	Federated			£3,950,000.00	0.32
Money Market Fund	100500	CCLA - PSDF			£2,920,000.00	0.30
Call account	88888	HSBC			£6,605,796.49	0.03
					£74,475,796.49	

*Yr 1- 1%, Yr 2 - 1.35%, Yr 3 - 1.70%
**Floor 1.50%   Cap 2.5%   Libor flat
***Yr 1 -1.20%,   Yr 2-1.35%,   Yr 3-1.50%
**** Yr 1 - 1.1%,   Yr 2 - 1.42%
***** Yr 1 - 0.8%,   Yr 2 - 0.95%,   Yr 3 - 1.10%
^Approximate rate

Interest Rate Forecast 2017/2020

APPENDIX 4

PWLB rates and forecast shown below have taken into account the 20 basis point certainty rate reduction effective as of the 1st November 2012.

Capita Asset Services Interest Rate View	Mar-17	Jun-17	Sep-17	Dec-17	Mar-18	Jun-18	Sep-18	Dec-18	Mar-19	Jun-19	Sep-19	Dec-19	Mar-20
Bank Rate View	0.25%	0.25%	0.25%	0.25%	0.25%	0.25%	0.25%	0.25%	0.25%	0.50%	0.50%	0.75%	0.75%
3 Month LIBID	0.30%	0.30%	0.30%	0.30%	0.30%	0.30%	0.30%	0.40%	0.50%	0.60%	0.70%	0.80%	0.90%
6 Month LIBID	0.40%	0.40%	0.40%	0.40%	0.40%	0.40%	0.40%	0.50%	0.60%	0.70%	0.80%	0.90%	1.00%
12 Month LIBID	0.70%	0.70%	0.70%	0.70%	0.70%	0.80%	0.80%	0.90%	1.00%	1.10%	1.20%	1.30%	1.40%
5yr PWLB Rate	1.60%	1.60%	1.60%	1.60%	1.70%	1.70%	1.70%	1.80%	1.80%	1.90%	1.90%	2.00%	2.00%
10yr PWLB Rate	2.30%	2.30%	2.30%	2.30%	2.30%	2.40%	2.40%	2.40%	2.50%	2.50%	2.60%	2.60%	2.70%
25yr PWLB Rate	2.90%	2.90%	2.90%	3.00%	3.00%	3.00%	3.10%	3.10%	3.20%	3.20%	3.30%	3.30%	3.40%
50yr PWLB Rate	2.70%	2.70%	2.70%	2.80%	2.80%	2.80%	2.90%	2.90%	3.00%	3.00%	3.10%	3.10%	3.20%
Bank Rate													
Capita Asset Services	0.25%	0.25%	0.25%	0.25%	0.25%	0.25%	0.25%	0.25%	0.25%	0.50%	0.50%	0.75%	0.75%
Capital Economics	0.25%	0.25%	0.25%	0.25%	0.25%	0.25%	0.25%	0.25%	0.25%	0.25%	0.50%	0.50%	0.50%
5yr PWLB Rate													
Capita Asset Services	1.60%	1.60%	1.60%	1.60%	1.70%	1.70%	1.70%	1.80%	1.80%	1.90%	1.90%	2.00%	2.00%
Capital Economics	1.60%	1.70%	1.90%	2.00%	2.10%	2.20%	2.30%	2.40%	2.50%	2.70%	2.80%	2.90%	3.00%
10yr PWLB Rate													
Capita Asset Services	2.30%	2.30%	2.30%	2.30%	2.30%	2.40%	2.40%	2.40%	2.50%	2.50%	2.60%	2.60%	2.70%
Capital Economics	2.40%	2.40%	2.50%	2.60%	2.60%	2.70%	2.70%	2.80%	2.90%	3.10%	3.20%	3.30%	3.40%
25yr PWLB Rate													
Capita Asset Services	2.90%	2.90%	2.90%	3.00%	3.00%	3.00%	3.10%	3.10%	3.20%	3.20%	3.30%	3.30%	3.40%
Capital Economics	2.95%	3.05%	3.05%	3.15%	3.25%	3.25%	3.35%	3.45%	3.55%	3.65%	3.75%	3.95%	4.05%
50yr PWLB Rate													
Capita Asset Services	2.70%	2.70%	2.70%	2.80%	2.80%	2.80%	2.90%	2.90%	3.00%	3.00%	3.10%	3.10%	3.20%
Capital Economics	2.80%	2.90%	3.00%	3.10%	3.10%	3.20%	3.20%	3.30%	3.40%	3.60%	3.70%	3.80%	3.90%

APPENDIX 5

Economic Background

UK. GDP growth rates in 2013, 2014 and 2015 of 2.2%, 2.9% and 1.8% were some of the strongest rates among the G7 countries. Growth is expected to have strengthened in 2016 with the first three quarters coming in respectively at +0.4%, +0.7% and +0.5%. The latest Bank of England forecast for growth in 2016 as a whole is +2.2%. The figure for quarter 3 was a pleasant surprise which confounded the downbeat forecast by the Bank of England in August of only +0.1%, (subsequently revised up in September, but only to +0.2%). During most of 2015 and the first half of 2016, the economy had faced headwinds for exporters from the appreciation of sterling against the Euro, and weak growth in the EU, China and emerging markets, and from the dampening effect of the Government's continuing austerity programme.

The **referendum vote for Brexit** in June 2016 delivered an immediate shock fall in confidence indicators and business surveys at the beginning of August, which were interpreted by the Bank of England in its August Inflation Report as pointing to an impending sharp slowdown in the economy. However, the following monthly surveys in September showed an equally sharp recovery in confidence and business surveys so that it is generally expected that the economy will post reasonably strong growth numbers through the second half of 2016 and also in 2017, albeit at a slower pace than in the first half of 2016.

The **Monetary Policy Committee, (MPC), meeting of 4th August** was therefore dominated by countering this expected sharp slowdown and resulted in a package of measures that included a cut in Bank Rate from 0.50% to 0.25%, a renewal of quantitative easing, with £70bn made available for purchases of gilts and corporate bonds, and a £100bn tranche of cheap borrowing being made available for banks to use to lend to businesses and individuals.

The **MPC meeting of 3 November** left Bank Rate unchanged at 0.25% and other monetary policy measures also remained unchanged. This was in line with market expectations, but a major change from the previous quarterly Inflation Report MPC meeting of 4 August, which had given a strong steer, in its forward guidance, that it was likely to cut Bank Rate again, probably by the end of the year if economic data turned out as forecast by the Bank. The MPC meeting of 15 December also left Bank Rate and other measures unchanged.

The latest MPC decision included a forward view that **Bank Rate** could go either up or down depending on how economic data evolves in the coming months. Our central view remains that Bank Rate will remain unchanged at 0.25% until the first increase to 0.50% in quarter 2 2019 (unchanged from our previous forecast). However, we would not, as yet, discount the risk of a cut in Bank Rate if economic growth were to take a significant dip downwards, though we think this is unlikely. We would also point out that forecasting as far ahead as mid 2019 is highly fraught as there are many potential economic headwinds which could blow the UK economy one way or the other as well as political developments in the UK, (especially over the terms of Brexit), EU, US and beyond, which could have a major impact on our forecasts.

The pace of Bank Rate increases in our forecasts has been slightly increased beyond the three year time horizon to reflect higher inflation expectations.

The August quarterly Inflation Report was based on a pessimistic forecast of near to zero GDP growth in quarter 3 i.e. a sharp slowdown in growth from +0.7% in quarter 2, in reaction to the shock of the result of the referendum in June. However, **consumers** have very much stayed in a 'business as usual' mode and there has been no sharp downturn in spending; it is consumer expenditure that underpins the services sector which comprises about 75% of UK GDP. After a fairly flat three months leading up to October, retail sales in October surged at the strongest rate since September 2015 and were again strong in November. In addition, the GfK consumer confidence index recovered quite strongly to -3 in October after an initial sharp plunge in July to -12 in reaction to the referendum result. However, in November it fell to -8 indicating a return to pessimism about future prospects among consumers, probably based mainly around concerns about rising inflation eroding purchasing power.

Bank of England GDP forecasts in the November quarterly Inflation Report were as follows, (August forecasts in brackets) - 2016 +2.2%, (+2.0%); 2017 1.4%, (+0.8%); 2018 +1.5%, (+1.8%). There has, therefore, been a sharp increase in the forecast for 2017, a marginal increase in 2016 and a small decline in growth, now being delayed until 2018, as a result of the impact of Brexit.

Capital Economics' GDP forecasts are as follows: 2016 +2.0%; 2017 +1.5%; 2018 +2.5%. They feel that pessimism is still being overdone by the Bank and Brexit will not have as big an effect as initially feared by some commentators.

The Chancellor has said he will do 'whatever is needed' i.e. to **promote growth**; there are two main options he can follow – fiscal policy e.g. cut taxes, increase investment allowances for businesses, and/or increase government expenditure on infrastructure, housing etc. This will mean that the PSBR deficit elimination timetable will need to slip further into the future as promoting growth, (and ultimately boosting tax revenues in the longer term), will be a more urgent priority. The Governor of the Bank of England, Mark Carney, had warned that a vote for Brexit would be likely to cause a slowing in growth, particularly from a reduction in business investment, due to the uncertainty of whether the UK would have continuing full access, (i.e. without tariffs), to the EU single market. He also warned that the Bank could not do all the heavy lifting to boost economic growth and suggested that the Government would need to help growth e.g. by increasing investment expenditure and by using fiscal policy tools. The newly appointed Chancellor, Phillip Hammond, announced, in the aftermath of the referendum result and the formation of a new Conservative cabinet, that the target of achieving a budget surplus in 2020 would be eased in the Autumn Statement on 23 November. This was duly confirmed in the Statement which also included some increases in infrastructure spending.

The other key factor in forecasts for Bank Rate is **inflation** where the MPC aims for a target for CPI of 2.0%. The November Inflation Report included an increase in the peak forecast for inflation from 2.3% to 2.7% during 2017; (Capital Economics are forecasting a peak of just under 3% in 2018). This increase was largely due to the effect of the sharp fall in the value of sterling since the referendum, although during November, sterling has recovered some of this fall to end up 15% down against the dollar, and 8% down against the euro (as at the MPC meeting date – 15.12.16).This depreciation will feed through into a sharp increase in the cost of imports and materials used in production in the UK. However, the MPC is expected to look through the acceleration in inflation caused by external, (outside of the UK), influences, although it has given a clear warning that if wage inflation were to rise significantly as a result of these cost pressures on consumers, then they would take action to raise Bank Rate.

What is clear is that **consumer disposable income** will come under pressure, as the latest employers' survey is forecasting median pay rises for the year ahead of only 1.1% at a time when inflation will be rising significantly higher than this. The CPI figure has been on an upward trend in 2016 and reached 1.2% in November. However, prices paid by factories for inputs rose to 13.2% though producer output prices were still lagging behind at 2.3% and core inflation was 1.4%, confirming the likely future upwards path.

Gilt yields, and consequently PWLB rates, have risen sharply since hitting a low point in mid-August. There has also been huge volatility during 2016 as a whole. The year started with 10 year gilt yields at 1.88%, fell to a low point of 0.53% on 12 August, and hit a new peak on the way up again of 1.55% on 15 November. The rebound since August reflects the initial combination of the yield-depressing effect of the MPC's new round of quantitative easing on 4 August, together with expectations of a sharp downturn in expectations for growth and inflation as per the pessimistic Bank of England Inflation Report forecast, followed by a sharp rise in growth expectations since August when subsequent business surveys, and GDP growth in quarter 3 at +0.5% q/q, confounded the pessimism. Inflation expectations also rose sharply as a result of the continuing fall in the value of sterling.

Employment had been growing steadily during 2016 but encountered a first fall in over a year, of 6,000, over the three months to October.The latest employment data in December, (for November), was distinctly weak with an increase in unemployment benefits claimants of 2,400 in November and of 13,300 in October. **House prices** have been rising during 2016 at a modest pace but the pace of increase has slowed since the referendum; a downturn in prices could dampen consumer confidence and expenditure.

<u>USA.</u> The American economy had a patchy 2015 with sharp swings in the quarterly **growth rate** leaving the overall growth for the year at 2.4%. Quarter 1 of 2016 at +0.8%, (on an annualised basis), and quarter 2 at 1.4% left average growth for the first half at a weak 1.1%. However, quarter 3 at 3.2% signalled a rebound to strong growth. The Fed. embarked on its long anticipated first increase in rates at its December 2015 meeting. At that point, confidence was high that there would then be four more increases to come in 2016. Since then, more downbeat news on the international scene, and then the Brexit vote, have caused a delay in the timing of the second increase of 0.25% which came, as expected, in December 2016 to a range of 0.50% to 0.75%. Overall, despite some data setbacks, the US is still, probably, the best positioned of the major world economies to make solid progress towards a combination of strong growth, full employment and rising inflation: this is going to require the central bank to take action to raise rates so as to make progress towards normalisation of monetary policy, albeit at lower central rates than prevailed before the 2008 crisis. The Fed. therefore also indicated that it expected three further increases of 0.25% in 2017 to deal with rising inflationary pressures.

The result of the **presidential election** in November is expected to lead to a strengthening of US growth if Trump's election promise of a major increase in expenditure on infrastructure is implemented. This policy is also likely to strengthen inflation pressures as the economy is already working at near full capacity. In addition, the unemployment rate is at a low point verging on what is normally classified as being full employment. However, the US does have a substantial amount of hidden unemployment in terms of an unusually large, (for a developed economy), percentage of the working population not actively seeking employment.

Trump's election has had a profound effect on the **bond market and bond yields** rose sharply in the week after his election. Time will tell if this is a a reasonable assessment of his election promises to cut taxes at the same time as boosting expenditure. This could lead to a sharp rise in total debt issuance from the current level of around 72% of GDP towards 100% during his term in office. However, although the Republicans now have a monopoly of power for the first time since the 1920s, in having a President and a majority in both Congress and the Senate, there is by no means any certainty that the politicians and advisers he has been appointing to his team, and both houses, will implement the more extreme policies that Trump outlined during his election campaign. Indeed, Trump may even rein back on some of those policies himself.

In the first week since the US election, there was a a major shift in **investor sentiment** away from bonds to equities, especially in the US. However, gilt yields in the UK and bond yields in the EU have also been dragged higher. Some commentators are saying that this rise has been an overreaction to the US election result which could be reversed. Other commentators take the view that this could well be the start of the long expected eventual unwinding of bond prices propelled upwards to unrealistically high levels, (and conversely bond yields pushed down), by the artificial and temporary power of quantitative easing.

EZ. In the Eurozone, **the ECB** commenced, in March 2015, its massive €1.1 trillion programme of quantitative easing to buy high credit quality government and other debt of selected EZ countries at a rate of €60bn per month. This was intended to run initially to September 2016 but was extended to March 2017 at its December 2015 meeting. At its December and March 2016 meetings it progressively cut its deposit facility rate to reach -0.4% and its main refinancing rate from 0.05% to zero. At its March meeting, it also increased its monthly asset purchases to €80bn. These measures have struggled to make a significant impact in boosting economic growth and in helping inflation to rise significantly from low levels towards the target of 2%. Consequently, at its December meeting it extended its asset purchases programme by continuing purchases at the current monthly pace of €80 billion until the end of March 2017, but then continuing at a pace of €60 billion until the end of December 2017, or beyond, if necessary, and in any case until the Governing Council sees a sustained adjustment in the path of inflation consistent with its inflation aim. It also stated that if, in the meantime, the outlook were to become less favourable or if financial conditions became inconsistent with further progress towards a sustained adjustment of the path of inflation, the Governing Council intended to increase the programme in terms of size and/or duration.

EZ GDP growth in the first three quarters of 2016 has been 0.5%, +0.3% and +0.3%, (+1.7% y/y). Forward indications are that economic growth in the EU is likely to continue at moderate levels. This has added to comments from many forecasters that those central banks in countries around the world which are currently struggling to combat low growth, are running out of ammunition to stimulate growth and to boost inflation. Central banks have also been stressing that national governments will need to do more by way of structural reforms, fiscal measures and direct investment expenditure to support demand and economic growth in their economies.

There are also significant specific political and other risks within the EZ: -

- **Greece** continues to cause major stress in the EU due to its tardiness and reluctance in implementing key reforms required by the EU to make the country more efficient and to make significant progress towards the country being able to pay its way – and before the EU is prepared to agree to release further bail out funds.
- **Spain** has had two inconclusive general elections in 2015 and 2016, both of which failed to produce a workable government with a majority of the 350 seats. At the

eleventh hour on 31 October, before it would have become compulsory to call a third general election, the party with the biggest bloc of seats (137), was given a majority confidence vote to form a government. This is potentially a highly unstable situation, particularly given the need to deal with an EU demand for implementation of a package of austerity cuts which will be highly unpopular.

- The under capitalisation of **Italian banks** poses a major risk. Some **German banks** are also undercapitalised, especially Deutsche Bank, which is under threat of major financial penalties from regulatory authorities that will further weaken its capitalisation. What is clear is that national governments are forbidden by EU rules from providing state aid to bail out those banks that are at risk, while, at the same time, those banks are unable realistically to borrow additional capital in financial markets due to their vulnerable financial state. However, they are also 'too big, and too important to their national economies, to be allowed to fail'.
- **4 December Italian constitutional referendum** on reforming the Senate and reducing its powers; this was also a confidence vote on Prime Minister Renzi who has resigned on losing the referendum. However, there has been remarkably little fall out from this result which probably indicates that the financial markets had already fully priced it in. A rejection of these proposals is likely to inhibit significant progress in the near future to fundamental political and economic reform which is urgently needed to deal with Italy's core problems, especially low growth and a very high debt to GDP ratio of 135%. These reforms were also intended to give Italy more stable government as no western European country has had such a multiplicity of governments since the Second World War as Italy, due to the equal split of power between the two chambers of the Parliament which are both voted in by the Italian electorate but by using different voting systems. It is currently unclear what the political, and other, repercussions are from this result.
- **Dutch general election 15.3.17**; a far right party is currently polling neck and neck with the incumbent ruling party. In addition, anti-big business and anti-EU activists have already collected two thirds of the 300,000 signatures required to force a referendum to be taken on approving the EU – Canada free trade pact. This could delay the pact until a referendum in 2018 which would require unanimous approval by all EU governments before it can be finalised. In April 2016, Dutch voters rejected by 61.1% an EU – Ukraine cooperation pact under the same referendum law. Dutch activists are concerned by the lack of democracy in the institutions of the EU.
- **French presidential election;** first round 13 April; second round 7 May 2017.
- **French National Assembly election June 2017.**
- **German Federal election August – 22 October 2017.** This could be affected by significant shifts in voter intentions as a result of terrorist attacks, dealing with a huge influx of immigrants and a rise in anti EU sentiment.
- The core EU, (note, not just the Eurozone currency area), principle of **free movement of people** within the EU is a growing issue leading to major stress and tension between EU states, especially with the Visegrad bloc of former communist states.

Given the number and type of challenges the EU faces in the next eighteen months, there is an identifiable risk for the EU project to be called into fundamental question. The risk of an electoral revolt against the EU establishment has gained traction after the shock results of the UK referendum and the US Presidential election. But it remains to be seen whether any shift in sentiment will gain sufficient traction to produce any further shocks within the EU.

Asia. Economic growth in **China** has been slowing down and this, in turn, has been denting economic growth in emerging market countries dependent on exporting raw materials to China. Medium term risks have been increasing in China e.g. a dangerous build up in the level of credit compared to the size of GDP, plus there is a need to address a major over supply of housing and surplus industrial capacity, which both need to be eliminated. This needs to be combined with a rebalancing of the economy from investment expenditure to consumer spending. However, the central bank has a track record of supporting growth through various monetary policy measures, though these further stimulate the growth of credit risks and so increase the existing major imbalances within the economy.

Economic growth in **Japan** is still patchy, at best, and skirting with deflation, despite successive rounds of huge monetary stimulus and massive fiscal action to promote consumer spending. The government is also making little progress on fundamental reforms of the economy.

Emerging countries. There have been major concerns around the vulnerability of some emerging countries exposed to the downturn in demand for commodities from China or to competition from the increase in supply of American shale oil and gas reaching world markets. The ending of sanctions on Iran has also brought a further significant increase in oil supplies into the world markets. While these concerns have subsided during 2016, if interest rates in the USA do rise substantially over the next few years, (and this could also be accompanied by a rise in the value of the dollar in exchange markets), this could cause significant problems for those emerging countries with large amounts of debt denominated in dollars. The Bank of International Settlements has recently released a report that $340bn of emerging market corporate debt will fall due for repayment in the final two months of 2016 and in 2017 – a 40% increase on the figure for the last three years.

Financial markets could also be vulnerable to risks from those emerging countries with major sovereign wealth funds, that are highly exposed to the falls in commodity prices from the levels prevailing before 2015, especially oil, and which, therefore, may have to liquidate substantial amounts of investments in order to cover national budget deficits over the next few years if the price of oil does not return to pre-2015 levels.

Brexit timetable and process

- March 2017: UK government notifies the European Council of its intention to leave under the Treaty on European Union Article 50
- March 2019: two-year negotiation period on the terms of exit. This period can be extended with the agreement of all members i.e. not that likely.
- UK continues as an EU member during this two-year period with access to the single market and tariff free trade between the EU and UK.
- The UK and EU would attempt to negotiate, among other agreements, a bi-lateral trade agreement over that period.
- The UK would aim for a negotiated agreed withdrawal from the EU, although the UK may also exit without any such agreements.

- If the UK exits without an agreed deal with the EU, World Trade Organisation rules and tariffs could apply to trade between the UK and EU - but this is not certain.
- On exit from the EU: the UK parliament would repeal the 1972 European Communities Act.
- The UK will then no longer participate in matters reserved for EU members, such as changes to the EU's budget, voting allocations and policies.
- It is possible that some sort of agreement could be reached for a transitional time period for actually implementing Brexit after March 2019 so as to help exporters to adjust in both the EU and in the UK.

Specified and Non-Specified Investments **APPENDIX 6**

	specified	non-specified	Minimum Credit Criteria Fitch (and equivalent) / Minimum Criteria	Maximum Investment per Institution	Max. maturity period
Term deposits – Local Authorities (category 1)	✓	✓	--	£12M	5 years
Term deposits – banks and building societies (category 1)	✓	✓	Short-term F1+ Long-term AA-	£12M	5 years
Term deposits – banks and building societies (category 2)	✓	✓	Short-term F1 Long-term A+	£11M	3 years
Term deposits – banks and building societies (category 3)	✓	✓	Short-term F1 Long-term A-	£8M	2 years
Term deposits – building societies (Category 4)	✓	✓	Assets in Excess of £10 billion	£4M	1 year
Council's bank (for term deposits use appropriate category 1 to 3) (category 5)	✓	✓	n/a	No limit *Although category limit for term deposits*	As category 1 to 3
Term deposits – UK part nationalised banks (category 6)	✓	✓	Short-term F3 Long term BBB-	£11M	3 years
Callable deposits	✓	✓	As category 1,2,3,4,5 and 6	As category 1,2,3,4,5 and 6	As category 1,2,3,4,5 and 6
Forward deposits	✓	✓	As category 1,2,3,4,5 and 6	As category 1,2,3,4,5 and 6	As category 1,2,3,4,5 and 6
Bonds Issued by multilateral development banks (category 10)		✓	Long term AAA	£4M	5 years
Debt Management Agency Deposit Facility	✓	✓	--	No limit	Liquid

(category 9)					
Collective Investment Schemes structured as Open Ended Investment Companies (OEICs)					
Money Market Funds (category 7)	✓		AAA mmf	£4M	liquid
Enhanced Money Market Funds (Category 8)	✓		AAA mmf	£4M	Liquid
Property funds (Category 11)		✓	--	£6M	25 years

Specified Investments (these are considered low risk assets where the possibility of loss of principal or investment income is small):
All such investments will be sterling denominated, with maturities up to a maximum of 1 year, meeting the minimum 'high' rating criteria where applicable.

Non-Specified Investments: All such investments will be sterling denominated, with maturities in excess of 1 year, meeting the minimum 'high' rating criteria where applicable. A maximum of 60% will be in aggregate in non-specified investments.

Part nationalised banks in the UK have credit ratings which do not conform to the credit criteria usually used by local authorities to identify banks which are of high creditworthiness. In particular, as they are no longer separate institutions in their own right, however, these institutions have effectively taken on the creditworthiness of the Government itself i.e. deposits made with them are effectively being made to the Government. It is therefore proposed to continue to keep the category of UK part nationalised banks for both specified and unspecified investments (category 6).

Appendix 7

LIST OF AUTHORISED COUNTERPARTIES

Category 1 - Limit of £12 million for each institution - Maximum investment period - 5 Years

		Long Term	Short Term
Min Criteria	**Fitch**	**AA-**	**F1+**
	Moody	**Aa3**	**P-1**
	S&P	**AA-**	**A-1+**

All Local Authorities

Bank of Nova Scotia (CAN)
DBS Bank Ltd (SING)
HSBC Bank plc (UK)
Oversea-Chinese Banking Corp Ltd (SING)
Svenska Handelsbanken (SW)
United Overseas Bank Ltd (SING)
National Bank of Abu Dhabi (U.A.E)
Qatar National Bank (Qatar)

Category 2 - Limit of £11 million for each institution - Maximum investment period - 3 Years

		Long Term	Short Term
Min Criteria	**Fitch**	**A+**	**F1**
	Moody	**A1**	**P-2**
	S&P	**A+**	**A-1**

Goldman Sachs International Bank (UK)
Standard Charted Bank (UK)

Category 3 - Limit of £8 million for each institution - Maximum investment period - 2 Years

		Long Term	Short Term
Min Criteria	**Fitch**	**A-**	**F1**
	Moody	**A3**	**P-2**
	S&P	**A-**	**A-1**

Barclays Bank plc (UK)
Deutsche Bank (GER)
Nationwide Building Society (UK)
Santander (UK)
Close Brothers (UK)

Category 4 - Limit of £4 million for each institution - Maximum Investment period - 1 year Building Society with Assets greater than £10 billion

Coventry Building Society (UK)
Leeds Building Society (UK)
Skipton Building Society (UK)
Yorkshire Building Society (UK)

Category 5 - Council's Bank
NO LIMIT – appropriate category 1 to 3

Lloyds Banking Group (Bank of Scotland / Lloyds)

Category 6 - Limit of £11 million for each institution - Maximum investment period - 3 Years
banks effectively nationalised by UK government

		Long Term	Short Term
Min Criteria	**Fitch**	**BBB-**	**F3**
	Moody	**Baa3**	**P-3**
	S&P	**BBB-**	**A-3**

Royal Bank of Scotland plc/National Westminster Bank plc (Uk)(Nationalised)

<u>Category 7 - Collective Investment Schemes structured as Open Ended Investment</u>
Companies (OEICs) MONEY MARKET FUNDS and Government Liquidity Funds
Limit of £4million for each institution

CCLA Investment Management Ltd (Public sector deposit fund)
Deutsche Banking Group
Federated Investors Ltd (Fitch Ratings)
Fidelity Investments International (Moody's Rating)
Standard Life (Fitch Ratings)

Northern Trust

<u>Category 8 - Collective Investment Schemes structured as Open Ended Investment Companies (OEICs)</u> – Enhanced Money Market Funds
Limit of £4million for each institution

<u>Category 9 - Debt Management Office</u>
Debt management Account - NO LIMIT (UK Govt)

Maximum investment £4 million

<u>Category 10 – Bonds issued by multilateral development banks – 5 Years</u>
Maximum investment £4 million

<u>Category 11 – Property Funds – 25 Years</u>
Maximum investment £6 million

APPENDIX 8

Approved countries for investments

Based on a majority rule of available ratings.

AAA

- Australia
- Canada
- Denmark
- Germany
- Netherlands (S&P AA+)
- Norway
- Singapore
- Sweden
- Switzerland
- U.S.A. (S&P AA+)

AA+

- Finland
- Hong Kong

AA

- Abu Dhabi (UAE)
- France
- Qatar
- U.K. (Moody Aa1)

APPENDIX 9

Treasury management scheme of delegation

(i) Full Council

- approval of annual strategy
- budget consideration and approval
- receiving and reviewing regular monitoring reports on treasury management and outturn report

(ii) Cabinet Member for Corporate Governance

- amendments to the annual treasury management strategy once approved by Full Council between its review in consultation with the Head of Finance and Property.

(iii) Audit and Governance Committee (responsibility for scrutiny)

- reviewing the treasury management policy and procedures and making recommendations to Full Council (the responsible body).
- Scrutiny of annual strategy prior to adoption by Full Council
- Scrutiny of regular monitoring reports and outturn report
- receiving and reviewing reports on treasury management policies, practices and activities

APPENDIX 10

The treasury management role of the section 151 officer

The S151 (responsible) officer

- recommending clauses, treasury management policy/practices for approval, reviewing the same regularly, and monitoring compliance
- submitting regular treasury management policy reports
- submitting budgets and budget variations
- receiving and reviewing management information reports
- reviewing the performance of the treasury management function
- ensuring the adequacy of treasury management resources and skills, and the effective division of responsibilities within the treasury management function
- ensuring the adequacy of internal audit, and liaising with external audit
- recommending the appointment of external service providers.

AGENDA ITEM NO .

ARUN DISTRICT COUNCIL

AUDIT & GOVERNANCE COMMITTEE 23 February 2017

Decision Paper

Subject : Annual Internal Audit Plan 2017/18

Report by : Chief Internal Auditor Report date : 2 February 2017

EXECUTIVE SUMMARY

Each year Internal Audit is required to develop an annual audit plan for the following financial year, for agreement by the Audit & Governance Committee

1. INTRODUCTION

Each year Internal Audit is required to develop an annual audit plan for the following financial year.

This provides the opportunity for the Chief Internal Auditor, in consultation with senior managers within the Authority and with the members of the Audit & Governance Committee, to determine where best the limited resources available to Internal Audit should be directed.

In order to prepare the plan, consideration has been given to accepted best practice, as promulgated by both CIPFA and the Chartered Institute of Internal Auditors.

2. POINTS TO NOTE

In 2016, the resource of the section reduced to 2.4 FTE and a revised 2016/17 plan was presented to the Committee at its September meeting. Since that time, the Council has decided not to pursue a number of potential shared services (including Internal Audit) with Chichester and Horsham Councils. Although the future transformation of services within the Council (as part of the Vision 2020 work) is as yet unclear, it is known that substantial Council-wide savings will be required in future years and it is therefore anticipated that the resource of the section will now remain at this level with savings being made from the reduction of the former level of 3 FTE.

The business case for the shared service considered by the Councils and preferred by the Project Steering Board would have had an ‘agreed’ combined FTE of 6.3 across the three Councils (i.e. 2.1 FTE per Council). In view of this, Council management feel that the provision of an effective service at the current level remains viable, even though there will be less cost savings than those if there had been a single, shared manager.

The reduction in resource will, however, mean that less audit work is possible and a risk-based audit methodology will continue to be used to prioritise resource to the most important areas, as agreed with senior management / Members. Unlike previous years, a detailed plan is not being provided for agreement by the Committee as the pace of change is likely to render it obsolete quickly.

At the time the Plan is being drafted, the Council has not yet decided what changes will now be made under the Vision 2020 work and how they will be achieved. This will only be known as the year progresses, but it is clear that there will be significant change and this will require audit involvement to consider risks, key controls, etc. going forwards. There is also the need for the inclusion of ‘mandatory’ items such as key controls testing of the main financial systems on behalf of external audit, governance and counter-fraud work, etc.

In addition, although the new high-level management structure has been announced, the new Group Heads will only take up their positions from 1st April 2017 and their operational structures have not yet been agreed.

In view of this, an outline-only plan is attached for the agreement of the Committee and there will need to be considerable flexibility through the year as to the assignment of resource to specific tasks. (NB - the outline plan has been prepared to be generally in line with the allocations that had been considered for the indicative common plan that had been drafted and included in the shared services business case).

3. CONCLUSION

The Committee is requested to consider the contents of this report.

4. DECISION

The Audit & Governance Committee is requested to agree the outline Annual Internal Audit Plan.

Background Papers: **Overview Select Committee 24 January 2017 report “The Council’s 2020 Vision – Shared Services Update” http://www1.arun.gov.uk/PublicViewer/Tempfiles/3cae786d372646d.pdf (pp 22-24)**

Contact: **Stephen Pearse** **ext 37561**

Outline Internal Audit Plan for 2017/18

3/4/17- 1/4/18 (52 weeks)

Based upon 2.4 FTE and in line with the number of days per auditor / classification of assignments that had been considered for a common shared internal audit service

Key Financial Systems	85
Computer Audit (including projects)	75
Business Systems Audit	163.2
Contract Audit	9
Follow-Ups	8
PSIAS / QAIP (includes reviewing & updating audit procedures)	9
Total Chargeable Days (Audit)	**349.2**
Governance / AGS	8
NFI	11
Corporate Fraud	6
Audit Advice	17
External Audit Liaison	4
Committee Representation	11
Planning & Control	23
Contingency (e.g. for special investigations)	8
Meetings (Corporate)	11
RIPA	2
FOI	2
Total Chargeable Days (Non-Audit)	**103**
Total Chargeable Days	**452.2**

(Chargeable days are those after allowance for bank holidays, leave, sickness admin, etc. which are an overhead and not directly relevant to Council service areas)

AGENDA ITEM NO. 9

ARUN DISTRICT COUNCIL

AUDIT & GOVERNANCE COMMITTEE
23 FEBRUARY 2017

Information Paper

Subject : Progress Against the Audit Plan

Report by : Chief Internal Auditor Report date : 2 February 2017

EXECUTIVE SUMMARY

Each year Internal Audit is undertakes its work against an annual audit plan, as approved by the Audit & Governance Committee at the beginning of the financial year.

The Committee is required to oversee the provision of an adequate and effective internal audit service.

1. INTRODUCTION

A revised Plan was presented to the Committee at its September meeting due to a reduction in audit resource available. The aim of this was to ensure that mandatory work is completed, that there is appropriate involvement in the progress of the Vision 2020 initiative and, where practical, to progress audit work on the highest risk areas identified in the original Plan.

However, the Committee was advised that with the proposed management restructure and further phases of the Vision 2020 work still to be progressed, there is considerable uncertainty as to where audit resource may be required in the remainder of the year.

Since that time, the work of the section has focused on:-

- input to the preparation of a Full Business Case for a possible shared audit service, via the project workstream including senior internal audit staff from Chichester and Horsham Councils.
  As at mid-December 2016, the joint Steering Board has considered the business cases provided and decided that none of the service areas under review will now progress towards a shared service. This decision is being reported to Members via meetings of the Overview Select Committee and Cabinet.
  Further to this decision, information is now awaited on the 'transformation' process for the Council's services in order to achieve necessary cost savings
- review of the initial papers and due diligence work for the potential creation of a wholly-owned Local Housing Company, as part of the Council's Vision 2020 Programme
  A business case for the initiative is currently due to be completed and will then be presented to Cabinet

- involvement in the financial management system replacement project. The new e5 system was implemented in October 2016 and work has been required to confirm that the implementation has been effective and that required data has been converted completely and accurately
  As at the end of January 2017, formal project management involvement has ceased and ongoing management (including resolution of any issues outstanding) has passed to Finance
- familiarisation with the aspects of the new e5 system that will be required for mandatory testing on behalf of the external auditors which is due to undertaken early in 2017 (changed processes and records for general ledger, purchase ledger and sundry debts)
  E&Y testing of key controls on the financial systems is due to take place in February, in advance of their site visit in March
- completion of final testing of records on the old systems (FMS and Task) for the 2016/17 financial year, prior to their archiving / de-commissioning.

Work on other areas of the Council has again therefore been limited in the last quarter.

In previous quarters a supplementary status report has been provided on areas where audit involvement is principally liaison / progress monitoring. No report is being provided at this meeting, as there will have been little change since the last meeting in December/

As at January 2017, the new Director structure has been implemented and the new Group Heads announced, who will take up their posts from 1 April 2017. However, this will now involve significant changes in management responsibility for functions and lower level structures have yet to be agreed.

2. CONCLUSION

The Committee is requested to note the update contained in this report.

Contact: **Stephen Pearse** **ext 37561**

The Chartered Institute of Public Finance & Accountancy

CIPFA Better Governance Forum

Audit Committee Update

Helping audit committees to be effective

Issue 21

The audit committee and internal audit quality

Briefing on topical issues

Audit committee training

December 2016

Introduction

Dear audit committee member,

In the latest issue of Audit Committee Update we address the quality assessments that are a mandatory requirement of the Public Sector Internal Audit Standards. Our article is from one of CIPFA's own assessors, Elizabeth Humphrey, and she outlines the key facts to know about internal audit quality assessments. In particular she highlights what part the audit committee should play in supporting the assessments.

The external quality assessment or EQA is one aspect of the quality assurance and improvement programme that internal auditors need to have in place, and supporting the quality of internal audit is one of the most important roles that the audit committee has. Unless the committee can feel confident about the work of its internal auditors, the assurance the committee can provide to the organisation is undermined.

The remainder of this issue focuses on keeping you up to date, with our regular briefing covering recent legislation, reports and guidance.

Overall I hope you will find this issue interesting, informative and helpful in your work on the committee.

Best wishes

Diana Melville

CIPFA Better Governance Forum

Sharing this Document

Receive our Briefings Directly

This briefing will be sent to the main contact of organisations that subscribe to the CIPFA Better Governance Forum with a request that it be sent to all audit committee members.

If you have an organisational email address (for example jsmith@mycouncil.gov.uk) then you will also be able to register on our website and download any of our guides and briefings directly. To register now, please visit www.cipfa.org/Register.

Previous Issues of Audit Committee Update

You can download all the previous issues from the CIPFA Better Governance Forum website. Click on the links below to find what you need.

Issue	Principal Content	Link
Issues from 2010 – subsequent issues have updated the content in these issues.		
Issues from 2011		
4	Strategic Risk Management, Governance Risks in 2011, Role of the Head of Internal Audit	Issue 4
5	Understanding the Impact of IFRS on the Accounts, Key Findings from CIPFA's Survey of Audit Committees in Local Government	Issue 5
6	Partnerships from the Audit Committee Perspective	Issue 6
Issues from 2012		
7	Assurance Planning, Risk Outlook for 2012, Government Response to the Future of Local Audit Consultation	Issue 7
8	Commissioning, Procurement and Contracting Risks	Issue 8
9	Reviewing Assurance over Value for Money	Issue 9
Issues from 2013		
10	Public Sector Internal Audit Standards and Updates to Guidance on Annual Governance Statements	Issue 10
11	Local Audit and Accountability Bill, the Implications for Audit Committees, Update of CIPFA's Guidance on Audit Committees	Issue 11
12	Reviewing Internal Audit Quality, New CIPFA Publication, Audit Committees Practical Guidance for Local Authorities and Police, Regular Briefing on Current Issues	Issue 12
Issues from 2014		
13	Reviewing the Audit Plan, Update on the Local Audit and Accountability Act, Briefing on Topical Governance Issues	Issue 13
14	External Audit Quality and Independence, Government Consultation on Local Audit Regulations, CIPFA's Consultation on a New Counter Fraud Code, Regular Briefing on Current Issues	Issue 14
15	CIPFA Code of Practice on Managing the Risk of Fraud and Corruption, the Audit Committee Role in Countering Fraud, Regular Briefing on Current Developments	Issue 15

Issues from 2015		
16	What Makes a Good Audit Committee Chair? Governance Developments in 2015	Issue 16
17	The Audit Committee Role in Reviewing the Financial Statements, Regular Briefing on Current Developments	Issue 17
18	Self-assessment and Improving Effectiveness, Appointment and Procurement of External Auditors, Regular Briefing on Current Issues	Issue 18
Issues from 2016		
19	Good Governance in Local Government – 2016 Framework, Appointing Local Auditors, Regular Briefing on Current Issues	Issue 19
20	CIPFA Survey on Audit Committees 2016, Regular Briefing on Current Issues	Issue 20

Workshops and Training for Audit Committee Members in 2017 from CIPFA

Development day for local government audit committees
This workshop is suitable for audit committee members or those working with the audit committee in local government. It will cover an update on new developments and legislation relevant to the audit committee role. In addition, it will feature the new governance framework, working effectively with internal audit and other key topics.

- 17 January 2017, London
- 18 January 2017, Manchester

Developments in police audit committees
These events are suitable for members of the joint audit committees supporting police and crime commissioners (PCCs) and chief constables. These events are run in conjunction with CIPFA's Police Network.

- 20 September 2017, London
- 21 September 2017, York

Other CIPFA events information and dates are available on the website.

In house training and facilitation

In house audit committee training and guidance tailored to your needs is available. Options include:

- key roles and responsibilities of the committee
- effective chairing and support for the committee
- working with internal and external auditors
- public sector internal audit standards
- corporate governance
- strategic risk management
- value for money

- fraud risks and counter fraud arrangements
- reviewing the financial statements
- assurance arrangements
- improving impact and effectiveness.

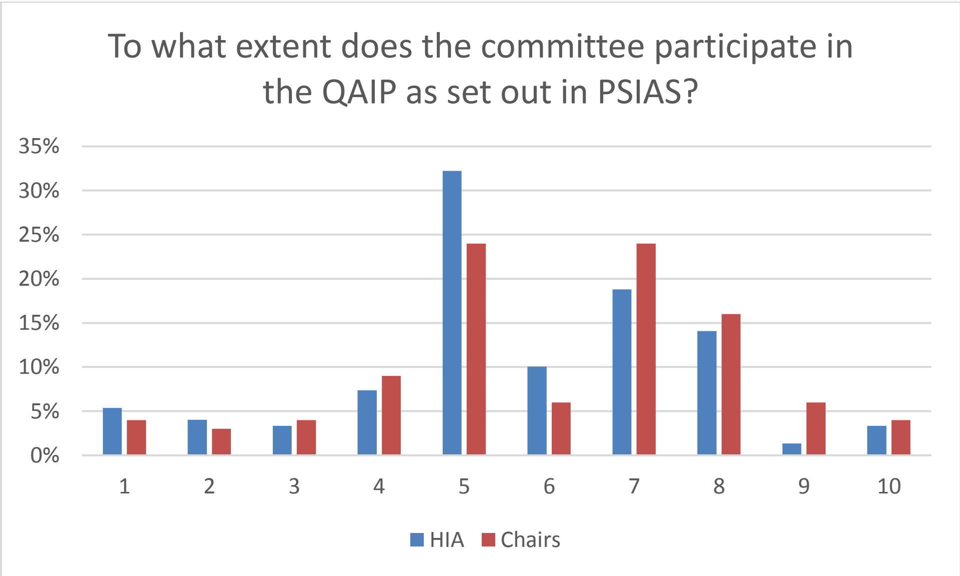
For further details contact blane.sweeney@cipfa.org or email diana.melville@cipfa.org or visit the CIPFA website where we have a brochure to download outlining the support we have available for audit committees.

The Audit Committee and Internal Audit: Supporting your Auditors to do their Best

How can you help? How would you know how they are doing?

The answer lies in the Public Sector Internal Audit Standards (PSIAS), the Quality, Assurance and Improvement Programme (QAIP) and the annual internal and external quality assessments (IQA and EQA), but how does the audit committee get involved in this alphabet jungle and what more could you do?

The PSIAS came into effect from 1 April 2013 and set out expectations of auditors, audit committees and senior management. By now, you should have received the results of up to three internal quality assessments (IQAs) against them (normally in the annual audit report). You may also have commissioned an external quality assessment (EQA) and had a chat with an external assessor. In the recent CIPFA survey on audit committees in local authorities and police there was a mixed response to the question about the audit committee's involvement in the quality programme. The chart below show the responses from heads of internal audit (HIA) and chairs of audit committees for local authorities. For further details of the survey download our briefings from the CIPFA website.



A score of 10 indicates a high level of participation.

Quality Assurance and Improvement Programme (QAIP)

Every audit section is expected to have a QAIP. This is the ongoing process through which they check that their performance meets their own criteria for delivery and also professional standards, including the PSIAS. A typical QAIP will consist of:

1. routine signing off of audits at different stages, for example after the terms of reference have been written, at the end of the fieldwork and before the draft and final reports are issued

2. a detailed review of the audit file at the end of the fieldwork stage, to check for mistakes, gaps in information and that all the key issues have been covered and are included in the report
3. post-audit questionnaires to auditees asking about the progress of the audit and the auditor's performance; these can be of limited value if the response rate to these questionnaires is poor
4. sample reviewing of completed audit files by staff who were not involved in the original audit (only large audit teams will have the resources to undertake this sort of review)
5. a set of performance indicators against which performance is measured over time
6. a programme for internal and external quality assessments (IQA and EQA), indicating who is to be involved.

Internal quality assessment (IQA)

The PSIAS require audit functions to review their performance against the standards periodically. While the standards don't specify a frequency, most audit teams carry out a review every year and report it in their annual report, together with their report of their activities in the year and their opinion on the system of internal control. The reporting should cover:

1. the scope of the review
2. who undertook the review, whether they were part of the audit team and their knowledge and experience of the standards
3. the outcome and conclusions of the review
4. actions to be undertaken as a consequence of the review.

IQAs should be carried out both within the audit team and by others within the organisation who have sufficient knowledge and understanding of internal audit to be able to reach a valid opinion. This is one area where the audit committee can play a useful role by being part of the review of the service, annually or from time to time. Carry out your own audit of the auditors by seeking evidence from others, looking at documentation and reviewing some audit work. You'll learn a lot and your auditors will greatly value your input. You could look for the following:

1. Evidence of thorough, risk-based planning. Are the risks to be audited documented? Do auditees think the auditors tackled the significant risks in their audit work? Does the audit work and report reflect the risks identified during the planning stage?
2. Evidence of effective reporting. Can you follow a trail from the audit plan to the audit report? Is the report clear and concise, but not too concise? Does it set out the objectives and scope of the audit, the risks to be examined and the outcome

of that examination? Do the recommendations seem sensible given the findings and are the responses to them acceptable?

3. Evidence that audit has sufficient resources and is maintaining its objectivity and independence, acting with integrity, confidentiality and competence. When did you last discuss these matters with your auditors? What do external audit, the director of finance, the chief executive have to say? What do you think?

External quality assessment (EQA)

Once in every five year cycle (ie before 1 April 2018), each audit team is required to commission an external review of their service against the PSIAS (an EQA). The external reviewer must be suitably qualified to carry out this work (typically they will be or have been a head of audit) and must be independent of the organisation. The level of independence is a matter of judgement but an arrangement whereby two heads of audit agree to review each other's service is not appropriate.

Although the sponsor of the review is likely to be an officer, the audit committee should be involved in the commissioning of the EQA, while it is being undertaken and at the end of the review as follows:

Commissioning:

1. Consider what is being commissioned: a peer review, a review against the IQA or a fully independent EQA.

2. Take a view on who might undertake this work, their independence of the organisation and qualifications to carry it out.

During the review:

1. At the very least, the chair of the audit committee should be one of the EQA interviewees. The reviewer will seek your perspective on audit's independence and objectivity, the planning and reporting of audit work and the way in which the auditors keep the audit committee informed, and the working relationships between the auditor and audit committee.

2. Some reviewers may want to speak to more audit committee members as their relationship with the audit team may differ from that between the chair and the auditors.

3. Some reviewers may wish to attend an audit committee to observe the interaction at first hand.

4. If any major findings come out of the review, you should expect to be informed of them as soon as possible.

After the review:

The reviewer will produce a report, identifying compliance and non-compliance with the standards and making recommendations and suggestions for improvement. This report should be included on the next audit committee agenda and you should follow up on activities against the action plan.

What do you do if your internal audit is provided by a contractor?

There has been some confusion about whether an IQA or EQA is required if you are using contracted internal audit and they have their own IQA and EQA arrangements. This will depend on the nature of the external provision and your officers will need to seek detailed advice.[1] In essence, any assessment, internal or external, looks both at the quality of the audit work and the way in which the audit function works with the organisation. While the quality of work may be covered by a review of the contractor's arrangements, especially if they do not vary their approach from client to client, the interaction with each client organisation probably isn't. Deciding on an appropriate scope for any review to avoid duplication and not be too onerous for the contractor is key.

Conclusion

Any quality assessment, internal or external, is intended to add value and improve the service provided by your internal auditors. An external reviewer is likely to be a great source of advice and suggestions. Make the most of the opportunities that come with such a review and use it to develop your audit team to deliver their best.

Elizabeth Humphrey CPFA

CIPFA Governance and Audit Associate

[1] A guidance note has been issued by the Internal Audit Standards Advisory Board (IASAB) on this topic: QAIP and Multi-client Service Providers (2014)

Recent Developments You May Need to Know About

Legislation, regulations and consultations

Appointment of local auditors
In our previous issues of Audit Committee Update we have provided updates on the requirement to appoint local auditors under the Local Audit and Accountability Act 2014. Public Sector Audit Appointments (PSAA) is the organisation appointed by the communities and local government secretary to conduct a sector led appointment process that eligible bodies can opt into.

PSAA issued their invitation to local bodies on 27 October 2016 with a closing date of 9 March 2017. They have put in a lengthy response period for the acceptance of the invitation, recognising that under the regulations councils must have the approval of full council to opt in. The appointment period will last for five years. Further details about the invitation and PSAA's plans are on their website.

The alternative to the PSAA appointment is to undertake an independent or shared appointment, using an auditor panel to provide oversight. Authorities should also have regard for the EU procurement thresholds.

For further details on the regulations and process for the appointment of local auditors please see earlier issues and the guidance on auditor panels available from CIPFA.

Forthcoming changes to the Public Sector Internal Audit Standards (PSIAS)

The responsible internal audit standard setters for the public sector will be issuing a consultation on amendments to the PSIAS. The PSIAS incorporate the international standards established by the Global Institute of Internal Audit and the Institute has recently published new amendments to the standards to be effective from 1 January 2017 for their members.

While it is the intention to maintain the alignment of the PSIAS to the international standards, there will be no amendment until after the completion of the consultation. The consultation will propose some amendments, deletions and additions to the public sector requirements or interpretations that the PSIAS contain. It is intended that the updated PSIAS will take effect from 1 April 2017.

Further details will be made available on the consultations part of the CIPFA website by 19 December. Audit committees are encouraged to consider the changes and to respond to the consultation.

Draft regulations The Combined Authorities (Overview and Scrutiny Committees, Access to Information and Audit Committees) Order 2016

The draft regulations on audit committees cover political balance and definition of independence for the independent member(s) on the committee. They also cover the method of appointment.

Reports, recommendations and guidance

Delivering Good Governance in Local Government

The guidance notes to support the new Framework are now available for English, Welsh and Scottish local authorities and for police. The framework applies from April 2016 and will need to be reflected in the annual governance statement for 2016/17.

- English local authorities
- Police
- Welsh local authorities
- Scottish local authorities

Briefings on the CIPFA surveys of audit committees

Six thematic briefings on the results of the survey are now available to download from the CIPFA website. The surveys were issued earlier this year and sought the views of chairs of audit committees, heads of internal audit in local authorities and CFOs for the PCC. The briefings cover effectiveness, the relationship with internal audit, training and support plus specific findings for local authorities and police. The briefings also contain recommendations, and local authority and police audit committees are encouraged to review the findings and recommendations and consider their application for their own committee. Audit committee survey briefings.

Reports in the public interest

PSAA publishes on its website reports in the public interest issued by local auditors. Over the last two months eight reports have been published, all on parish councils. In each case the council failed to meet its statutory duty to prepare an annual return about its finances and governance.

National Fraud Initiative

The report from the latest data matching investigations in England is now available. The initiative overseen by the Cabinet Office covers all local authority bodies plus other key sources of data and other public bodies. This year's report identified £200m of fraud. Another notable finding was a drop in the level of social housing fraud being identified. The reports for Scotland, Wales and Northern Ireland were published earlier in the year. See the last issue for further details.

Local government ethics in England: how is local ownership working?

The Localism Act 2011 placed the emphasis for the maintenance of standards on local ownership. This research report makes a preliminary assessment of local ownership in practice since the Act was passed among the 14 councils and three police forces that comprise England's North East region. Public Money and Management

Government interventions in local government

The Communities and Local Government Select Committee published a report in August identifying lessons to be learned from the government interventions in Rotherham and Tower Hamlets. The report emphasised the need for authorities to ensure they have proper checks and balances and scrutiny arrangements in place to drive a culture of transparency and continuous improvement. Communities and Local Government published their response to the recommendations in October.

As part of the annual review of governance arrangements to support the governance statement, authorities should be considering the adequacy of its scrutiny arrangements. Having effective scrutiny underpins the Principles in Delivering Good Governance in Local Government: Framework (CIPFA/Solace, 2016)

Financial resilience and sustainability

These challenges are significant for many public bodies. Reports from the state audit institutions provide insights into the experiences of specific sectors.

- Wales Audit Office report on the Financial Resilience of Local Authorities in Wales 2015–16
- National Audit Office report on Financial Sustainability of Local Authorities: Capital Expenditure and Resourcing
- National Audit Office report Financial Sustainability of the NHS
- Audit Scotland's annual review of the financial health and performance of the NHS in Scotland NHS in Scotland 2016
- Audit Scotland's Audit of Higher Education in Scottish Universities

In addition the National Audit Office is planning to produce a report on the financial sustainability of schools.

Value Creation in the Public Sector

The International Integrated Reporting Council and CIPFA, with the support of the World Bank, have published an introductory guide for public sector leaders on integrated thinking and reporting. The Guide outlines the fundamental concepts at the heart of Integrated Reporting (<IR>) and provides case studies of entities and organisations implementing <IR> to help them achieve the outcomes they are aiming for.

Upholding the Seven Principles of Public Life in Regulation

The latest report from the Committee on Standards in Public Life reviews how regulatory bodies in the United Kingdom uphold the Seven Principles of Public Life. Striking the Balance Upholding the Seven Principles of Public Life in Regulation

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