Arun District Council
Civic Centre
Maltravers Road
Littlehampton
West Sussex
BN17 5LF

Tel: (01903 737500)
Fax: (01903) 730442
DX: 57406 Littlehampton
Minicom: 01903 732765

e-mail: committees@arun.gov.uk

Committee Manager : Jane Fulton (Ext 37611)

7 February 2018

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, 22 February 2018 at 9.30am** and you are requested to attend.

Members: Councillors Chapman (Chairman), Mrs Oakley (Vice-Chairman), Blampied, Brooks, Cates, Edwards, Mrs Porter, Purchese 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 pecuniary, personal and/or prejudicial interests that they may have in relation to items on this agenda and are reminded that they should re-declare their interest before consideration of the item or as soon as the interest becomes apparent.

   Members and officers should make their declaration by stating :

   a) the item they have the interest in
   b) whether it is a pecuniary, personal and/or prejudicial
   c) the nature of the interest

3. MINUTES

   To approve as a correct record the Minutes of the meeting held on 7 December 2017 (which have been 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. *MEMBERS ALLOWANCES – PROGRESSING THE NEXT REVIEW AND EXTENSION OF APPOINTMENTS FOR THE INDEPENDENT PANEL

The Committee has responsibility for reviewing Councillor Allowances based on reports received from the Council's Independent Remuneration Panel created under the Local Authorities (Members Allowances) Regulations 2003 and to then make recommendations at Full Council.

During 2012, a new Independent Remuneration Panel was recruited and during 2013 this Panel worked on the seventh review of the Members' Allowances Scheme which was formally adopted by Full Council held on 23 October 2013.

A review has not been completed and considered by Full Council since this time and now that the senior management restructuring has been completed, it is timely for a review to be undertaken.

This report updates the Committee on proposals to take forward this review and it seeks approval to extend the existing appointments of the Panel.

6. ERNST & YOUNG - AUDIT PLANNING REPORT

Ernst & Young's Audit Plan and Progress Report is *attached.*

7. *ERNST & YOUNG – CERTIFICATION OF CLAIMS AND RETURNS ANNUAL REPORT 2016/2017

Ernst & Young's Annual Certification Report for 2016/2017 is *attached*.

8. *ACCOUNTING POLICIES FOR 2017/18 ACCOUNTS

This report allows the Committee to consider and approve the accounting policies that will be applied to the Statement of Accounts for 2017/18 for approval by the Committee in July 2018.

9. *TREASURY MANAGEMENT STRATEGY STATEMENT & ANNUAL INVESTMENT STRATEGY – 2018/19

This report presents the Treasury Management Strategy Statement and Annual Investment Strategy 2018/19. The Committee is asked to scrutinise the report prior to making recommendations to Full Council.

10. *ANNUAL INTERNAL AUDIT PLAN – 2018/19

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

11. *PROGRESS AGAINST THE AUDIT PLAN

Each year the Internal Audit undertakes its work against an annual audit plan, as approved by the 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.

12. *SUMMARY OF FINDINGS FROM REPORTS ISSUED NOVEMBER 2017 TO JANUARY 2018

The Committee is requested to consider the *attached* report.

13. *WORKPLAN FOR THE AUDIT & GOVERNANCE COMMITTEE – 2018/19

The Chief Internal Auditor will update the Committee on any changes to the rolling work plan for 2018/19. The latest version is *attached*.

14. INFORMATION / ADVISORY DOCUMENTS RECEIVED

•CIPFA Fraud & Corruption Tracker 2017 summary report. A copy can be obtained from the CIPFA website:-
http://www.cipfa.org/services/counter-fraud-centre/fraud-and-corruption-tracker

Note: *Indicates report is attached for all Members of the Audit & Governance Committee only and the press (excluding exempt items). Copies of reports can be obtained on request from the Committee Manager or accessed via the website at www.arun.gov.uk

Note: Members are reminded that if they have any detailed questions would they please inform the Chairman and/or relevant officers.

AGENDA ITEM NO. 5

ARUN DISTRICT COUNCIL

REPORT TO AND DECISION OF THE AUDIT & GOVERNANCE COMMITTEE ON 22 FEBRUARY 2018

PART A : REPORT

SUBJECT: Members Allowances – Progressing the Next Review and Extension of Appointments for the Independent Panel

REPORT AUTHOR: Jackie Follis – Group Head of Policy DATE: 19 January 2018
EXTN: 37611

EXECUTIVE SUMMARY:

The Committee has responsibility for reviewing Councillor Allowances based on reports received from the Council's Independent Remuneration Panel created under the Local Authorities (Members Allowances) Regulations 2003 and to then make recommendations at Full Council.

During 2012, a new Independent Remuneration Panel was recruited and during 2013 this Panel worked on the seventh review of the Members' Allowances Scheme which was formally adopted by Full Council held on 23 October 2013.

A review has not been completed and considered by Full Council since this time and now that the senior management restructuring has been completed, it is timely for a review to be undertaken.

This report updates the Committee on proposals to take forward this review and it seeks approval to extend the existing appointments of the Panel.

RECOMMENDATIONS:

The Committee is requested to:

(1) Note the approach to be taken by the Independent Panel for its next review in terms of the timetable proposed; and

(2) Agree to extending the terms of office for all three members of the Panel until 31 March 2020.

1. BACKGROUND:

1.1 As it has been nearly five years since Full Council approved the last review of the Members Allowances scheme and as the senior management restructure has now been undertaken, it is timely for the Independent Remuneration Panel to conduct another review of the Council's Members Allowances scheme.

1.2 The Panel undertook an informal review of the Members' Allowances Scheme during 2015 after the District Elections. In consulting with Group Leaders at that time it was decided that the review be postponed until the management restructuring had been completed.

1.3 It is proposed that the Terms of Reference of the Panel remain unchanged as these have been previously agreed by the Audit & Governance Committee. As an aid memoire, the Panel's Terms of Reference are to consider/review:

- the nature and type of role and responsibility of Elected Members and the level of commitment involved
- the difference in responsibility and time commitment of Leading Members; Cabinet Members and back-bench Members and the Chairman and Vice-Chairman of the Council and other Members with specific responsibilities
- schemes operating elsewhere in authorities similar to Arun
- the level of remuneration paid for other types of public duties
- whether allowances should be payable to meet Members out of pocket expenses
- the need to attract and retain Members of appropriate calibre and representative of the demographic make-up of the District
- the need to ensure that the scheme is straight-forward and economic to operate and justified in terms of affordability (in the public's perception) and working within existing budgetary constraints
- a scheme that aims to compensate for the time put into the roles and responsibilities undertaken – bearing in mind that there should be an element of public service
- a scheme that encourages Councillors to work flexibly and to develo themselves and their role in the community.

The following general principles should be applied:

- membership of the Council should be as inclusive as possible so as to allow all types of people to become a Councillor
- the need to encourage people to stand as Councillors – not to see a lack of remuneration/loss of earnings as a deterrent
- Members should be able to renounce all or part of their allowances
- account should be taken of hidden costs of Council membership
- account should be taken of any additional and/or onerous responsibilities undertaken by Members
- there should be an unremunerated element to service as a Member
- some recompense should be available to Councillors with care responsibilities
- the desirability of clearer public accountability for the work of Members
- allowances should be broadly in line with those paid by adjacent Authorities and those of a similar size
- the scheme of allowances should be equitable, transparent and simple to understand and administer while being affordable and justifiable in the perception of the public.

1.4 The Panel does not intend to provide an interim progress report to the Committee, it will present its draft outcome report with recommendations for the review to the meeting of the Audit & Governance Committee in November 2018 in line with the timetable set out later in this report.

2. PROPOSAL(S):

TIMETABLE FOR THE REVIEW

2.1 There will be many issues for the Panel to examine thoroughly in undertaking this next review following the senior management restructuring and changes made to the terms of reference and delegations of Committees. The Panel is also very aware that there will be many changes for it to record since the last review agreed by Full Council was back in October 2013.

2.2 Although the Panel is aware of some of the issues that were not concluded by the Panel as part of previous reviews, it feels that by asking Members to complete a questionnaire and by conducting interviews with Councillors, it will be able to then take a detailed look into what it feels these outstanding issues are. The Panel is aware of the need to ensure that the period of time to be covered by the questionnaire needs to adequately cover at least one cycle of meetings and to allow Members to be able to focus on considering all aspects of their Ward work taking into account peaks and troughs in workload.

2.3 The Panel has concluded that asking Members to keep a diary log should not be requested for this review due to the lack of responses received in the past.

2.4 In conjunction with the work undertaken on the questionnaire, the Panel will also be undertaking some research work on reviews undertaken by other authorities that are similar to Arun. Other research is also taking place with the South East Employers with regard to the existing Basic Allowance and its comparison with the Retail Price Index and other local earnings comparisons.

2.5 The Panel is proposing the following timetable for concluding its review:

Researching reviews undertaken by neighbouring authorities and those in the Council's CIPFA family group. Examining the results of the SEEMP Annual Survey	February 2018 to April 2018
Allowances questionnaire to be sent to all Members of the Council	March to May 2018
Questionnaire to be returned to Democratic Services	Beginning of June 2018
Questionnaire Analysis and Review Period	To end of June 2018
Councillor Interviews [Selection criteria to be agreed]	During June 2018
Drawing of Conclusions and Preparation of Recommendations	July to August 2018
Review to be concluded	September 2018
Meeting of the Audit & Governance	15 November 2018

Committee to consider the Panel's final draft report and to agree a new scheme to recommend onto Full Council	
Recommendations considered by Full Council for adoption	9 January 2018

2.6 Working to this timetable should allow the Panel sufficient time to consider any additional areas that Members may request should be considered as part of a fuller review. However, this will be dependent on the number of issues that are raised through the interview process and, if necessary, the timetable will be reviewed.

2.7 The Panel is proposing that the review should be concluded at Full Council on 9 January 2019 so that it is in place ahead of the District and Town/Parish Elections due in May 2019.

<u>TERMS OF OFFICE FOR THE INDEPENDENT REMUNERATION PANEL</u>

2.8 It is proposed that following consultation with Group Leaders, the term of office for the Panel be extended to March 2020 and that a phased appointment period is then introduced to ensure continuity of experience on the Panel.

3. OPTIONS:

(1) To agree to proceed with the next review of the Members Allowances scheme in line with the proposals set out within the report or to defer this review until after the May 2019 Elections; and

(2) Whatever the outcome of (1) is; the terms of office for the Panel be extended to the end of March 2020 or further

4. CONSULTATION:

Consultation will need to be undertaken with Group Leaders on the proposals ahead of the Audit & Governance Committee meeting.

Has consultation been undertaken with:	**YES**	**NO**
Relevant Town/Parish Council		**x**
Relevant District Ward Councillors		**x**
Other groups/persons (please specify)		

5. ARE THERE ANY IMPLICATIONS IN RELATION TO THE FOLLOWING COUNCIL POLICIES: (Explain in more detail at 6 below)	**YES**	**NO**
Financial	x	
Legal		x
Human Rights/Equality Impact Assessment		x

Community Safety including Section 17 of Crime & Disorder Act		x
Sustainability		x
Asset Management/Property/Land		x
Technology	x	
Other (please explain)		x

6. IMPLICATIONS:

The Committee is urged to support the proposals in place for the next review of the Members Allowances scheme so that a new scheme is in place ahead of the next District and Town/Parish Elections in May 2019.

7. REASON FOR THE DECISION:

To review the existing scheme so that the level of allowances paid to Members reflects recent changes made to the management structure and changes to the terms of reference and delegations to Committees etc.

8. BACKGROUND PAPERS:

Former reports made to the Audit & Governance Committee

Existing Members Allowances scheme

Arun District Council
Audit planning report
Year ended 31 March 2018

25 January 2018

EY
Building a better working world

Private and Confidential

25 January 2018

Arun District Council
Civic Centre
Maltravers Road
Littlehampton
BN17 5LF

Dear Audit and Governance Committee Members

Audit planning report

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 and Governance Committee with a basis to review our proposed audit approach and scope for the 2017/18 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.

This report is intended solely for the information and use of the Audit and Governance Committee and management, and is not intended to be and should not be used by anyone other than these specified parties.

We welcome the opportunity to discuss this report with you on 22 February 2018 as well as understand whether there are other matters which you consider may influence our audit.

Yours faithfully

Kevin Suter

For and on behalf of Ernst & Young LLP

Enc

Contents

In April 2015 Public Sector Audit Appointments Ltd (PSAA) issued "Statement of responsibilities of auditors and audited bodies". It is available from the 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 February 2017)" issued by the 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 in legislation, and covers matters of practice and procedure which are of a recurring nature.

This report is made solely to the **Audit and Governance Committee and management of Arun District Council** in accordance with the statement of responsibilities. Our work has been undertaken so that we might state to the **Audit and Governance Committee, and management of Arun District Council** those matters we are required to state to them in this report and for no other purpose. To the fullest extent permitted by law we do not accept or assume responsibility to anyone other than the **Audit and Governance Committee and management of Arun District Council** for this report or for the opinions we have formed. It should not be provided to any third-party without our prior written consent.

01 Overview of our 2017/18 audit strategy

Overview of our 2017/18 audit strategy

The following 'dashboard' summarises the significant accounting and auditing matters outlined in this report. It seeks to provide the Audit and Governance Committee with an overview of our initial risk identification for the upcoming audit and any changes in risks identified in the current year.

Audit risks and areas of focus

Risk / area of focus	Risk identified	Change from PY	Details
Risk of management override	Fraud risk/ Significant risk	No change in risk or focus	As identified in ISA 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 would otherwise appear to be operating effectively.
Valuation of Land and Buildings and Pension Liabilities	Other financial statement risk	Increase in focus	The valuation of land and buildings and pension liabiltiies are complex and are subject to a number of assumptions and judgements, including reliance by management on the work of external experts.

Materiality

Planning materiality

£1.704m

Materiality has been set at £1.7m, which represents 2% of the prior years gross revenue expenditure.

Performance materiality

£1.278m

Performance materiality has been set at £1.278m, which represents 75% of materiality.

Audit differences

£0.085m

We will report all uncorrected misstatements relating to the primary statements (comprehensive income and expenditure statement, balance sheet, movement in reserves statement, cash flow statement, the related notes, the housing revenue account and related notes and the collection fund and related notes) greater than £0.085m. Other misstatements identified will be communicated to the extent that they merit the attention of the Audit and Governance Committee.

Overview of our 2017/18 audit strategy

Audit scope

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; and

- 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.

Audit team changes

Key changes to our team.

Partner in charge – Kevin Suter
Kevin takes over from Paul King as the Engagement Lead. Kevin has significant public sector audit experience over 20 years, with a portfolio of Local Authorities, Local Government Pension Fund and National Park Authority audits.

02 Audit risks

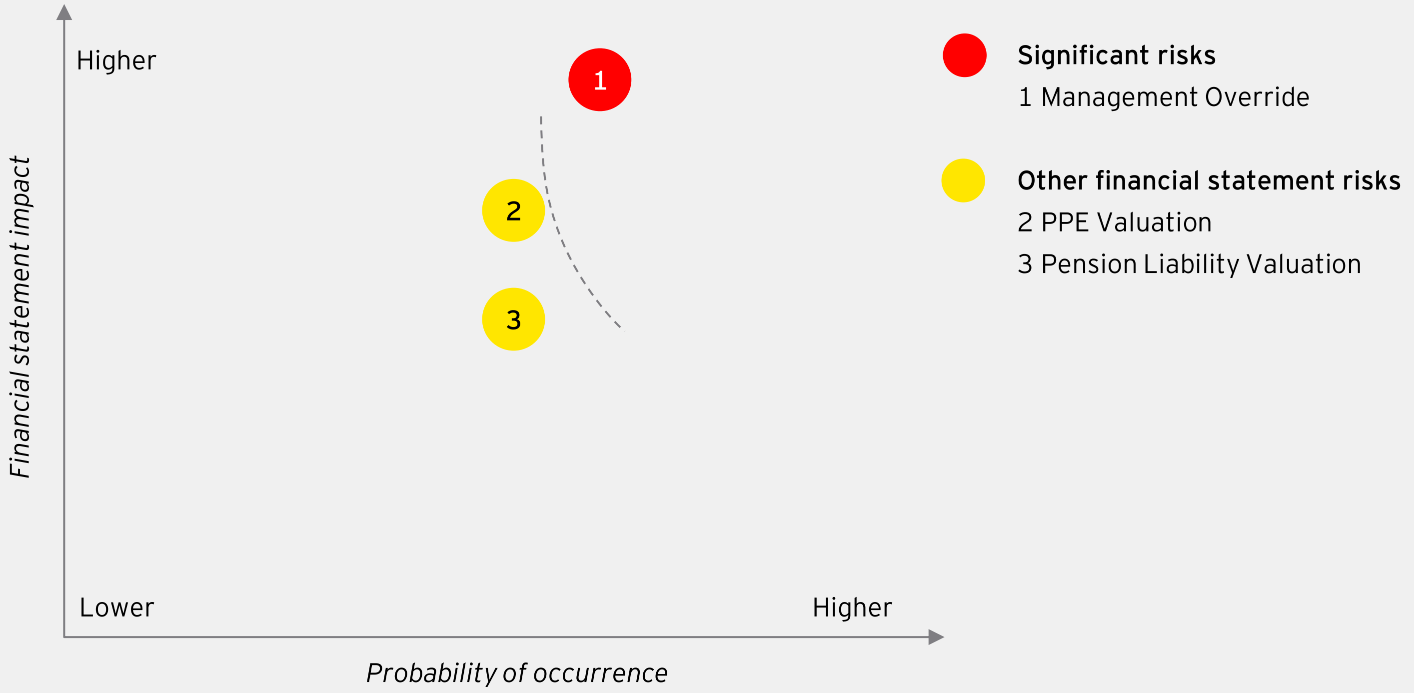
Audit risks

Risk assessment

Risk assessment

We have obtained an understanding of your strategy, reviewed your principal risks as identified in your 2017 Annual Report and Accounts and combined it with our understanding of the sector to identify key risks that impact our audit.

The following 'dashboard' summarises the significant matters that are relevant for planning our year-end audit:



Audit risks

Our response to significant risks

We have set out the significant risks (including fraud risks denoted by*) identified for the current year audit along with the rationale and expected audit approach. The risks identified below may change to reflect any significant findings or subsequent issues we identify during the audit.

Risk of management override*	What is the risk?	What will we do?
	The financial statements as a whole are not free of material misstatements whether caused by fraud or error. As identified in ISA (UK and Ireland) 240, management is in a unique position to perpetrate fraud because of its ability to manipulate accounting records directly or indirectly and prepare fraudulent financial statements by overriding controls that otherwise appear to be operating effectively. We identify and respond to this fraud risk on every audit engagement.	▸ Inquiry of management about risks of fraud and the controls put in place 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 those identified risks of fraud; ▸ Performing mandatory procedures regardless of specifically identified fraud risks, including testing of journal entries and other adjustments in the preparation of the financial statements; ▸ Reviewing accounting estimates for evidence of management bias; and ▸ Evaluating the business rationale for significant unusual transactions.

Audit risks

Other areas of audit focus

We have identified other areas of the audit, that have not been classified as significant risks, but are still important when considering the risks of material misstatement to the financial statements and disclosures and therefore may be key audit matters we will include in our audit report.

What is the risk/area of focus?	What will we do?
Valuation of Land and Buildings The fair value of Property, Plant and Equipment (PPE) represent significant balances in the Council's accounts and are subject to valuation changes, impairment reviews and depreciation charges. Management is required to make material judgemental inputs and apply estimation techniques to calculate the year-end balances recorded in the balance sheet. The Council has also changed valuer this year and changes in methodology and assumptions will have to be evaluated. The Council has recently acquired a significant investment property and this is expected to have a material effect on the financial statements and will have similar risks as above for PPE.	We will: ▸ Review the competency of the valuer by assessing their qualifications, experience and professional reputation; ▸ Review the relationship of the valuer to the Council; ▸ Review the output of the Council's valuer; ▸ Challenge the assumptions used by the Trust's valuer by reference to external evidence and our EY valuation specialists (where necessary); ▸ Review the valuation methodology and techniques to determine whether they are complete, adequate and consistent with appraisal methodology given the circmstances of the property in its market; and ▸ Test the journals for the valuation adjustments to confirm that they have been accurately processed in the financial statements.
Pension Liablity Valuation The Local Authority Accounting Code of Practice and IAS19 require the Council to make extensive disclosures within its financial statements regarding its membership of the Local Government Pension Scheme administered by West Sussex County Council. The Council's pension fund deficit is a material estimated balance and the Code requires that this liability be disclosed on the Council's balance sheet. At 31 March 2017 this totalled £27 million. The information disclosed is based on the IAS 19 report issued to the Council by the actuary to the County Council. Accounting for this scheme involves significant estimation and judgement and therefore management engages an actuary to undertake the calculations on their behalf. ISAs (UK and Ireland) 500 and 540 require us to undertake procedures on the use of management experts and the assumptions underlying fair value estimates.	We will: ▸ Liaise with the auditors of West Sussex County Council Pension Fund, to obtain assurances over the information supplied to the actuary in relation to Arun District Council; ▸ Assess the work of the Pension Fund actuary (Hymans) including the assumptions they have used by relying on the work of PWC - Consulting Actuaries commissioned by the National Audit Office for all Local Government sector auditors, and considering any relevant reviews by the EY actuarial team; and ▸ Review and test the accounting entries and disclosures made within the Council's financial statements in relation to IAS19.

03 Value for Money Risks

Value for Money

Background

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

For 2017/18 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.

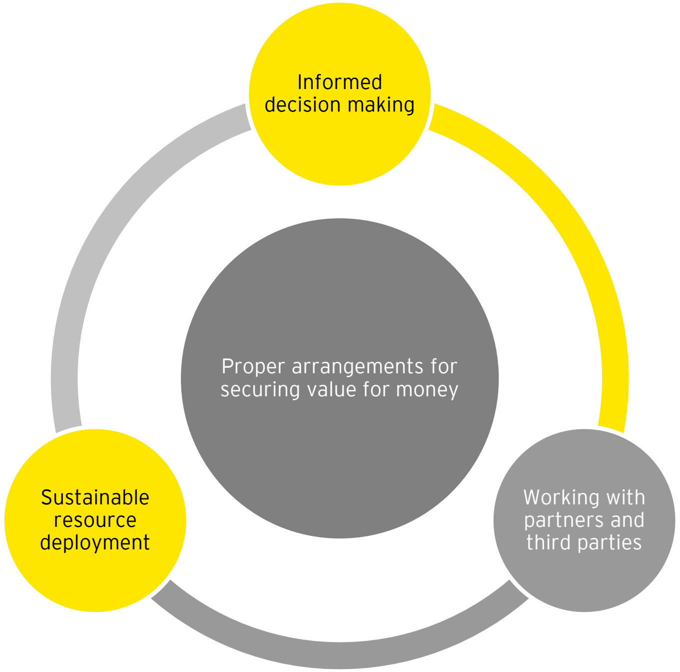
In considering your proper arrangements, we will draw on the requirements of the CIPFA/SOLACE framework for local government to ensure that our assessment is made against a framework that you are already required to have in place and to report on through documents such as your annual governance statement.

We are only required to determine whether there are any risks that we consider significant, which the Code of Audit Practice 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. This has resulted in the identification of the significant risk noted on the following page which we view as relevant to our value for money conclusion .



Value for Money

Value for Money Risks

What is the significant value for money risk?	What arrangements does the risk affect?	What will we do?
Financial pressures in the public sector continue to mount. As a result of these pressures there is increased focus and wider public interest in the financial resilience of Local Government. The Council does not have many ongoing developments or income generation schemes integrated into its revenue and capital budgets which could have a significant impact on the medium term finances	Deploy resources in a sustainable manner	Our approach will focus on: • Reviewing achievement against the 2017-18 budget • Reviewing the reasonableness of the 2018-19 budget and five year Finance Strategy • Understanding the progress made with and achievablility of efficiency and savings plans, including the purchase of the commercial property in Bognor Regis and the establishment of the local property company

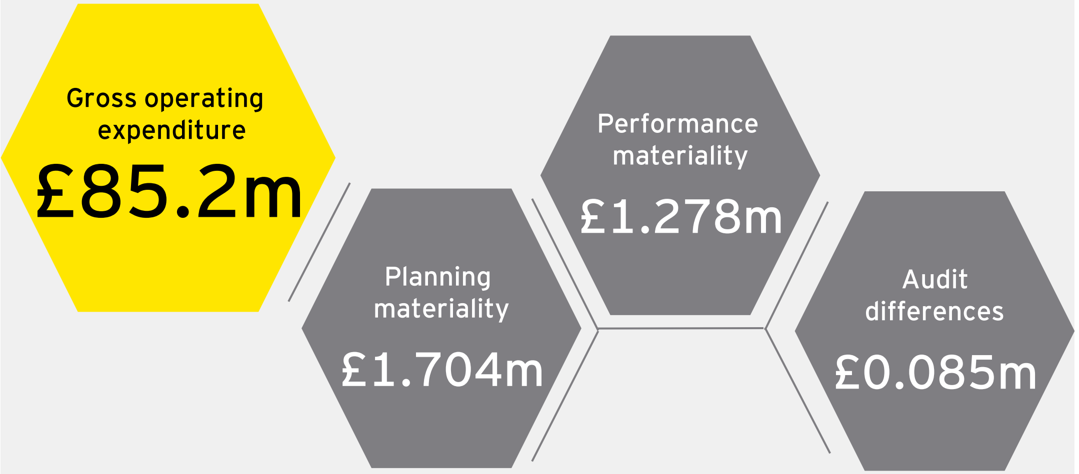
04 Audit materiality

Audit materiality

Materiality

Materiality

For planning purposes, materiality for 2017/18 has been set at £1.704m. This represents 2% of the Council's prior year gross revenue expenditure. It will be reassessed throughout the audit process. Gross revenue expenditure is the most appropriate basis for determining planning materiality for a public sector body and we consider misstatements greater than 2% of gross revenue expenditure to be material. Our evaluation requires professional judgement and so takes into account qualitative as well as quantitative considerations. We have provided supplemental information about audit materiality in Appendix D.



We request that the Audit and Governance Committee confirm its understanding of, and agreement to, these materiality and reporting levels.

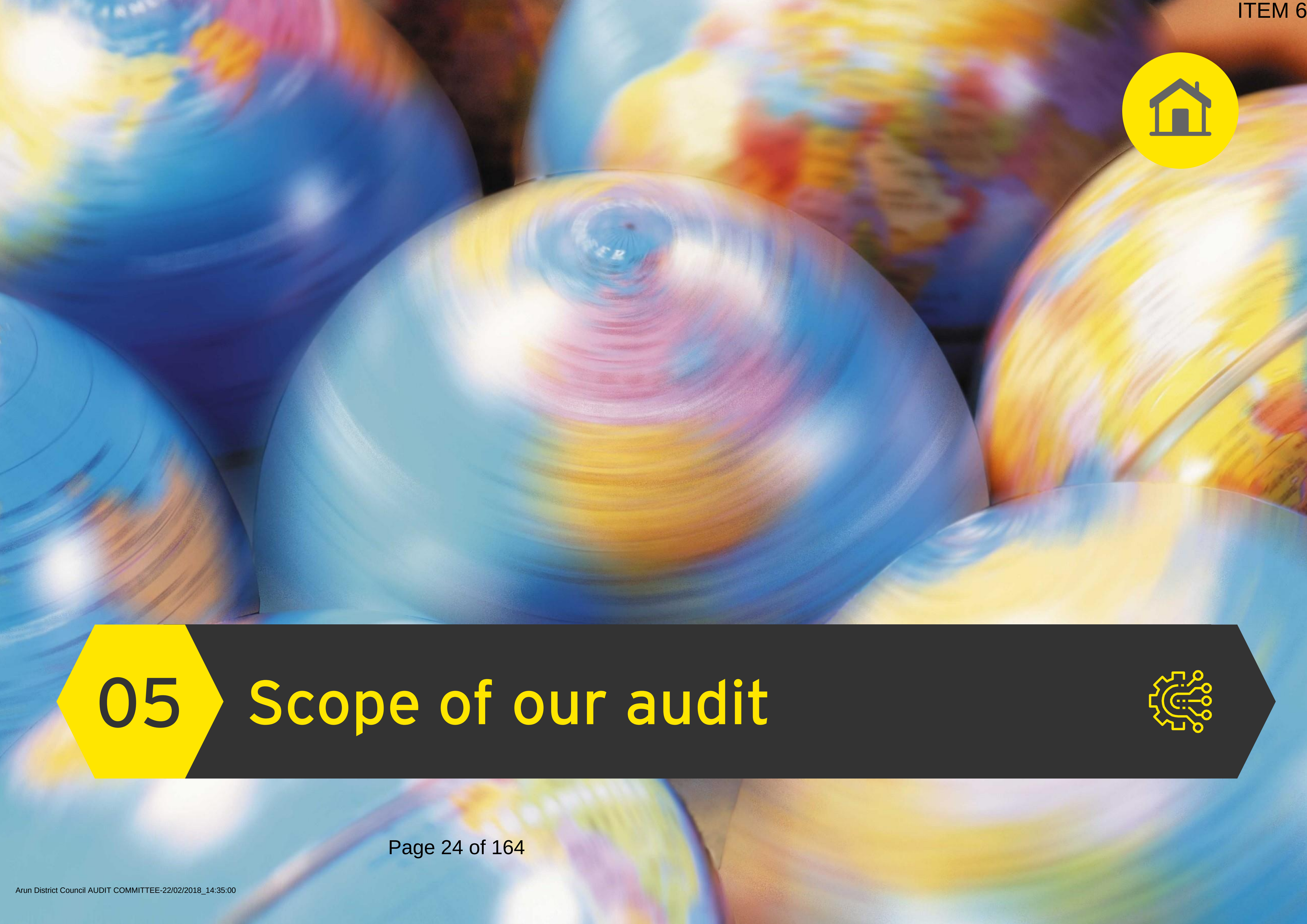
Key definitions

Planning materiality – the amount over which we anticipate misstatements would influence the economic decisions of a user of the financial statements.

Performance materiality – the amount we use to determine the extent of our audit procedures. We have set performance materiality at £1.278m which represents 75% of planning materiality. There have been few errors in the past and when they have been material has been isolated in nature. The control environment does support the prevention and detection of errors and no material weaknesses have been identified in prior years. In our judgement, the possibility of misstatements exceeding 25% is considered remote.

Audit difference threshold – we propose that misstatements identified below this threshold are deemed clearly trivial. We will report to you all uncorrected misstatements over this amount relating to the comprehensive income and expenditure statement, balance sheet, the housing revenue account and the collection fund that have an effect on income or that relate to other comprehensive income.

Other uncorrected misstatements, such as reclassifications and misstatements in the cashflow statement and movement in reserves statement or disclosures, and corrected misstatements will be communicated to the extent that they merit the attention of the Audit and Governance Committee, or are important from a qualitative perspective.



05 Scope of our audit

Scope of our audit

Our Audit Process and Strategy

Objective and Scope of our Audit scoping

Under the Code of Audit Practice our principal objectives are to review and report on the Council's financial statements and 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).

We also 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; and
- Auditor independence.

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

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.

Scope of our audit

Our Audit Process and Strategy (continued)

Audit Process Overview

Our audit involves:

- Identifying and understanding the key processes and internal controls; and
- Substantive tests of detail of transactions and amounts.

For 2017/18 we plan to follow a substantive approach to the audit as we have concluded this is the most efficient way to obtain the level of audit assurance required to conclude that the financial statements are not materially misstated.

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; and
- 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 and Governance Committee.

Internal audit:
We will regularly meet with the Chief Internal Auditor, and 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 they raise issues that could have an impact on the financial statements.

06 Audit team

Audit team

Audit team

The engagement team is lead by Kevin Suter, who has significant experiences of auditing District Councils and Local Government bodies. Kevin 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 and together will ensure that the audit delivers high quality and value to the Council.

Use of specialists

When auditing key judgements, we are often required to use the input and advice provided by specialists who have qualifications and expertise not possessed by the core audit team. The areas where EY specialists are expected to provide input for the current year audit are:

Area	Specialists
Valuation of Land and Buildings	EY Valuations Team
Pensions disclosure	EY Actuaries

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 business 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 specialist to establish whether the source data 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.

07 Audit timeline

Audit timeline

Timetable of communication and deliverables

Timeline

Below is a timetable showing the key stages of the audit and the deliverables we have agreed to provide to you through the audit cycle in 2017/18.

From time to time matters may arise that require immediate communication with the Audit and Governance Committee and we will discuss them with the Audit and Governance Committee Chair as appropriate. We will also provide updates on corporate governance and regulatory matters as necessary.

Audit phase	Timetable	Audit committee timetable	Deliverables
Planning: Risk assessment and setting of scopes.	October		
	November		
Walkthrough of key systems and processes	December	Audit and Governance Committee	2016/17 Annual Audit Letter
	January		
Testing of routine processes and controls Interim audit testing	February	Audit and Governance Committee	Audit Planning Report
Testing of routine processes Interim audit testing	March		
	April		
	May		
	June		
Year end audit Audit Completion procedures	July	Audit and Governance Committee	Audit Results Report Audit opinions and completion certificates

Audit timeline

Earlier deadline for production of the financial statements

The Accounts and Audit Regulations 2015 introduced a significant change in statutory deadlines from the 2017/18 financial year. From that year the timetable for the preparation and approval of accounts will be brought forward with draft accounts needing to be prepared by 31 May and the publication of the accounts by 31 July.

These changes provide risks for both the preparers and the auditors of the financial statements:

- The Council now has less time to prepare the financial statements and supporting working papers. Risks to the Council include slippage in delivering data for analytics work in format and to time required, late working papers and internal quality assurance arrangements.
- As your auditor, we have a more significant peak in our audit work and a shorter period to complete the audit. Risks for auditors relate to delivery of all audits within same compressed timetable. Slippage at one client could potentially put delivery of others at risk.

To mitigate this risk we will require:

- good quality draft financial statements and supporting working papers by the agreed deadline;
- appropriate Council staff to be available throughout the agreed audit period; and
- complete and prompt responses to audit questions.

If you are unable to meet key dates within our agreed timetable, we will notify you of the impact on the timing of your audit, which may be that we postpone your audit until later in the summer and redeploy the team to other work to meet deadlines elsewhere. Where additional work is required to complete your audit, due to additional risks being identified, additional work being required as a result of scope changes, or poor audit evidence, we will notify you of the impact on the fee and the timing of the audit. Such circumstances may result in a delay to your audit while we complete other work elsewhere.

To support the Council we will:

- Work with the Council to engage early to facilitate early substantive testing where appropriate.
- Provide an early review on the Council's streamlining of the Statement of Accounts where non-material disclosure notes are removed.
- Facilitate faster close workshops to provide an interactive forum for Local Authority accountants and auditors to share good practice and ideas to enable us all to achieve a successful faster closure of accounts for the 2017/18 financial year.
- Work with the Council to implement EY Client Portal, this will:
  - Streamline our audit requests through a reduction of emails and improved means of communication;
  - Provide on -demand visibility into the status of audit requests and the overall audit status;
  - Reduce risk of duplicate requests; and
  - Provide better security of sensitive data.
- Agree the team and timing of each element of our work with you.
- Agree the supporting working papers that we require to complete our audit.

08 Independence

Independence

Introduction

The FRC Ethical Standard and ISA (UK) 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 upon our integrity, objectivity and independence. The Ethical Standard, as revised in June 2016, requires that we communicate formally both at the planning stage and at the conclusion of the audit, as well as during the course of 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 Ernst & Young (EY) including consideration of all relationships between the 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. ▸ Where EY has determined it is appropriate to apply more restrictive independence rules than permitted under the Ethical Standard	▸ In order for you to assess the integrity, objectivity and independence of the firm and each covered person, we are required to provide a written disclosure of relationships (including the provision of non-audit services) that may bear on our integrity, objectivity and independence. This is required to have regard to relationships with the entity, its directors and senior management, its affiliates, and its connected parties and the threats to integrity or objectivity, including those that could compromise independence that these create. We are also required to disclose 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 the firm and each covered person is independent and, if applicable, that any non-EY firms used in the group audit or external experts used have confirmed their independence to us; ▸ Written confirmation that all covered persons are independent; ▸ Details of any inconsistencies between FRC Ethical Standard and your policy for the supply of non-audit services by EY and any apparent breach of that policy; ▸ Details of any contingent fee arrangements for non-audit services provided by us or our network firms; and ▸ An opportunity to discuss auditor independence issues.

In addition, during the course of the audit, we are required to communicate with you whenever any significant judgements are made about threats to objectivity and independence and the appropriateness of safeguards put in place, 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 services that have been contracted, and details of any written proposal to provide non-audit services that has been submitted;

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, analysed in appropriate categories, are disclosed.

Independence

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 the principal threats, if any. We have adopted the safeguards noted below to mitigate these threats along with the reasons why they are considered to be effective. However we will only perform non –audit services if the service has been pre-approved in accordance with your policy.

Overall Assessment

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

Self interest threats

A self interest threat arises when EY has financial or other interests in the Council. Examples include 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 you. 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 you have approved.

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

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 you. We confirm that no member of our audit engagement team, including those from other service lines, has objectives or is rewarded in relation to sales to you, in compliance with Ethical Standard part 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 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 company. Management threats may also arise during the provision of a non-audit service in relation to which management is required to make judgements or decision 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.

Independence

Other communications

EY Transparency Report 2017
Ernst & Young (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 in place 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 1 July 2017 and can be found here: http://www.ey.com/uk/en/about-us/ey-uk-transparency-report-2017

09 Appendices

Appendix A

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.

	Planned fee 2017/18	Scale fee 2017/18	Final Fee 2016/17
	£	£	£
Total Fee - Code work	57,103	57,103	57,103
Certification of claims and returns	8,330	8,330	8,204*
Total audit	65,433	65,433	65,307
Other non-audit services	-	-	-
Total other non-audit services	0	0	0
Total fees	65,433	65,433	65,307

**The proposed final fee includes £961.50 in respect of additional work required to review and capture extended testing undertaken due to errors identified during our testing. The proposed additional fee is subject to approval by PSAA*

All fees exclude VAT

The agreed fee presented is based on the following assumptions:

- Officers meeting the agreed timetable of deliverables;
- 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.

Appendix B

Regulatory update

In previous reports to the Audit and Governance Committee, we highlighted the issue of regulatory developments. The following table summarises progress on implementation:

Earlier deadline for production and audit of the financial statements from 2017/18	
Proposed effective date	Effective for annual periods beginning on or after 1 April 2017.
Details	The Accounts and Audit Regulations 2015 introduced a significant change in statutory deadlines from the 2017/18 financial year. From that year the timetable for the preparation and approval of accounts will be brought forward with draft accounts needing to be prepared by 31 May and the publication of the audited accounts by 31 July.
Impact on Arun District Council	These changes provide challenges for both the preparers and the auditors of the financial statements. We held a faster close workshop for clients on 29 November 2017 to facilitate early discussion and sharing of ideas and good practice. We are now working with the Council on ideas coming from the workshop, for example: • Streamlining the Statement of Accounts removing all non-material disclosure notes; • Bringing forward the commissioning and production of key externally provided information such as IAS 19 pension information, asset valuations; • Providing training to departmental finance staff regarding the requirements and implications of earlier closedown; • Re-ordering tasks from year-end to monthly/quarterly timing, reducing year-end pressure; • Establishing and agreeing working materiality amounts with the auditors.

Appendix C

Required communications with the Audit Committee

We have detailed the communications that we must provide to the Audit and Governance Committee.

		Our Reporting to you
Required communications	**What is reported?**	**When and where**
Terms of engagement	Confirmation by the Audit and Governance Committee of acceptance of terms of engagement as written in the engagement letter signed by both parties.	The statement of responsibilities serves as the formal terms of engagement between the PSAA's appointed auditors and audited bodies.
Our responsibilities	Reminder of our responsibilities as set out in the engagement letter	The statement of responsibilities serves as the formal terms of engagement between the PSAA's appointed auditors and audited bodies.
Planning and audit approach	Communication of the planned scope and timing of the audit, any limitations and the significant risks identified. When communicating key audit matters this includes the most significant risks of material misstatement (whether or not due to fraud) including those that have the greatest effect on the overall audit strategy, the allocation of resources in the audit and directing the efforts of the engagement team	Audit planning report
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

Appendix C

Required communications with the Audit Committee (continued)

Required communications	What is reported?	Our Reporting to you: When and where
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
Misstatements	▸ Uncorrected misstatements and their effect on our audit opinion, unless prohibited by law or regulation ▸ The effect of uncorrected misstatements related to prior periods ▸ A request that any uncorrected misstatement be corrected ▸ Corrected misstatements that are significant ▸ Material misstatements corrected by management	Audit results report
Fraud	▸ Enquiries of the Audit and Governance 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

Appendix C

Required communications with the Audit Committee (continued)

		Our Reporting to you
Required communications	**What is reported?**	**When and where**
Independence	Communication of all significant facts and matters that bear on EY's, and all individuals involved in the audit, objectivity and independence Communication of key elements of the audit engagement partner'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 Planning Report and 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 and Governance 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 and Governance Committee may be aware of	Audit results report
Internal controls	▸ Significant deficiencies in internal controls identified during the audit	Audit results report

Appendix C

Required communications with the Audit Committee (continued)

		Our Reporting to you
Required communications	**What is reported?**	**When and where**
Representations	Written representations we are requesting from management and/or those charged with governance	Audit results report
Material inconsistencies and misstatements	Material inconsistencies or misstatements of fact identified in other information which management has refused to revise	Audit results report
Auditors report	▸ Key audit matters that we will include in our auditor's report ▸ Any circumstances identified that affect the form and content of our auditor's report	Audit results report
Fee Reporting	▸ Breakdown of fee information when the audit plan is agreed ▸ Breakdown of fee information at the completion of the audit ▸ Any non-audit work	Audit planning report Audit results report
Certification work	Summary of certification work undertaken	Certification report

Appendix D

Additional audit information

Other required procedures during the course of the audit	
In addition to the key areas of audit focus outlined in section 2, we have to perform other procedures as required by auditing, ethical and independence standards and other regulations. We outline the procedures below that we will undertake during the course of our audit.	
Our responsibilities required by auditing standards	▶ Identifying and assessing the risks of material misstatement of the financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion. ▶ Obtaining an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Council's internal control. ▶ Evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by management. ▶ Concluding on the appropriateness of management's use of the going concern basis of accounting. ▶ Evaluating the overall presentation, structure and content of the financial statements, including the disclosures, and whether the financial statements represent the underlying transactions and events in a manner that achieves fair presentation. ▶ Obtaining sufficient appropriate audit evidence regarding the financial information of the entities or business activities within the Council to express an opinion on the financial statements. Reading other information contained in the financial statements, including the board's statement that the annual report is fair, balanced and understandable, the Audit and Governance Committee reporting appropriately addresses matters communicated by us to the Audit and Governance Committee and reporting whether it is materially inconsistent with our understanding and the financial statements; and ▶ Maintaining auditor independence.

Appendix D

Additional audit information (continued)

Purpose and evaluation of materiality

For the purposes of determining whether the accounts are free from material error, we define materiality as the magnitude of an omission or misstatement that, individually or in the aggregate, in light of the surrounding circumstances, could reasonably be expected to influence the economic decisions of the users of the financial statements. Our evaluation of it requires professional judgement and necessarily takes into account qualitative as well as quantitative considerations implicit in the definition. We would be happy to discuss with you your expectations regarding our detection of misstatements in the financial statements.

Materiality determines:

- The locations at which we conduct audit procedures to support the opinion given on the financial statements; and
- The level of work performed on individual account balances and financial statement disclosures.

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 of the circumstances that may ultimately influence our judgement about materiality. 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 accounts, including the total effect of the audit misstatements we identify, and our evaluation of materiality at that date.

Arun District Council
Audit planning report
Year ended 31 March 2018

25 January 2018

Building a better working world

Private and Confidential

25 January 2018

Arun District Council
Civic Centre
Maltravers Road
Littlehampton
BN17 5LF

Dear Audit and Governance Committee Members

Audit planning report

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 and Governance Committee with a basis to review our proposed audit approach and scope for the 2017/18 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.

This report is intended solely for the information and use of the Audit and Governance Committee and management, and is not intended to be and should not be used by anyone other than these specified parties.

We welcome the opportunity to discuss this report with you on 22 February 2018 as well as understand whether there are other matters which you consider may influence our audit.

Yours faithfully

Kevin Suter

For and on behalf of Ernst & Young LLP

Enc

Contents

In April 2015 Public Sector Audit Appointments Ltd (PSAA) issued "Statement of responsibilities of auditors and audited bodies". It is available from the 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 February 2017)" issued by the 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 in legislation, and covers matters of practice and procedure which are of a recurring nature.
This report is made solely to the **Audit and Governance Committee and management of Arun District Council** in accordance with the statement of responsibilities. Our work has been undertaken so that we might state to the **Audit and Governance Committee, and management of Arun District Council** those matters we are required to state to them in this report and for no other purpose. To the fullest extent permitted by law we do not accept or assume responsibility to anyone other than the **Audit and Governance Committee and management of Arun District Council** for this report or for the opinions we have formed. It should not be provided to any third-party without our prior written consent.

01 Overview of our 2017/18 audit strategy

Overview of our 2017/18 audit strategy

The following 'dashboard' summarises the significant accounting and auditing matters outlined in this report. It seeks to provide the Audit and Governance Committee with an overview of our initial risk identification for the upcoming audit and any changes in risks identified in the current year.

Audit risks and areas of focus

Risk / area of focus	Risk identified	Change from PY	Details
Risk of management override	Fraud risk/ Significant risk	No change in risk or focus	As identified in ISA 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 would otherwise appear to be operating effectively.
Valuation of Land and Buildings and Pension Liabilities	Other financial statement risk	Increase in focus	The valuation of land and buildings and pension liabiltiies are complex and are subject to a number of assumptions and judgements, including reliance by management on the work of external experts.

Materiality

Planning materiality

£1.704m

Materiality has been set at £1.7m, which represents 2% of the prior years gross revenue expenditure.

Performance materiality

£1.278m

Performance materiality has been set at £1.278m, which represents 75% of materiality.

Audit differences

£0.085m

We will report all uncorrected misstatements relating to the primary statements (comprehensive income and expenditure statement, balance sheet, movement in reserves statement, cash flow statement, the related notes, the housing revenue account and related notes and the collection fund and related notes) greater than £0.085m. Other misstatements identified will be communicated to the extent that they merit the attention of the Audit and Governance Committee.

Overview of our 2017/18 audit strategy

Audit scope

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; and

- 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.

Audit team changes

Key changes to our team.

Partner in charge – Kevin Suter
Kevin takes over from Paul King as the Engagement Lead. Kevin has significant public sector audit experience over 20 years, with a portfolio of Local Authorities, Local Government Pension Fund and National Park Authority audits.

02 Audit risks

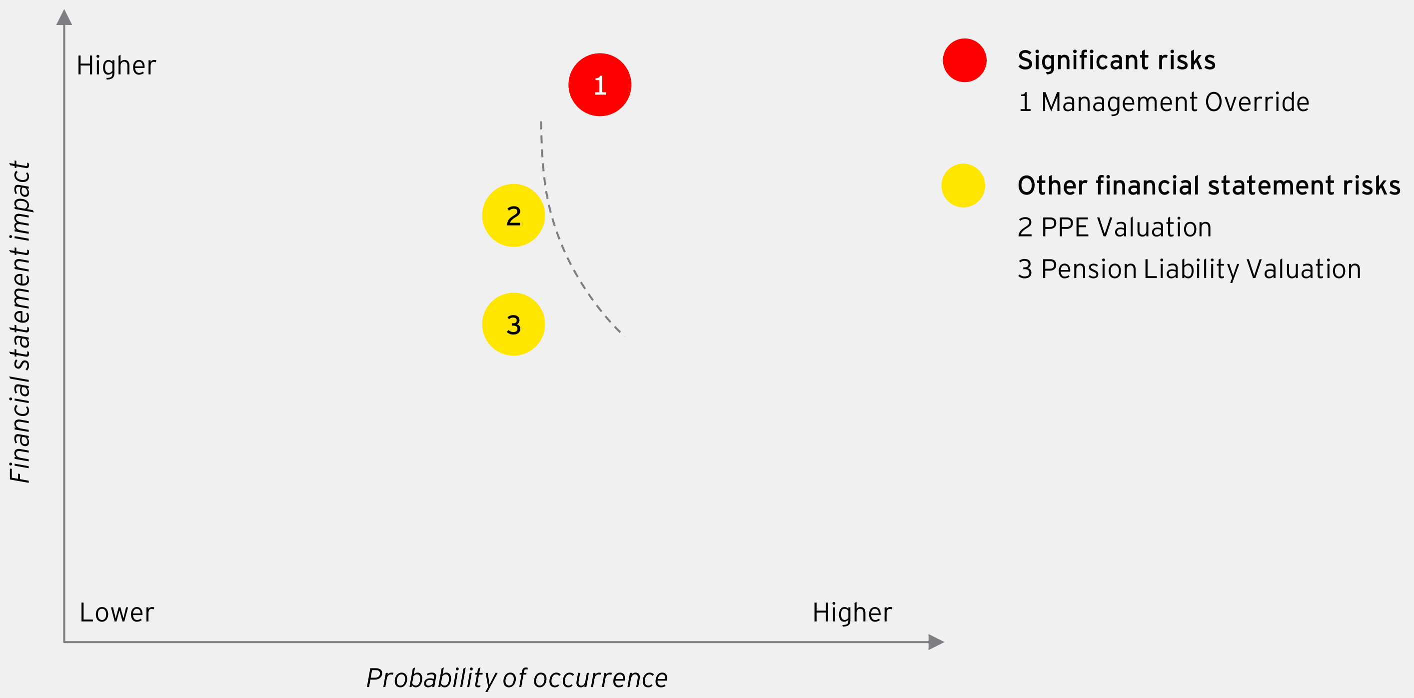
Audit risks

Risk assessment

Risk assessment

We have obtained an understanding of your strategy, reviewed your principal risks as identified in your 2017 Annual Report and Accounts and combined it with our understanding of the sector to identify key risks that impact our audit.

The following 'dashboard' summarises the significant matters that are relevant for planning our year-end audit:



Audit risks

Our response to significant risks

We have set out the significant risks (including fraud risks denoted by*) identified for the current year audit along with the rationale and expected audit approach. The risks identified below may change to reflect any significant findings or subsequent issues we identify during the audit.

Risk of management override*

What is the risk?	What will we do?
The financial statements as a whole are not free of material misstatements whether caused by fraud or error. As identified in ISA (UK and Ireland) 240, management is in a unique position to perpetrate fraud because of its ability to manipulate accounting records directly or indirectly and prepare fraudulent financial statements by overriding controls that otherwise appear to be operating effectively. We identify and respond to this fraud risk on every audit engagement.	▶ Inquiry of management about risks of fraud and the controls put in place 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 those identified risks of fraud; ▶ Performing mandatory procedures regardless of specifically identified fraud risks, including testing of journal entries and other adjustments in the preparation of the financial statements; ▶ Reviewing accounting estimates for evidence of management bias; and ▶ Evaluating the business rationale for significant unusual transactions.

Audit risks

Other areas of audit focus

We have identified other areas of the audit, that have not been classified as significant risks, but are still important when considering the risks of material misstatement to the financial statements and disclosures and therefore may be key audit matters we will include in our audit report.

What is the risk/area of focus?	What will we do?
Valuation of Land and Buildings The fair value of Property, Plant and Equipment (PPE) represent significant balances in the Council's accounts and are subject to valuation changes, impairment reviews and depreciation charges. Management is required to make material judgemental inputs and apply estimation techniques to calculate the year-end balances recorded in the balance sheet. The Council has also changed valuer this year and changes in methodology and assumptions will have to be evaluated. The Council has recently acquired a significant investment property and this is expected to have a material effect on the financial statements and will have similar risks as above for PPE.	We will: ▸ Review the competency of the valuer by assessing their qualifications, experience and professional reputation; ▸ Review the relationship of the valuer to the Council; ▸ Review the output of the Council's valuer; ▸ Challenge the assumptions used by the Trust's valuer by reference to external evidence and our EY valuation specialists (where necessary); ▸ Review the valuation methodology and techniques to determine whether they are complete, adequate and consistent with appraisal methodology given the circmstances of the property in its market; and ▸ Test the journals for the valuation adjustments to confirm that they have been accurately processed in the financial statements.
Pension Liablity Valuation The Local Authority Accounting Code of Practice and IAS19 require the Council to make extensive disclosures within its financial statements regarding its membership of the Local Government Pension Scheme administered by West Sussex County Council. The Council's pension fund deficit is a material estimated balance and the Code requires that this liability be disclosed on the Council's balance sheet. At 31 March 2017 this totalled £27 million. The information disclosed is based on the IAS 19 report issued to the Council by the actuary to the County Council. Accounting for this scheme involves significant estimation and judgement and therefore management engages an actuary to undertake the calculations on their behalf. ISAs (UK and Ireland) 500 and 540 require us to undertake procedures on the use of management experts and the assumptions underlying fair value estimates.	We will: ▸ Liaise with the auditors of West Sussex County Council Pension Fund, to obtain assurances over the information supplied to the actuary in relation to Arun District Council; ▸ Assess the work of the Pension Fund actuary (Hymans) including the assumptions they have used by relying on the work of PWC - Consulting Actuaries commissioned by the National Audit Office for all Local Government sector auditors, and considering any relevant reviews by the EY actuarial team; and ▸ Review and test the accounting entries and disclosures made within the Council's financial statements in relation to IAS19.

03 Value for Money Risks

Value for Money

Background

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

For 2017/18 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.

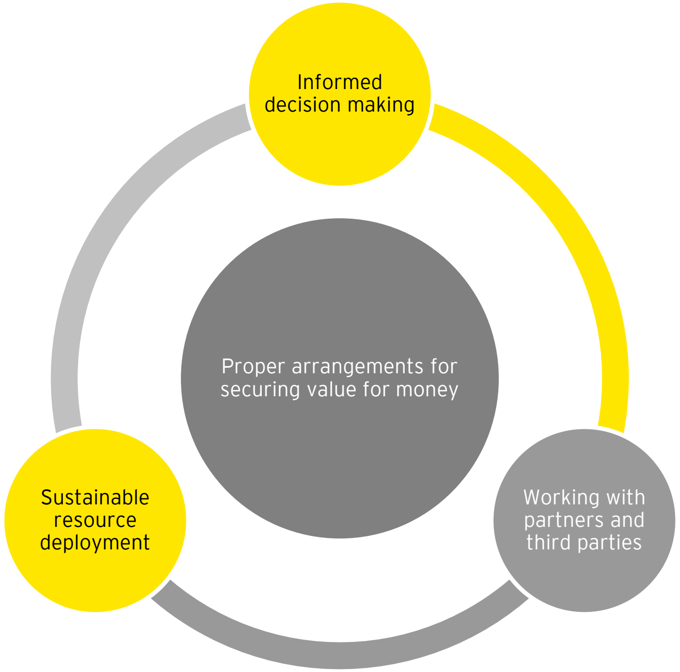
In considering your proper arrangements, we will draw on the requirements of the CIPFA/SOLACE framework for local government to ensure that our assessment is made against a framework that you are already required to have in place and to report on through documents such as your annual governance statement.

We are only required to determine whether there are any risks that we consider significant, which the Code of Audit Practice 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. This has resulted in the identification of the significant risk noted on the following page which we view as relevant to our value for money conclusion .



Value for Money

Value for Money Risks

What is the significant value for money risk?	What arrangements does the risk affect?	What will we do?
Financial pressures in the public sector continue to mount. As a result of these pressures there is increased focus and wider public interest in the financial resilience of Local Government. The Council does not have many ongoing developments or income generation schemes integrated into its revenue and capital budgets which could have a significant impact on the medium term finances	Deploy resources in a sustainable manner	Our approach will focus on: • Reviewing achievement against the 2017-18 budget • Reviewing the reasonableness of the 2018-19 budget and five year Finance Strategy • Understanding the progress made with and achievablility of efficiency and savings plans, including the purchase of the commercial property in Bognor Regis and the establishment of the local property company

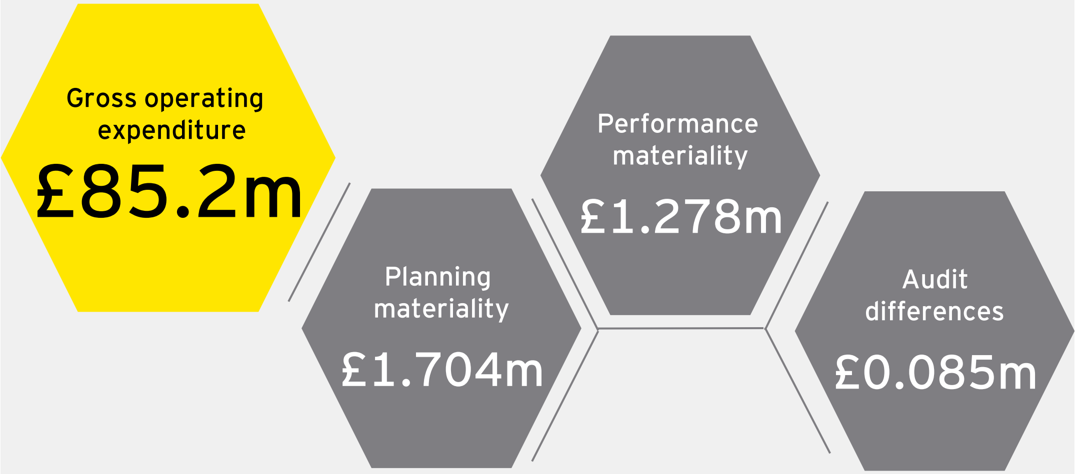
04 Audit materiality

Audit materiality

Materiality

Materiality

For planning purposes, materiality for 2017/18 has been set at £1.704m. This represents 2% of the Council's prior year gross revenue expenditure. It will be reassessed throughout the audit process. Gross revenue expenditure is the most appropriate basis for determining planning materality for a public sector body and we consider misstatements greater than 2% of gross revenue expenditure to be material. Our evaluation requires professional judgement and so takes into account qualitative as well as quantitative considerations. We have provided supplemental information about audit materiality in Appendix D.



We request that the Audit and Governance Committee confirm its understanding of, and agreement to, these materiality and reporting levels.

Key definitions

Planning materiality – the amount over which we anticipate misstatements would influence the economic decisions of a user of the financial statements.

Performance materiality – the amount we use to determine the extent of our audit procedures. We have set performance materiality at £1.278m which represents 75% of planning materiality. There have been few errors in the past and when they have been material has been isolated in nature. The control environment does support the prevention and detection of errors and no material weaknesses have been identified in prior years. In our judgement, the possibility of misstatements exceeding 25% is considered remote.

Audit difference threshold – we propose that misstatements identified below this threshold are deemed clearly trivial. We will report to you all uncorrected misstatements over this amount relating to the comprehensive income and expenditure statement, balance sheet, the housing revenue account and the collection fund that have an effect on income or that relate to other comprehensive income.

Other uncorrected misstatements, such as reclassifications and misstatements in the cashflow statement and movement in reserves statement or disclosures, and corrected misstatements will be communicated to the extent that they merit the attention of the Audit and Governance Committee, or are important from a qualitative perspective.

05 Scope of our audit

Scope of our audit

Our Audit Process and Strategy

Objective and Scope of our Audit scoping

Under the Code of Audit Practice our principal objectives are to review and report on the Council's financial statements and 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).

We also 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; and
- Auditor independence.

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

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.

Scope of our audit

Our Audit Process and Strategy (continued)

Audit Process Overview

Our audit involves:

- Identifying and understanding the key processes and internal controls; and
- Substantive tests of detail of transactions and amounts.

For 2017/18 we plan to follow a substantive approach to the audit as we have concluded this is the most efficient way to obtain the level of audit assurance required to conclude that the financial statements are not materially misstated.

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; and
- 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 and Governance Committee.

Internal audit:
We will regularly meet with the Chief Internal Auditor, and 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 they raise issues that could have an impact on the financial statements.

06 Audit team

Audit team

Audit team

The engagement team is lead by Kevin Suter, who has significant experiences of auditing District Councils and Local Government bodies. Kevin 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 and together will ensure that the audit delivers high quality and value to the Council.

Use of specialists

When auditing key judgements, we are often required to use the input and advice provided by specialists who have qualifications and expertise not possessed by the core audit team. The areas where EY specialists are expected to provide input for the current year audit are:

Area	Specialists
Valuation of Land and Buildings	EY Valuations Team
Pensions disclosure	EY Actuaries

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 business 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 specialist to establish whether the source data 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.

07 Audit timeline

Audit timeline

Timetable of communication and deliverables

Timeline

Below is a timetable showing the key stages of the audit and the deliverables we have agreed to provide to you through the audit cycle in 2017/18.

From time to time matters may arise that require immediate communication with the Audit and Governance Committee and we will discuss them with the Audit and Governance Committee Chair as appropriate. We will also provide updates on corporate governance and regulatory matters as necessary.

Audit phase	Timetable	Audit committee timetable	Deliverables
Planning: Risk assessment and setting of scopes.	October		
	November		
Walkthrough of key systems and processes	December	Audit and Governance Committee	2016/17 Annual Audit Letter
	January		
Testing of routine processes and controls Interim audit testing	February	Audit and Governance Committee	Audit Planning Report
Testing of routine processes Interim audit testing	March		
	April		
	May		
	June		
Year end audit Audit Completion procedures	July	Audit and Governance Committee	Audit Results Report Audit opinions and completion certificates

Audit timeline

Earlier deadline for production of the financial statements

The Accounts and Audit Regulations 2015 introduced a significant change in statutory deadlines from the 2017/18 financial year. From that year the timetable for the preparation and approval of accounts will be brought forward with draft accounts needing to be prepared by 31 May and the publication of the accounts by 31 July.

These changes provide risks for both the preparers and the auditors of the financial statements:

- The Council now has less time to prepare the financial statements and supporting working papers. Risks to the Council include slippage in delivering data for analytics work in format and to time required, late working papers and internal quality assurance arrangements.
- As your auditor, we have a more significant peak in our audit work and a shorter period to complete the audit. Risks for auditors relate to delivery of all audits within same compressed timetable. Slippage at one client could potentially put delivery of others at risk.

To mitigate this risk we will require:

- good quality draft financial statements and supporting working papers by the agreed deadline;
- appropriate Council staff to be available throughout the agreed audit period; and
- complete and prompt responses to audit questions.

If you are unable to meet key dates within our agreed timetable, we will notify you of the impact on the timing of your audit, which may be that we postpone your audit until later in the summer and redeploy the team to other work to meet deadlines elsewhere. Where additional work is required to complete your audit, due to additional risks being identified, additional work being required as a result of scope changes, or poor audit evidence, we will notify you of the impact on the fee and the timing of the audit. Such circumstances may result in a delay to your audit while we complete other work elsewhere.

To support the Council we will:

- Work with the Council to engage early to facilitate early substantive testing where appropriate.
- Provide an early review on the Council's streamlining of the Statement of Accounts where non-material disclosure notes are removed.
- Facilitate faster close workshops to provide an interactive forum for Local Authority accountants and auditors to share good practice and ideas to enable us all to achieve a successful faster closure of accounts for the 2017/18 financial year.
- Work with the Council to implement EY Client Portal, this will:
  - Streamline our audit requests through a reduction of emails and improved means of communication;
  - Provide on -demand visibility into the status of audit requests and the overall audit status;
  - Reduce risk of duplicate requests; and
  - Provide better security of sensitive data.
- Agree the team and timing of each element of our work with you.
- Agree the supporting working papers that we require to complete our audit.

08 Independence

Independence

Introduction

The FRC Ethical Standard and ISA (UK) 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 upon our integrity, objectivity and independence. The Ethical Standard, as revised in June 2016, requires that we communicate formally both at the planning stage and at the conclusion of the audit, as well as during the course of 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 Ernst & Young (EY) including consideration of all relationships between the 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. ▸ Where EY has determined it is appropriate to apply more restrictive independence rules than permitted under the Ethical Standard	▸ In order for you to assess the integrity, objectivity and independence of the firm and each covered person, we are required to provide a written disclosure of relationships (including the provision of non-audit services) that may bear on our integrity, objectivity and independence. This is required to have regard to relationships with the entity, its directors and senior management, its affiliates, and its connected parties and the threats to integrity or objectivity, including those that could compromise independence that these create. We are also required to disclose 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 the firm and each covered person is independent and, if applicable, that any non-EY firms used in the group audit or external experts used have confirmed their independence to us; ▸ Written confirmation that all covered persons are independent; ▸ Details of any inconsistencies between FRC Ethical Standard and your policy for the supply of non-audit services by EY and any apparent breach of that policy; ▸ Details of any contingent fee arrangements for non-audit services provided by us or our network firms; and ▸ An opportunity to discuss auditor independence issues.

In addition, during the course of the audit, we are required to communicate with you whenever any significant judgements are made about threats to objectivity and independence and the appropriateness of safeguards put in place, 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 services that have been contracted, and details of any written proposal to provide non-audit services that has been submitted;

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, analysed in appropriate categories, are disclosed.

Independence

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 the principal threats, if any. We have adopted the safeguards noted below to mitigate these threats along with the reasons why they are considered to be effective. However we will only perform non –audit services if the service has been pre-approved in accordance with your policy.

Overall Assessment

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

Self interest threats

A self interest threat arises when EY has financial or other interests in the Council. Examples include 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 you. 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 you have approved.

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

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 you. We confirm that no member of our audit engagement team, including those from other service lines, has objectives or is rewarded in relation to sales to you, in compliance with Ethical Standard part 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 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 company. Management threats may also arise during the provision of a non-audit service in relation to which management is required to make judgements or decision 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.

Independence

Other communications

EY Transparency Report 2017
Ernst & Young (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 in place 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 1 July 2017 and can be found here: http://www.ey.com/uk/en/about-us/ey-uk-transparency-report-2017

09 Appendices

Appendix A

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.

	Planned fee 2017/18	Scale fee 2017/18	Final Fee 2016/17
	£	£	£
Total Fee - Code work	57,103	57,103	57,103
Certification of claims and returns	8,330	8,330	8,204*
Total audit	65,433	65,433	65,307
Other non-audit services	-	-	-
Total other non-audit services	0	0	0
Total fees	65,433	65,433	65,307

**The proposed final fee includes £961.50 in respect of additional work required to review and capture extended testing undertaken due to errors identified during our testing. The proposed additional fee is subject to approval by PSAA*

All fees exclude VAT

The agreed fee presented is based on the following assumptions:

- Officers meeting the agreed timetable of deliverables;
- 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.

Appendix B

Regulatory update

In previous reports to the Audit and Governance Committee, we highlighted the issue of regulatory developments. The following table summarises progress on implementation:

Earlier deadline for production and audit of the financial statements from 2017/18	
Proposed effective date	Effective for annual periods beginning on or after 1 April 2017.
Details	The Accounts and Audit Regulations 2015 introduced a significant change in statutory deadlines from the 2017/18 financial year. From that year the timetable for the preparation and approval of accounts will be brought forward with draft accounts needing to be prepared by 31 May and the publication of the audited accounts by 31 July.
Impact on Arun District Council	These changes provide challenges for both the preparers and the auditors of the financial statements. We held a faster close workshop for clients on 29 November 2017 to facilitate early discussion and sharing of ideas and good practice. We are now working with the Council on ideas coming from the workshop, for example: • Streamlining the Statement of Accounts removing all non-material disclosure notes; • Bringing forward the commissioning and production of key externally provided information such as IAS 19 pension information, asset valuations; • Providing training to departmental finance staff regarding the requirements and implications of earlier closedown; • Re-ordering tasks from year-end to monthly/quarterly timing, reducing year-end pressure; • Establishing and agreeing working materiality amounts with the auditors.

Appendix C

Required communications with the Audit Committee

We have detailed the communications that we must provide to the Audit and Governance Committee.

Our Reporting to you

Required communications	What is reported?	When and where
Terms of engagement	Confirmation by the Audit and Governance Committee of acceptance of terms of engagement as written in the engagement letter signed by both parties.	The statement of responsibilities serves as the formal terms of engagement between the PSAA's appointed auditors and audited bodies.
Our responsibilities	Reminder of our responsibilities as set out in the engagement letter	The statement of responsibilities serves as the formal terms of engagement between the PSAA's appointed auditors and audited bodies.
Planning and audit approach	Communication of the planned scope and timing of the audit, any limitations and the significant risks identified. When communicating key audit matters this includes the most significant risks of material misstatement (whether or not due to fraud) including those that have the greatest effect on the overall audit strategy, the allocation of resources in the audit and directing the efforts of the engagement team	Audit planning report
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

Appendix C

Required communications with the Audit Committee (continued)

		Our Reporting to you
Required communications	**What is reported?**	**When and where**
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
Misstatements	▸ Uncorrected misstatements and their effect on our audit opinion, unless prohibited by law or regulation ▸ The effect of uncorrected misstatements related to prior periods ▸ A request that any uncorrected misstatement be corrected ▸ Corrected misstatements that are significant ▸ Material misstatements corrected by management	Audit results report
Fraud	▸ Enquiries of the Audit and Governance 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

Appendix C

Required communications with the Audit Committee (continued)

		Our Reporting to you
Required communications	**What is reported?**	**When and where**
Independence	Communication of all significant facts and matters that bear on EY's, and all individuals involved in the audit, objectivity and independence Communication of key elements of the audit engagement partner'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 Planning Report and 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 and Governance 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 and Governance Committee may be aware of	Audit results report
Internal controls	▸ Significant deficiencies in internal controls identified during the audit	Audit results report

Appendix C

Required communications with the Audit Committee (continued)

		Our Reporting to you
Required communications	**What is reported?**	**When and where**
Representations	Written representations we are requesting from management and/or those charged with governance	Audit results report
Material inconsistencies and misstatements	Material inconsistencies or misstatements of fact identified in other information which management has refused to revise	Audit results report
Auditors report	▸ Key audit matters that we will include in our auditor's report ▸ Any circumstances identified that affect the form and content of our auditor's report	Audit results report
Fee Reporting	▸ Breakdown of fee information when the audit plan is agreed ▸ Breakdown of fee information at the completion of the audit ▸ Any non-audit work	Audit planning report Audit results report
Certification work	Summary of certification work undertaken	Certification report

Appendix D

Additional audit information

Other required procedures during the course of the audit	
In addition to the key areas of audit focus outlined in section 2, we have to perform other procedures as required by auditing, ethical and independence standards and other regulations. We outline the procedures below that we will undertake during the course of our audit.	
Our responsibilities required by auditing standards	▶ Identifying and assessing the risks of material misstatement of the financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion. ▶ Obtaining an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Council's internal control. ▶ Evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by management. ▶ Concluding on the appropriateness of management's use of the going concern basis of accounting. ▶ Evaluating the overall presentation, structure and content of the financial statements, including the disclosures, and whether the financial statements represent the underlying transactions and events in a manner that achieves fair presentation. ▶ Obtaining sufficient appropriate audit evidence regarding the financial information of the entities or business activities within the Council to express an opinion on the financial statements. Reading other information contained in the financial statements, including the board's statement that the annual report is fair, balanced and understandable, the Audit and Governance Committee reporting appropriately addresses matters communicated by us to the Audit and Governance Committee and reporting whether it is materially inconsistent with our understanding and the financial statements; and ▶ Maintaining auditor independence.

Appendix D

Additional audit information (continued)

Purpose and evaluation of materiality

For the purposes of determining whether the accounts are free from material error, we define materiality as the magnitude of an omission or misstatement that, individually or in the aggregate, in light of the surrounding circumstances, could reasonably be expected to influence the economic decisions of the users of the financial statements. Our evaluation of it requires professional judgement and necessarily takes into account qualitative as well as quantitative considerations implicit in the definition. We would be happy to discuss with you your expectations regarding our detection of misstatements in the financial statements.

Materiality determines:

- The locations at which we conduct audit procedures to support the opinion given on the financial statements; and
- The level of work performed on individual account balances and financial statement disclosures.

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 of the circumstances that may ultimately influence our judgement about materiality. 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 accounts, including the total effect of the audit misstatements we identify, and our evaluation of materiality at that date.

Certification of claims and returns annual report 2016-17

Arun District Council

December 2017

Ernst & Young LLP

Building a better working world

Ernst & Young LLP
Wessex House
19 Threefield Lane
Southampton
SO14 3QB

Tel: + 44 2380 382000
Fax: + 44 2380 382001
ey.com

The Members of the Audit and Governance Committee
Arun District Council
Arun Civic Centre
Maltravers Road
Littlehampton
West Sussex
BN17 5LF

12 December 2017

Direct line: 07974 757910
Email: pking1@uk.ey.com

Dear Members

Certification of claims and returns annual report 2016-17 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 2016-17 claims and returns.

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 2016-17, 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 2016-17 certification work and highlights the significant issues.

We checked and certified the housing benefits subsidy claim with a total value of £50,130,018. We met the submission deadline. We issued a qualification letter – details of the qualification matters are included in section 1. Our certification work found errors but these had no effect on the subsidy claim.

Fees for certification and other returns work are summarised in section 2. The housing benefits subsidy claim fees for 2016-17 were published by the Public Sector Audit Appointments Ltd (PSAA) in March 2016 and are now available on the PSAA's website (www.psaa.co.uk).

Building a better working world

We welcome the opportunity to discuss the contents of this report with you at the Audit and Governance Committee meeting on 22 February 2018.

Yours faithfully

Paul King
Associate Partner
Ernst & Young LLP
Enc

Contents

1. Housing benefits subsidy claim

Scope of work	Results
Value of claim presented for certification	£50,130,018
Amended/Not amended	Not amended
Qualification letter	Yes
Fee – 2016-17 Fee – 2015-16	£8,325.40 £8,330

Recommendations from 2015-16	Findings in 2016-17
None	N/A

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.

The certification guidance requires auditors to complete more extensive '40+' or extended testing if initial testing identifies errors in the calculation of benefit or compilation of the claim. 40+ testing may also be carried out as a result of errors that have been identified in the audit of previous years' claims. We found one error in rent allowances caused by the incorrect income in the assessment of benefit entitlement.

Extended testing identified four further cases where similar errors had occurred in consideration of claimant income in the assessment of entitlement to rent allowance benefit. We extrapolated the financial impact of our findings to determine the total financial impact of the errors on the claim. The total value of extrapolated errors was £1,435. No amendments were made to the claim in respect of this issue. This was because, given the nature of the populations tested, it was unlikely that even significant additional work would result in amendments to the claim that would allow us to conclude it was fairly stated. We reported the extrapolated value of these errors to the DWP in a qualification letter. The DWP then decides whether to ask the Council to carry our further work to quantify the error or to claw back the benefit subsidy paid.

In Non HRA rent rebates, we found one error where the rent liability had been incorrectly recorded but this had no impact on the claim and one error where benefit had been underpaid as a result of self-employed earning being incorrectly calculated. Extended testing identified one further error, although this error had no impact on the subsidy awarded. As there is no eligibility to subsidy for benefit which has not been paid, the underpayment identified does not affect subsidy and has not, therefore, been classified as an error for subsidy purposes.

2. 2016-17 certification fees

The PSAA determine a scale fee each year for the audit of claims and returns. For 2016-17, these scale fees were published by the PSAA in March 2016 and are available on the PSAA's website (www.psaa.co.uk).

Claim or return	2016-17	2016-17	2015-16
	Actual fee £	Indicative fee £	Actual fee £
Housing benefits subsidy claim	8,203.90	9,053	8,330

The proposed final fee includes £961.50 in respect of additional work required to review and capture extended testing undertaken due to errors identified during our testing and the impact thereof on the qualification letter. We carried out two sets of extended testing in 2016-17, compared to one set of extended testing in 2014-15, which is the year from which the indicative fee for 2016-17 was set by PSAA. The proposed additional fee is subject to approval by the PSAA. The final fee is actually lower than the indicative fee for 2016-17 because it also includes a discount of £1,810.60 (20%) on the indicative fee afforded to the Council for performing the initial testing themselves.

3. Looking forward

2017-18

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 2017-18 is £8,330. This was set by PSAA and is based on final 2015-16 certification fees.

Details of individual indicative fees are available at the following web address: https://www.psaa.co.uk/audit-fees/201718-work-programme-and-scales-of-fees/individual-indicative-certification-fees/

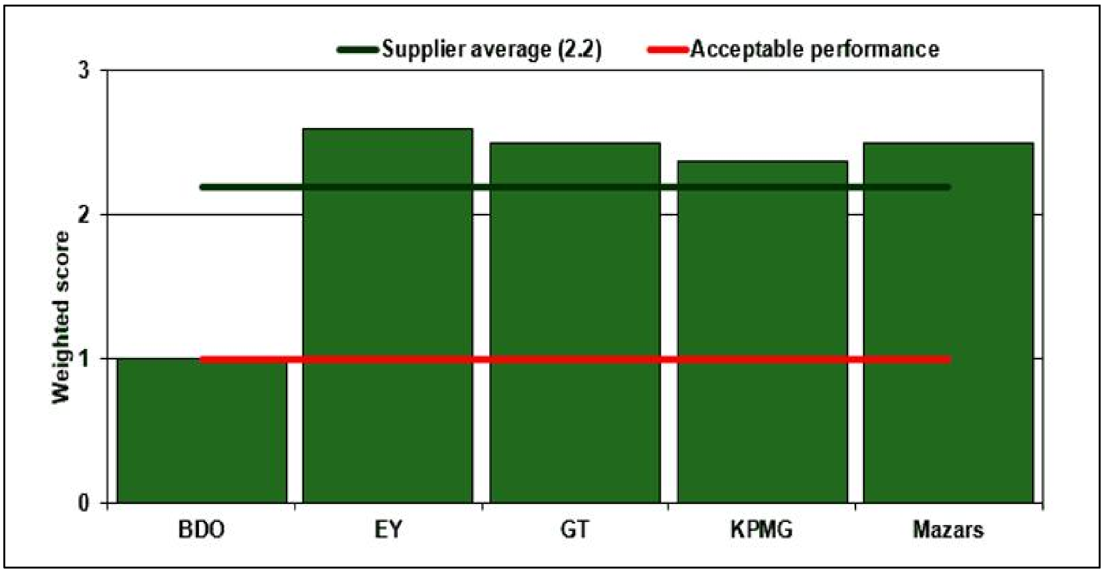
We must seek the agreement of PSAA to any proposed variations to these indicative certification fees. We will inform the Director of Finance and Resources before seeking any such variation.

2018-19

From 2018-19, the Council will be responsible for appointing their own reporting accountant to undertake the certification of the housing benefit subsidy claim in accordance with the Housing Benefit Assurance Process (HBAP) requirements that are being established by the DWP. DWP's HBAP guidance is under consultation and is expected to be published around January 2018.

We would be pleased to undertake this work for you, and can provide a competitive quotation for this work.

We currently provide HB subsidy certification to 106 clients, through our specialist Government & Public Sector team. We provide a quality service, and are proud that in the PSAA's latest Annual Regulatory and Compliance Report (July 2017) we score the highest of all providers, with an average score of 2.6 (out of 3).



As we also expect to be appointed by PSAA in December 2017 as your statutory auditor we can provide a comprehensive assurance service, making efficiencies for you and building on the knowledge and relationship we have established with your Housing Benefits service.

EY | Assurance | Tax | Transactions | Advisory

Ernst & Young LLP

The UK firm Ernst & Young LLP is a limited liability partnership registered in England and Wales with registered number OC300001 and is a member firm of Ernst & Young Global Limited.

Ernst & Young LLP, 1 More London Place, London, SE1 2AF.

ey.com

AGENDA ITEM NO. 8

ARUN DISTRICT COUNCIL

AUDIT AND GOVERNANCE COMMITTEE – 22 FEBRUARY 2018

Recommendation Paper

Subject : Approval of Accounting Policies 2017/18

Report by : Carolin Martlew, Financial Services Manager

Report date : January 2018

EXECUTIVE SUMMARY

The report allows the Audit and Governance Committee to consider and approve the accounting policies that will be applied to the Statement of Accounts 2017/18 for approval by the committee in July 2018.

RECOMMENDATIONS

The Committee is requested to approve the accounting policies that will be applied to the Statement of Accounts 2017/18.

1.0 INTRODUCTION

1.1 It is the responsibility of the charged with governance (the Audit and Governance Committee) to consider and agree the accounting policies to be applied to the Statement of Accounts for the year ended 31 March 2018.

1.2 The Statement of Accounts sets out the Council's income and expenditure for the year, and its financial position at 31st March 2018.

1.3 The Council is required to prepare the Statement of Accounts using proper accounting practices as required by the Local Government Act 2003. These practices are primarily prescribed by the Code of Practice on Local Government

Accounting in the United Kingdom 2017/18, underpinned by International Financial Reporting Standards (IFRS) and the Service Reporting Code of Practice (SeRCOP)

2.0 THE ACCOUNTING POLICIES

2.1 The Accounting policies are the specific principles, bases and conventions, rules and practices applied by the Council in preparing and presenting the financial statements. The accounting policies included in Appendix 1.

2.2 It should be noted that it is recommended practice for Council's to only adopt Accounting Policies that are relevant to their Statement of Accounts. If during the preparation of the Accounts and external audit issues arise that require additions to the adopted policies the committee will be updated of any subsequent changes.

Background Papers: The code of Practice on Local Authority on Local Authority Accounting in the United Kingdom 2017/18 Accounts (CIPFA);
Service Reporting Code of Practice (CIPFA);
Prudential Code (CIPFA);
LAAP Bulletin: Closure of the 2017/18 Accounts and Related Matters (CIPFA);

Contact: Carolin Martlew, Financial Services Manager ext. 37568
carolin.martlew@arun.gov.uk

1. Accounting Policies

i. General Principles

The Statement of Accounts summarises the Council's transactions for the 2017/18 financial year and its position at the year-end of 31 March 2018. The Council is required to prepare an annual Statement of Accounts by the Accounts and Audit Regulations 2015, and those Regulations require the statements to be prepared in accordance with proper accounting practices. These practices primarily comprise the Code of Practice on Local Authority Accounting in the United Kingdom 2017/18 and the Service Reporting Code of Practice 2017/18, supported by International Financial Reporting Standards (IFRS). The accounting convention adopted in the Statement of Accounts is principally historical cost, modified by the revaluation of certain categories of non-current assets and financial instruments.

ii. Accruals of Expenditure and Income

Activity is accounted for in the year that it takes place, not simply when cash payments are made or received. In particular:

- Revenue from the sale of goods is recognised when the Council transfers the significant risks and rewards of ownership to the purchaser and it is probable that economic benefits or service potential associated with the transaction will flow to the Council.

- Revenue from the provision of services is recognised when the Council can measure reliably the percentage of completion of the transaction and it is probable that economic benefits or service potential associated with the transaction will flow to the Council.

- Supplies are recorded as expenditure when they are consumed – where there is a gap between the date supplies are received and their consumption; they are carried as inventories on the Balance Sheet, subject to considerations of materiality.

- Expenses in relation to services received (including services provided by employees) are recorded as expenditure when the services are received rather than when payments are made, subject to considerations of materiality.

- Interest receivable on investments and payable on borrowings is accounted for respectively as income and expenditure on the basis of the effective interest rate for the relevant financial instrument rather than the cash flows fixed or determined by the contract.

- Where revenue and expenditure have been recognised but cash has not been received or paid, a debtor or creditor for the relevant amount is recorded in the Balance Sheet. Where debts may not be settled, the balance of debtors is written down and a charge made to revenue for the income that might not be collected.

iii. Cash and Cash Equivalents

Cash is represented by cash in hand and deposits with financial institutions repayable without penalty on notice of not more than 24 hours. Cash equivalents are highly liquid investments that mature in one month or less from the date of acquisition and that are readily convertible to known amounts of cash with insignificant risk of change in value.

In the Cash Flow Statement, cash and cash equivalents are shown net of bank overdrafts that are repayable on demand and form an integral part of the Council's cash management.

iv. Exceptional Items

When items of income and expense are material, their nature and amount is disclosed separately, either on the face of the Comprehensive Income and Expenditure Statement or in the notes to the accounts, depending on how significant the items are to an understanding of the Council's financial performance.

v. Prior Period Adjustments, Changes in Accounting Policies and Estimates & Errors

Prior period adjustments may arise as a result of a change in accounting policies or to correct a material error. Changes in accounting estimates are accounted for prospectively, i.e. in the current and future years affected by the change and do not give rise to a prior period adjustment.

Changes in accounting policies are only made when required by proper accounting practices or the change provides more reliable or relevant information about the effect of transactions, other events and conditions on the Council’s financial position or financial performance. Where a change is made, it is applied retrospectively (unless stated otherwise) by adjusting opening balances and comparative amounts for the prior period as if the new policy had always been applied.

Material errors discovered in prior period figures are corrected retrospectively by amending opening balances and comparative amounts for the prior period.

vi. Charges to Revenue for Non-Current Assets

Services and support services are debited with the following amounts to record the cost of holding fixed assets during the year:

- depreciation attributable to the assets used by the relevant service

- revaluation and impairment losses on assets used by the service where there are no accumulated gains in the Revaluation Reserve against which the losses can be written off

- amortisation of intangible fixed assets attributable to the service.

The Council is not required to raise council tax to fund depreciation, revaluation and impairment losses or amortisation. However, it is required to make an annual contribution from revenue towards the reduction in its overall borrowing requirement equal to an amount calculated on a prudent basis determined by the Council in accordance with statutory guidance. Depreciation, revaluation and impairment losses and amortisation are therefore replaced by the contribution in the General Fund Balance for MRP, by way of an adjusting transaction with the Capital Adjustment Account in the Movement in Reserves Statement for the difference between the two.

Whilst the Council is no longer debt-free, the debt held relates solely to the HRA self-financing settlement, and under current regulations there is no requirement for MRP. However, the Council has an approved loan repayment provision policy which ensures that there will be sufficient funds available to repay the housing debt when it matures.

vii. Council Tax and Non-Domestic Rates

Billing authorities act as agents, collecting council tax and non-domestic rates (NDR) on behalf of the major preceptors (including Government for NDR) and, as principals, collecting council tax and NDR for themselves. Billing authorities are required by statue to maintain a separate fund (i.e. the Collection Fund) for the collection and distribution of amounts due in respect of council tax and NDR. Under legislative framework for the Collection Fund, billing authorities, major preceptors and central government share proportionally the risks and rewards that the amount of council tax and NDR collected could be less or more than predicted.

Accounting for Council Tax and NDR

The council tax and NDR income included in the Comprehensive Income and Expenditure Statement is the Council's share of accrued income for the year. However, regulations determine the amount of council tax and NDR that must be included in the Council's General Fund. Therefore, the difference between the income included in the Comprehensive Income and Expenditure Statement and the amount required by regulation to be credited to the General Fund is taken to the Collection Fund Adjustment Account and included as a reconciling item in the Movement in Reserves Statement.

The Balance Sheet includes the Council's share of the end of the year balances in respect of council tax and NDR relating to arrears, impairment allowances for doubtful debts, overpayments and prepayments and appeals.

viii. Employee Benefits

Benefits Payable during Employment

Short-term employee benefits are those due to be settled within 12 months of the year-end. They include such benefits as wages and salaries, paid annual leave and paid sick leave, bonuses and non-monetary benefits (e.g. cars) for current employees and are recognised as an expense for services in the year in which employees render service to the Council. An accrual is made for the cost of holiday entitlements (or any form of leave, e.g. time off in lieu) earned by employees but not taken before the year-end which employees can carry forward into the next financial year. The accrual is made at the wage and salary rates applicable in the following accounting year, being the period in which the employee takes the benefit. The accrual is charged to Surplus or Deficit on the Provision of Services, but then reversed out through the Movement in Reserves Statement so that holiday benefits are charged to revenue in the financial year in which the holiday absence occurs.

Termination Benefits

Termination benefits are amounts payable as a result of a decision by the Council to terminate an officer's employment before the normal retirement date or an officer's decision to accept voluntary redundancy in exchange for those benefits and are charged on an accruals basis to the appropriate service segment or, where applicable, to the Non Distributed Costs line in the Comprehensive Income and Expenditure Statement when the Council can no longer withdraw the offer of those benefits or when the Council recognises costs for a restructuring.

Where termination benefits involve the enhancement of pensions, statutory provisions require the General Fund balance to be charged with the amount payable by the Council to the pension fund or pensioner in the year, not the amount calculated according to the relevant accounting standards. In the Movement in Reserves Statement, appropriations are required to and from the Pensions Reserve to remove the notional debits and credits for pension enhancement termination benefits and replace them with debits for the cash paid to the pension fund and pensioners and any such amounts payable but unpaid at the year-end.

Post-employment Benefits

Employees of the Council are members of The Local Government Pensions Scheme, administered by West Sussex County Council. The scheme provides defined benefits to members (retirement lump sums and pensions), earned as employees work for the Council.

The Local Government Pension Scheme

The Local Government Scheme is accounted for as a defined benefits scheme:

- The liabilities of the West Sussex County Council Pension Fund attributable to the Council are included in the Balance Sheet on an actuarial basis using the projected unit method – i.e. an assessment of the future payments that will be made in relation to retirement benefits earned to date by employees, based on assumptions about mortality rates, employee turnover rates, etc, and projections of projected earnings for current employees.

- Liabilities are discounted to their value at current prices using an appropriate discount rate.

- The assets of the West Sussex County Council Pension Fund attributable to the council are included in the Balance Sheet at their fair value:

- quoted securities – current bid price
- unquoted securities – professional estimate
- unitised securities – current bid price
- property – market value.

The change in the net pensions liability is analysed into the following components:

- Service cost comprising:

  - current service cost – the increase in liabilities as a result of years of service earned this year – allocated in the Comprehensive Income and Expenditure Statement to the services for which the employees worked;
  - past service cost – the increase in liabilities as a result of a scheme amendment or curtailment whose effect relates to years of service earned in earlier years – debited to the Surplus or Deficit on the Provision of Services in the Comprehensive Income and Expenditure Statement;
  - net interest on the defined benefit liability (asset), i.e. net interest expense for the Council – the change during the period in the net defined benefit liability (asset) that arises from the passage of time charged to the Financing and Investment Income and Expenditure line of the Comprehensive Income and Expenditure Statement - this is calculated by applying the discount rate used to measure the defined benefit obligation at the beginning of the period to the net defined benefit liability (asset) at the beginning of the period – taking into account any changes in the net defined benefit liability (asset) during the period as a result of contribution and benefit payments.

- Remeasurements comprising:

  - the return on plan assets – excluding amounts included in net interest on the net defined benefit liability (asset) – charged to the Pensions Reserve as Other Comprehensive Income and Expenditure
  - actuarial gains and losses – changes in the net pensions liability that arise because events have not coincided with assumptions made at the last actuarial valuation or because the actuaries have updated their assumptions – charged to the Pensions Reserve as Other Comprehensive Income and Expenditure

- Contributions paid to the West Sussex County Council Pension Fund – cash paid as employer's contributions to the pension fund in settlement of liabilities; not accounted for as an expense.

In relation to retirement benefits, statutory provisions require the General Fund balance to be charged with the amount payable by the Council to the pension fund or directly to pensioners in the year, not the amount calculated according to the relevant accounting standards. In the Movement in Reserves Statement, this means that there are transfers to and from the Pensions Reserve to remove the notional debits and credits for retirement benefits and replace them with debits for the cash paid to the pension fund and pensioners and any such amounts payable but unpaid at the year-end. The negative balance that arises on the Pensions Reserve thereby measures the beneficial impact to the General Fund of being required to account for retirement benefits on the basis of cash flows rather than as benefits are earned by employees.

Discretionary Benefits

The Council also has restricted powers to make discretionary awards of retirement benefits in the event of early retirements. Any liabilities estimated to arise as a result of an award to any member of staff are accrued in the year of the decision to make the award and accounted for using the same policies as are applied to the Local Government Pension Scheme.

ix. Events After the Balance Sheet Date

Events after the Balance Sheet date are those events, both favourable and unfavourable, that occur between the end of the reporting period and the date when the Statement of Accounts is authorised for issue. Two types of events can be identified:

- those that provide evidence of conditions that existed at the end of the reporting period – the Statement of Accounts is adjusted to reflect such events

- those that are indicative of conditions that arose after the reporting period – the Statement of Accounts is not adjusted to reflect such events, but where a category of events would have a material effect, disclosure is made in the notes of the nature of the events and their estimated financial effect.

Events taking place after the date of authorisation for issue are not reflected in the Statement of Accounts.

x. Financial Instruments

Financial Liabilities

Financial liabilities are recognised on the Balance Sheet when the Council becomes a party to the contractual provisions of a financial instrument and are initially measured at fair value and are carried at their amortised cost. Annual charges to the Financing and Investment Income and Expenditure line in the Comprehensive Income and Expenditure Statement for interest payable are based on the carrying amount of the liability, multiplied by the effective rate of interest for the instrument. The effective interest rate is the rate that exactly discounts estimated future cash payments over the life of the instrument to the amount at which it was originally recognised.

For the borrowings that the Council has, this means that the amount presented in the Balance Sheet is the outstanding principal repayable (plus accrued interest); and interest charged to the Comprehensive Income and Expenditure Statement is the amount payable for the year according to the loan agreement.

Trade payables (amounts due to contractors and suppliers) are recognised in the accounts when contractual obligations are incurred in relation to exchange of goods and services, rather than when receipts or payments pass from one party to another. The trade payables are accounted for at amortised cost taken as being equivalent to the carrying amount on initial recognition (i.e. the transaction amount).

The financial guarantees given by the Council are not recognised in the Balance Sheet, but are disclosed in note 38.

Financial Assets

Financial assets are classified into two types:

- loans and receivables – assets that have fixed or determinable payments but are not quoted in an active market

- available-for-sale assets – assets that have a quoted market price and/or do not have fixed or determinable payments.

Loans and Receivables

Loans and receivables are recognised on the Balance Sheet when the Council becomes a party to the contractual provisions of a financial instrument and are initially measured at fair value. They are subsequently measured at their amortised cost. Annual credits to the Financing and Investment Income and Expenditure line in the Comprehensive Income and Expenditure Statement for interest receivable are based on the carrying amount of the asset multiplied by the effective rate of interest for the instrument. For the loans that the Council has made, this means that the amount presented in the Balance Sheet is the outstanding principal receivable (plus accrued interest) and interest credited to the Comprehensive Income and Expenditure Statement is the amount receivable for the year in the loan agreement.

Available-for-sale Assets

Available-for-sale assets are recognised on the Balance Sheet when the Council becomes a party to the contractual provisions of a financial instrument and are initially measured and carried at fair value (see xxi). Where the asset has fixed or determinable payments, annual credits to the Financing and Investment Income and Expenditure line in the Comprehensive Income and Expenditure Statement for interest receivable are based on the amortised cost of the asset multiplied by the effective rate of interest for the instrument. Where there are no fixed or determinable payments, income (e.g. dividends) is credited to the Comprehensive Income and Expenditure Statement when it becomes receivable by the Council.

Assets are maintained in the Balance Sheet at fair value. Values are based on the following techniques:

- instruments with quoted market prices – the market price
- other instruments with fixed and determinable payments – discounted cash flow analysis
- equity shares with no quoted market prices – multiple valuation techniques (which include market approach, income approach and cost approach).

Changes in fair value are balanced by an entry in the Available-for-Sale Reserve and the gain/loss is recognised in the Surplus or Deficit on Revaluation of Available-for-Sale Financial Assets. The exception is where impairment losses have been incurred – these are debited to the Financing and Investment Income and Expenditure line in the Comprehensive Income and Expenditure Statement, along with any net gain or loss for the asset accumulated in the Available-for-Sale Reserve.

Where assets are identified as impaired because of a likelihood arising from a past event that payments due under the contract will not be made (fixed or determinable payments) or fair value falls below cost, the asset is written down and a charge made to the Financing and Investment Income and Expenditure line in the Comprehensive Income and Expenditure Statement. If the asset has fixed or determinable payments, the impairment loss is measured as the difference between the carrying amount and the present value of the revised future cash flows discounted at the asset's original effective interest rate. Otherwise, the impairment loss is measured as any shortfall of fair value against the acquisition cost of the instrument (net of any principal repayment and amortisation).

Any gains and losses that arise on the de-recognition of the asset are credited or debited to the Financing and Investment Income and Expenditure line in the Comprehensive Income and Expenditure Statement, along with any accumulated gains or losses previously recognised in the Available-for-Sale Reserve.

Where fair value cannot be measured reliably, the instrument is carried at cost (less any impairment losses).

xi. Government Grants and Contributions

Whether paid on account, by instalments or in arrears, government grants and third party contributions and donations are recognised as due to the Council when there is reasonable assurance that:

- the Council will comply with the conditions attached to the payments, and
- the grants or contributions will be received

Amounts recognised as due to the Council are not credited to the Comprehensive Income and Expenditure Statement until conditions attached to the grant or contribution have been satisfied. Conditions are stipulations that specify that the future economic benefits or service potential embodied in the asset in the form of the grant or contribution are required to be consumed by the recipient as specified, or future economic benefits or service potential must be returned to the transferor.

Monies advanced as grants and contributions for which conditions have not been satisfied are carried in the Balance Sheet as creditors. When conditions are satisfied, the grant or contribution is credited to the relevant service line (attributable revenue grants and contributions) or Taxation and Non-Specific Grant Income (non-ringfenced revenue grants and all capital grants) in the Comprehensive Income and Expenditure Statement.

Where capital grants are credited to the Comprehensive Income and Expenditure Statement, they are reversed out of the General Fund Balance in the Movement in Reserves Statement. Where the grant has yet to be used to finance capital expenditure, it is posted to the Capital Grants Unapplied reserve. Where it has been applied, it is posted to the Capital Adjustment Account. Amounts in the Capital Grants Unapplied reserve are transferred to the Capital Adjustment Account once they have been applied to fund capital expenditure.

xii. Intangible Assets

Expenditure on non-monetary assets that do not have physical substance but are controlled by the Council as a result of past events (e.g. software licences) is capitalised when it is expected that future economic benefits or service potential will flow from the intangible asset to the Council.

Intangible assets are measured initially at cost. Amounts are only revalued where the fair value of the assets held by the Council can be determined by reference to an active market. In practice, no intangible asset held by the Council meets this criterion, and they are therefore carried at amortised cost. The depreciable amount of an intangible asset is amortised over its useful life to the relevant service line(s) in the Comprehensive Income and Expenditure Statement.

An asset is tested for impairment whenever there is an indication that the asset might be impaired – any losses recognised are posted to the relevant service line(s) in the Comprehensive Income and Expenditure Statement. Any gain or loss arising on the disposal or abandonment of an intangible asset is posted to the Other Operating Expenditure line in the Comprehensive Income and Expenditure Statement.

Where expenditure on intangible assets qualifies as capital expenditure for statutory purposes, amortisation, impairment losses and disposal gains and losses are not permitted to have an impact on the General Fund Balance. The gains and losses are therefore reversed out of the General Fund Balance in the Movement in Reserves Statement and posted to the Capital Adjustment Account and (for any sale proceeds greater than £10k) the Capital Receipts Reserve.

xiii. Investment Property

Investment properties are those that are used solely to earn rentals and/or for capital appreciation. The definition is not met if the property is used in any way to facilitate the delivery of services or production of goods or is held for sale.

Investment properties are measured initially at cost and subsequently at fair value (see xxi). Properties are not depreciated but are revalued annually by a professionally qualified valuer according to market conditions at the year-end. Gains and losses on revaluation are posted to the Financing and Investment Income and Expenditure line in the Comprehensive Income and Expenditure Statement. The same treatment is applied to gains and losses on disposal

Rentals received in relation to investment properties are credited to the Financing and Investment Income line and result in a gain for the General Fund Balance. However, revaluation and disposal gains and losses are not permitted by statutory arrangements to have an impact on the General Fund Balance. The gains and losses are therefore reversed out of the General Fund Balance in the Movement in Reserves Statement and posted to the Capital Adjustment Account and (for any sale proceeds greater than £10k) the Capital Receipts Reserve.

xiv. Leases

Leases are classified as finance leases where the terms of the lease transfer substantially all the risks and rewards incidental to ownership of the property, plant or equipment from the lessor to the lessee. All other leases are classified as operating leases.

Where a lease covers both land and buildings, the land and buildings elements are considered separately for classification.

Arrangements that do not have the legal status of a lease but convey a right to use an asset in return for payment are accounted for under this policy where fulfilment of the arrangement is dependent on the use of specific assets.

The Authority as Lessee

Finance Leases
Property, plant and equipment held under finance leases is recognised on the Balance Sheet at the commencement of the lease at its fair value measured at the lease's inception (or the present value of the minimum lease payments, if lower). The asset recognised is matched by a liability for the obligation to pay the lessor. Initial direct costs of the Council are added to the carrying amount of the asset. Premiums paid on entry into a lease are applied to writing down the lease liability. Contingent rents are charged as expenses in the periods in which they are incurred.

Lease payments are apportioned between:

- a charge for the acquisition of the interest in the property, plant, or equipment – applied to write down the lease liability, and

- a finance charge (debited to the Financing and Investment Income and Expenditure line in the Comprehensive Income and Expenditure Statement).

Property, plant and equipment recognised under finance leases is accounted for using the policies applied generally to such assets, subject to depreciation being charged over the lease term if this is shorter than the asset's estimated useful life (where ownership of the asset does not transfer to the authority at the end of the lease period).

The Council is not required to raise council tax to cover depreciation or revaluation and impairment losses arising on leased assets. Instead, a prudent annual contribution is made from revenue funds towards deemed capital investment in accordance with statutory requirements. Depreciation and revaluation and impairment losses are therefore substituted by a revenue contribution in the General Fund Balance, by way of an adjusting transaction with the Capital Adjustment Account in the Movement in Reserves Statement for the difference between the two.

Operating Leases
Rentals paid under operating leases are charged to the Comprehensive Income and Expenditure Statement as an expense of the services benefitting from use of the leased property, plant or equipment. Charges are made on a straight-line basis over the life of the lease, which matches the pattern of payments in all cases.

The Authority as Lessor

Finance Leases
The Council has no leases currently determined as finance leases.

Operating Leases
Where the Council grants an operating lease over a property, the asset is retained in the Balance Sheet. Rental income is credited to Other Operating Expenditure in the Comprehensive Income and Expenditure Statement. Credits are made on a straight-line basis over the life of the lease, which matches the pattern of receipts in all cases.

xv. Support Services

Support Services are identified as a separate heading in the Comprehensive Income and Expenditure Statement except for the proportion allocated to the Housing Revenue Account in line with the Council's local reporting format.

xvi. Property, Plant and Equipment

Assets that have physical substance and are held for use in the production or supply of goods or services, for rental to others, or for administrative purposes and that are expected to be used during more than one financial year are classified as Property, Plant and Equipment.

Recognition

Expenditure on the acquisition, creation or enhancement of Property, Plant and Equipment is capitalised on an accruals basis, provided that it is probable that the future economic benefits or service potential associated with the item will flow to the Council and the cost of the item can be measured reliably. Expenditure that maintains but does not add to an asset’s potential to deliver future economic benefits or service potential (i.e. repairs and maintenance) is charged as an expense when it is incurred. Expenditure on individual items of less than £25k is regarded as de minimis, and charged to revenue.

Measurement

Assets are initially measured at cost, comprising:

- the purchase price
- any costs attributable to bringing the asset to the location and condition necessary for it to be capable of operating in the manner intended by management.

The Council does not capitalise borrowing costs incurred whilst assets are under construction.

The cost of assets acquired other than by purchase is deemed to be their fair value, unless the acquisition does not have commercial substance (i.e. it will not lead to a variation in the cash flows of the Council). In the latter case, where an asset is acquired via an exchange, the cost of the acquisition is the carrying amount of the asset given up by the Council.

Donated assets are measured initially at fair value. The difference between fair value and any consideration paid is credited to the Taxation and Non-Specific Grant Income line of the Comprehensive Income and Expenditure Statement, unless the donation has been made conditionally. Until conditions are satisfied, the gain is held in the Donated Assets Account. Where gains are credited to the Comprehensive Income and Expenditure Statement, they are reversed out of the General Fund Balance to the Capital Adjustment Account in the Movement in Reserves Statement.

Assets are then carried in the Balance Sheet using the following measurement bases:

- infrastructure, community assets and assets under construction – depreciated historical cost
- dwellings – current value, determined using the basis of existing use value for social housing (EUV-SH)
- surplus assets – the current value measurement base is fair value, the price that would be received to sell an asset in an orderly transaction between market participants at the measurement date
- all other assets – current value, determined as the amount that would be paid for the asset in its existing use (existing use value – EUV).

Where there is no market-based evidence of current value because of the specialist nature of an asset, depreciated replacement cost (DRC) is used as an estimate of current value.

Where non-property assets that have short useful lives or low values (or both), depreciated historical cost basis is used as a proxy for current value.

Assets included in the Balance Sheet at current value are revalued sufficiently regularly to ensure that their carrying amount is not materially different from their current value at the year-end, but as a minimum every five years.

Increases in valuations are matched by credits to the Revaluation Reserve to recognise unrealised gains. [Exceptionally, gains might be credited to the Comprehensive Income and Expenditure Statement where they arise from the reversal of a loss previously charged to a service.]

Where decreases in value are identified, they are accounted for by:

- where there is a balance of revaluation gains for the asset in the Revaluation Reserve, the carrying amount of the asset is written down against that balance (up to the amount of the accumulated gains)

- where there is no balance in the Revaluation Reserve or an insufficient balance, the carrying amount of the asset is written down against the relevant service line(s) in the Comprehensive Income and Expenditure Statement.

The Revaluation Reserve contains revaluation gains recognised since 1 April 2007 only, the date of its formal implementation. Gains arising before that date have been consolidated into the Capital Adjustment Account.

Impairment

Assets are assessed at each year-end as to whether there is any indication that an asset may be impaired. Where indications exist and any possible differences are estimated to be material, the recoverable amount of the asset is estimated and, where this is less than the carrying amount of the asset, an impairment loss is recognised for the shortfall.

Where impairment losses are identified, they are accounted for by:

- where there is a balance of revaluation gains for the asset in the Revaluation Reserve, the carrying amount of the asset is written down against that balance (up to the amount of the accumulated gains)

- where there is no balance in the Revaluation Reserve or an insufficient balance, the carrying amount of the asset is written down against the relevant service line(s) in the Comprehensive Income and Expenditure Statement.

Where an impairment loss is reversed subsequently, the reversal is credited to the relevant service line(s) in the Comprehensive Income and Expenditure Statement, up to the amount of the original loss, adjusted for depreciation that would have been charged if the loss had not been recognised.

Depreciation

Depreciation is provided for on all Property, Plant and Equipment assets by the systematic allocation of their depreciable amounts over their useful lives. An exception is made for assets without a determinable finite useful life (i.e. freehold land and certain Community Assets) and assets that are not yet available for use (i.e. assets under construction).

Depreciation is calculated on the following basis:

- buildings (other than HRA dwellings) – straight-line allocation over the useful life of the property as estimated by the valuer
- vehicles, plant and equipment – generally straight-line allocation over 5 - 20 years
- infrastructure – straight-line allocation over 20 - 40 years
- HRA dwellings – a depreciation procedure will be formulated in consultation with the Council's valuer and presented to the Asset Management Group for approval.

Where appropriate the individual components of an asset will be depreciated separately. The materiality thresholds for applying componentisation are as follows:

- Assets other than HRA dwellings:
  Componentisation will only apply to an asset whose depreciable capital value is greater than or equal to £500k.
- HRA dwellings:
  Componentisation will be covered as part of the HRA dwellings depreciation procedure.

Revaluation gains are also depreciated, with an amount equal to the difference between current value depreciation charged on assets and the depreciation that would have been chargeable based on their historical cost being transferred each year from the Revaluation Reserve to the Capital Adjustment Account.

Disposals and Non-current Assets Held for Sale

When it becomes probable that the carrying amount of an asset will be recovered principally through a sale transaction rather than through its continuing use, it is reclassified as an Asset Held for Sale. The asset is revalued immediately before reclassification and then carried at the lower of this amount and fair value less costs to sell. Where there is a subsequent decrease to fair value less costs to sell, the loss is posted to the Other Operating Expenditure line in the Comprehensive Income and Expenditure Statement. Gains in fair value are recognised only up to the amount of any previous losses recognised in the Surplus or Deficit on Provision of Services. Depreciation is not charged on Assets Held for Sale.

If assets no longer meet the criteria to be classified as Assets Held for Sale, they are reclassified back to non-current assets and valued at the lower of their carrying amount before they were classified as held for sale, adjusted for depreciation, amortisation or revaluations that would have been recognised had they not been classified as Held for Sale, and their recoverable amount at the date of the decision not to sell.

Assets that are to be abandoned or scrapped are not reclassified as Assets Held for Sale.

When an asset is disposed of or decommissioned, the carrying amount of the asset in the Balance Sheet (whether Property, Plant and Equipment or Assets Held for Sale) is written off to the Other Operating Expenditure line in the Comprehensive Income and Expenditure Statement as part of the gain or loss on disposal. Receipts from disposals (if any) are credited to the same line in the Comprehensive Income and Expenditure Statement also as part of the gain or loss on disposal (i.e. netted off against the carrying value of the asset at the time of disposal). Any revaluation gains accumulated for the asset in the Revaluation Reserve are transferred to the Capital Adjustment Account.

Amounts received for a disposal in excess of £10k are categorised as capital receipts. A proportion of receipts relating to housing disposals are payable to the Government in accordance with statutory requirements. The balance of receipts is required to be credited to the Capital Receipts Reserve, and can then only be used for new capital investment or set aside to reduce the Council’s underlying need to borrow (the Capital Financing Requirement). A further constraint applies to the use of the additional receipts resulting from the Government's policies for reinvigorating the Right to Buy. In accordance with the terms of an agreement between the Council and the Government these receipts can only be used to fund 30% of the cost of new social housing, the remaining 70% being met from other resources. Failure to meet these conditions will result in the receipts being paid to the Government. Receipts are appropriated to the Reserve from the General Fund Balance in the Movement in Reserves Statement.

Disposals and Non-current Assets Held for Sale

The written-off value of disposals is not a charge against council tax, as the cost of non-current assets is fully provided for under separate arrangements for capital financing. Amounts are appropriated to the Capital Adjustment Account from the General Fund Balance in the Movement in Reserves Statement.

xvii. Provisions, Contingent Liabilities and Contingent Assets

Provisions

Provisions are made where an event has taken place that gives the Council a legal or constructive obligation that probably requires settlement by a transfer of economic benefits or service potential, and a reliable estimate can be made of the amount of the obligation. For instance, the Council may be involved in a court case that could eventually result in the making of a settlement or the payment of compensation.

Provisions are charged as an expense to the appropriate service line in the Comprehensive Income and Expenditure Statement when the Council has an obligation, and are measured at the best estimate at the balance sheet date of the expenditure required to settle the obligation, taking into account relevant risks and uncertainties.

When payments are eventually made, they are charged to the provision carried in the Balance Sheet. Estimated settlements are reviewed at the end of each financial year – where it becomes less than probable that a transfer of economic benefits will now be required (or a lower settlement than anticipated is made), the provision is reversed and credited back to the relevant service.

Where some or all of the payment required to settle a provision is expected to be recovered from another party (e.g. from insurance claim), this is only recognised as income for the relevant service area if it virtually certain that reimbursement will be received if the Council settles the obligation.

Contingent Liabilities

A contingent liability arises where an event has taken place that gives the Council a possible obligation whose existence will only be confirmed by the occurrence or otherwise of uncertain future events not wholly within the control of the Council. Contingent liabilities also arise in circumstances where a provision would otherwise be made but either it is not probable that an outflow of resources will be required or the amount of the obligation cannot be measured reliably.

Contingent liabilities are not recognised in the Balance Sheet but disclosed in a note to the accounts.

Contingent Assets

A contingent asset arises where an event has taken place that gives the Council a possible asset whose existence will only be confirmed by the occurrence or otherwise of uncertain future events not wholly within the control of the Council.

Contingent assets are not recognised in the Balance Sheet but disclosed in a note to the accounts where it is probable that there will be an inflow of economic benefits or service potential.

xviii. Reserves

The Council sets aside specific amounts as reserves for future policy purposes or to cover contingencies. Reserves are created by transferring amounts out of the General Fund Balance. When expenditure to be financed from a reserve is incurred, it is charged to the appropriate service in that year to score against the Surplus or Deficit on the Provision of Services in the Comprehensive Income and Expenditure

Statement. The reserve is then transferred back into the General Fund Balance so that there is no net charge against council tax for the expenditure.

Certain reserves are kept to manage the accounting processes for non-current assets, financial instruments, local taxation, retirement and employee benefits and do not represent usable resources for the Council – these reserves are explained in the relevant policies.

xix. Revenue Expenditure Funded from Capital under Statute

Expenditure incurred during the year that may be capitalised under statutory provisions but that does not result in the creation of a non-current asset has been charged as expenditure to the relevant service in the Comprehensive Income and Expenditure Statement in the year. Where the Council has determined to meet the cost of this expenditure from existing capital resources or by borrowing, a transfer in the Movement in Reserves Statement from the General Fund Balance to the Capital Adjustment Account then reverses out the amounts charged so that there is no impact on the level of council tax.

xx. Value Added Tax (VAT)

VAT payable is included as an expense only to the extent that it is not recoverable from Her Majesty's Revenue and Customs. VAT receivable is excluded from income.

xxi. Fair Value

The Council measures some of its non-financial assets such as Surplus Assets and Investment Properties and some of its Financial Instruments such as Property Funds and Public Works Loan Board (PWLB) loans at fair value at each reporting date. Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. The fair value measurement assumes that the transaction to sell the asset or transfer the liability takes place either:

a) in the principal market for the asset or liability, or

b) in the absence of a principal market, in the most advantageous market for the asset or liability

The Council's external valuers measure the fair value of an asset or liability using the assumptions that market participants would use when pricing the asset or liability, assuming the market participates act in their economic best interest. When measuring the fair value of a non-financial asset, a market participant's ability to generate economic benefits by using the asset in its highest and best use or by selling it to another market participant that would use the asset in its highest and best use is taken into account.

Valuation techniques are used that are appropriate in the circumstances and for which sufficient data is available, where possible maximising the use of relevant observable inputs and minimising the use of unobservable inputs. These inputs are categorised within the fair value hierarchy as follows:

- Level 1 – quoted prices (unadjusted) in active markets for identical assets or liabilities that the Council can access at the measurement date

- Level 2 – inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly or indirectly

- Level 3 – unobservable inputs for the asset or liability.

AGENDA ITEM NO. 9

ARUN DISTRICT COUNCIL

REPORT TO AUDIT AND GOVERNANCE COMMITTEE ON 22 February 2018

PART A: REPORT

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

REPORT AUTHOR: Sian Southerton – Senior Accountant (Treasury)
DATE: January 2018 **EXTN:** 37861

EXECUTIVE SUMMARY:

The purpose of this report is to present the Treasury Management Strategy Statement and Annual Investment Strategy 2018/2019 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 2018/19;
(ii) approve the Annual Investment Strategy for 2018/19; and
(iii) approve the Prudential Indicators for 2018/19, 2019/2020 and 2020/21 as contained in appendix 1 and the body of the report.

BACKGROUND:

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 borrowing, 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 currently 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 receive a mid-year report at its November 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 which the Audit and Governance Committee will receive at its July meetings prior to approval by Full Council.

1.2.4 **Capital Strategy**

In December 2017, CIPFA issued revised Prudential and Treasury Management Codes. As from 2019-20, all local authorities will be required to prepare an additional report, a Capital Strategy report, which is intended to provide the following: -

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

The aim of this report is to ensure that all elected members on the full council fully understand the overall strategy, governance procedures and risk appetite entailed by this Strategy.

The Capital Strategy will include capital expenditure, investments and liabilities and treasury management in sufficient detail to allow all members to understand how stewardship, value for money, prudence, sustainability and affordability will be secured. The decision not to complete this for the 2018/19 strategy is due to the timescale given, but it will be addressed in the 2019/20 strategy.

1.3 Treasury Management Strategy for 2018/19

The strategy for 2018/19 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). All members were invited to attended a workshop presented by Link Asset Services (Treasury advisors) explaining the roles and responsibilities of elected members and giving them an economic update. The latest session was held on 7th December 2017.

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 Link 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 2018/19 to 2020/21 (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 21st February 2018.

Currently Arun's only borrowing relates to the HRA self-financing settlement. However, the Council now has a significant capital programme including HRA acquisition/new build, the new Littlehampton Leisure Centre and the purchase of temporary accommodation units. Much of this programme will be funded from capital receipts and revenue resources but it is likely that additional borrowing will be required at some point in the near future, however the source has not yet been identified. 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.

		Current			

Capital Expenditure	Actual 2016/17 £,000	Estimate 2017/18 £,000	Estimate 2018/19 £,000	Estimate 2019/20 £,000	Estimate 2020/21 £,000
Non HRA	2,624	10,057	2,310	2,719	2,823
HRA	4,221	6,548	8,047	7,869	7,942
HRA settlement	-	-	-	-	-
Total	**6,845**	**16,605**	**10,0357**	**10,587**	**10,766**
Financed by:					
Capital receipts (1-4-1)	1,359	6,802	1,500	1,500	1,500
Capital grants	599	777	1,000	1,000	1,000
Capital reserves	2,555	2,696	3,017	2,839	2,912
Revenue	42	15	1,340	1,749	1,853
	4,555	**10,290**	**6,857**	**7,087**	**7,266**
Net financing need for the year	**2,290**	**6,315**	**3,500**	**3,500**	**3,500**

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, and so charges the economic consumption of capital assets as they are used.

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. In 2016/17 a new Grounds Maintenance Contract and Combined Cleansing Contract was entered into. Under IFRIC 4, it has been deemed that both contracts contain finance leases.

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

CFR at 31 March	Actual	Current Estimate	Estimate	Estimate	Estimate

	2016/17 £,000	2017/18 £,000	2018/19 £,000	2019/20 £,000	2020/21 £,000
Capital Financing Requirement					
General Fund	-3,769	-3,982	-4,198	-4,394	-4,475
HRA	56,604	56,547	56,387	56,110	55,716
Total CFR	**52,835**	**52,565**	**52,189**	**51,716**	**51,241**
Movement in CFR	**(1,253)**	**(270)**	**(376)**	**(473)**	**(475)**

Movement in CFR represented by					
New leasing arrangements (GF)	1,251	0	0	0	0
HRA unfinanced	1,082	3,487	3,500	3,500	3,500
Less MRP/VRP	(3,586)	(3,757)	(3,876)	(3,973)	(3,975)
Movement in CFR	**(1,253)**	**(270)**	**(376)**	**(473)**	**(475)**

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 2018/19 HRA budget. If borrowing is taken out for general fund in 2018/19, 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	2016/17 Actual £m	2017/18 Estimate £m	2018/19 Estimate £m	2019/20 Estimate £m	2020/21 Estimate £m
Fund balances	17.6	15.3	14.0	12.10	11.10
Earmarked Reserves	13.9	11.4	10.1	6.9	3.9
Capital Receipts	13.2	8.8	2.6	2.2	2.0
Other	2.0	2.0	2.0	2.0	2.0
Total core funds	**46.7**	**37.5**	**28.7**	**23.2**	**19.0**
Under/over borrowing	13.94	14.50	13.30	9.80	11.0
Expected investments	**60.64**	**52.00**	**42.00**	**33.00**	**30.00**

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 2016/17 %	Current Estimate 2017/18 %	Estimate 2018/19 %	Estimate 2019/20 %	Estimate 2020/21 %
Non-HRA	-2.51	-1.91	-1.79	-1.79	-1.79
HRA	32.63	32.79	33.17	33.29	32.29

3 Borrowing

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 2017 and 31 December 2017 summarised below;

	2016/17 Actual £'000	2017/18 Actual at 31/12/17 £'000
Total Investments	60,641	69,509
Total Debt	53,180	53,180

The investments held at 31st December 2017 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 2018/19 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 now £53.18m). 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 Group Head of Corporate Support 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. In most cases, this would be a similar figure to the CFR, but may be lower or higher depending on the levels of actual debt and the ability to fund under-borrowing by other cash resources.

The Council is requested to approve an operational boundary of £60M in Appendix 1 (2018/19).

3.2.2 The Authorised Limit for external debt.

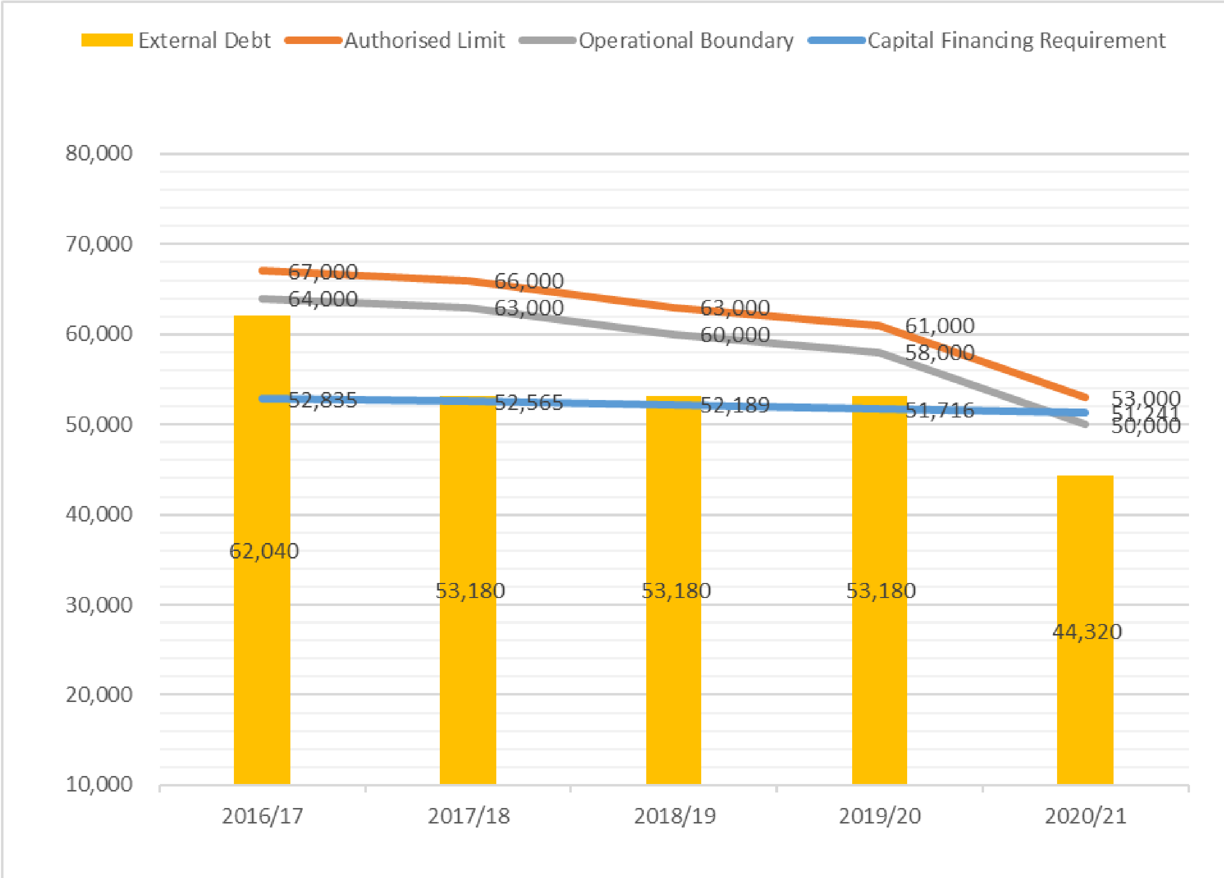
A further key prudential indicator represents a control on the maximum level of borrowing. This represents a limit beyond which external debt is prohibited, and this limit needs to be set or revised by the full Council. It reflects the level of external debt which, while not desired, could be afforded 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 £63M (appendix 1 2018/19).

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.



The bars in the chart above show the actual external debt (£62M – 44M) and does not include and potential future borrowing.

3.3 Prospects for Interest Rates

3.3.1 The Council has appointed Link 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 Link Asset Services central view.

	Dec-17	Mar-18	Jun-18	Sep-18	Dec-18	Mar-19	Jun-19	Sep-19	Dec-19	Mar-20	Jun-20	Sep-20	Dec-20	Mar-21
Bank Rate	0.50%	0.50%	0.50%	0.50%	0.75%	0.75%	0.75%	0.75%	1.00%	1.00%	1.00%	1.25%	1.25%	1.25%
5yr PWLB Rate	1.50%	1.60%	1.60%	1.70%	1.80%	1.80%	1.90%	1.90%	2.00%	2.10%	2.10%	2.20%	2.30%	2.30%
10yr PWLB View	2.10%	2.20%	2.30%	2.40%	2.40%	2.50%	2.60%	2.60%	2.70%	2.70%	2.80%	2.90%	2.90%	3.00%
25yr PWLB View	2.80%	2.90%	3.00%	3.00%	3.10%	3.10%	3.20%	3.20%	3.30%	3.40%	3.50%	3.50%	3.60%	3.60%
50yr PWLB Rate	2.50%	2.60%	2.70%	2.80%	2.90%	2.90%	3.00%	3.00%	3.10%	3.20%	3.30%	3.30%	3.40%	3.40%

3.3.2 As expected, the Monetary Policy Committee (MPC) delivered a 0.25% increase in Bank Rate at its meeting on 2 November. This removed the emergency cut in August 2016 after the EU referendum. The MPC also gave forward guidance that they expected to increase Bank rate only twice more by 0.25% by 2020 to end at 1.00%. The Link Asset Services forecast as above includes increases in Bank Rate of 0.25% in November 2018, November 2019 and August 2020.

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 more protracted move from bonds to equities after a historic long-term trend, over about the last 25 years, of falling bond yields. The action of central banks since the financial crash of 2008, in implementing substantial Quantitative Easing, added further impetus to this downward trend in bond yields and rising bond prices. Quantitative Easing has also directly led to a rise in equity values as investors searched for higher returns and took on riskier assets. The sharp rise in bond yields since the US Presidential election in November 2016 has called into question whether the previous trend may go into reverse, especially now the Fed. has taken the lead in reversing monetary policy by starting, in October 2017, a policy of not fully reinvesting proceeds from bonds that it holds when they mature.

Until 2015, monetary policy was focused on providing stimulus to economic growth but has since started to refocus on countering the threat of rising inflationary pressures as stronger economic growth becomes more firmly established. The Fed. has started raising interest rates and this trend is expected to continue during 2018 and 2019. These increases will make holding US bonds much less attractive and cause their prices to fall, and therefore bond yields to rise. Rising bond yields in the US are likely to exert some upward pressure on bond yields in the UK and other developed economies. However, the degree of that upward pressure is likely to be dampened by how strong or weak the prospects for economic growth and rising inflation are in each country, and on the degree of progress towards the reversal of monetary policy away from quantitative easing and other credit stimulus measures.

From time to time, gilt yields – and therefore PWLB rates - can be subject to exceptional levels of volatility due to geo-political, sovereign debt crisis and emerging market developments. Such volatility could occur at any time during the forecast period.

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 balance of risks to economic recovery in the UK is probably to the downside, particularly with the current level of uncertainty over the final terms of Brexit.

Downside risks to current forecasts for UK gilt yields and PWLB rates currently include:

- The Bank of England takes action too quickly over the next three years to raise Bank Rate and causes UK economic growth, and increases in inflation, to be weaker than we currently anticipate.

- Geopolitical risks, especially North Korea, but also in Europe and the Middle East, which could lead to increasing safe haven flows.
- A resurgence of the Eurozone sovereign debt crisis, possibly Italy, due to its high level of government debt, low rate of economic growth and vulnerable banking system.
- Weak capitalisation of some European banks.
- Germany is still without an effective government after the inconclusive result of the general election in October. In addition, Italy is to hold a general election on 4 March and the anti EU populist Five Star party is currently in the lead in the polls, although it is unlikely to get a working majority on its own. Both situations could pose major challenges to the overall leadership and direction of the EU as a whole and of the individual respective countries. Hungary will hold a general election in April 2018.
- The result of the October 2017 Austrian general election has now resulted in a strongly anti-immigrant coalition government. In addition, the Czech ANO party became the largest party in the October 2017 general election on a platform of being strongly against EU migrant quotas and refugee policies. Both developments could provide major impetus to other, particularly former Communist bloc countries, to coalesce to create a major block to progress on EU integration and centralisation of EU policy. This, in turn, could spill over into impacting the Euro, EU financial policy and financial markets.
- Rising protectionism under President Trump
- A sharp Chinese downturn and its impact on emerging market countries

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

- The Bank of England is too slow in its pace and strength of increases in Bank Rate and, therefore, allows inflation pressures to build up too strongly within the UK economy, which then necessitates a later rapid series of increases in Bank Rate faster than we currently expect.
- UK inflation returning to sustained significantly higher levels causing an increase in the inflation premium inherent to gilt yields.
- The Fed causing a sudden shock in financial markets through misjudging the pace and strength of increases in its Fed. Funds Rate and in the pace and strength of reversal of Quantitative Easing, which then leads to a fundamental reassessment by investors of the relative risks of holding bonds, as opposed to equities. This could lead to a major flight from bonds to equities and a sharp increase in bond yields in the US, which could then spill over into impacting bond yields around the world.

Investment and borrowing rates

- Investment returns are likely to remain low during 2018/19 but to be on a gently rising trend over the next few years.

- Borrowing interest rates increased sharply after the result of the general election in June and then also after the September MPC meeting when financial markets reacted by accelerating their expectations for the timing of Bank Rate increases. Since then, borrowing rates have eased back again somewhat. Apart from that, there has been little general trend in rates during the current financial year. 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 the future when authorities may not be able to avoid new borrowing to finance capital expenditure and/or the refinancing of 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 As stated in 2.1, The Council has a significant capital programme including HRA acquisition/new build, the new Littlehampton Leisure Centre and the purchase of temporary accommodation units.

The level of expenditure and reduction in rental income within the HRA will almost certainly require additional borrowing. 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.

The source of any of this potential borrowing has not been identified at the time of writing. 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 £1,000,000 overdraft facility for this purpose, plus access to the money markets should it be needed.

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

3.4.2 **Treasury Management indicators for debt**

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	2018/19	2019/20	2020/21
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 2018/19			
	Actual at 31/03/18	Lower	Upper
Under 12 months	0%	0%	40%
12 months and within 24 months	16.66%	0%	40%
24 months and within 5 years	16.66%	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.

3.7 Municipal Bond Agency

It is possible that the Municipal Bond Agency will be offering loans to local authorities in the future. The Agency hopes that the borrowing rates will be lower than those offered by the Public Works Loan Board (PWLB). This Authority may make use of this new source of borrowing as and when appropriate.

4 Annual Investment Strategy

4.1 Investment Policy

The Council's investment policy has regard to the CLG's Guidance on Local Government Investments ("the Guidance") and the CIPFA Treasury Management in the Public Services Code of Practice and Cross Sectoral Guidance Notes 2017 ("the CIPFA TM Code"). The Council's investment priorities will be security first, portfolio 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 Non Treasury Investments

Although not classed as treasury management activities, the Council may also purchase property for investment purposes and may also make loans and investments for service purposes.

These will be subject to to the Council's normal approval processes for revenue and capital expenditure and need not comply with this treasury management strategy.

4.3 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 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 Link 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 Link 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. Lloyds being the incumbent bank, has no limit however the Council will only invest £11M in term deposits with them.

4.4 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 all 3 rating agencies. 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).

4.5 Fair value risk management (new for 18/19 under IFRS9)

The Council is able to invest in variable Net Asset Value Instruments, or instruments that are revalued to Fair Value each accounting period, subject to the risk management provision below:

Investment	**Risk**	**Mitigating actions and risk management**
Money Market Funds	These funds are likely to be Low Volatility Net Asset value funds (LNAV)	Exposure is limited to £4m per fund
External Pooled funds, including the Local Authority Property Fund (CCLA)	The Council may incur a loss in the General fund if the Fair Value of these investments fall.	The Council's investment in external pooled funds. Each type has a set duration and value limit as in appendix 7

4.6 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 £5M 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 £67M (as at 31 December 2017). These funds are partially cash-flow derived and there is a core balance of approximately £53M 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 to 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 £14.8M, £13.2M, £10.2M and £8.5M at 31 March 2017 respectively.

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

	Amount £	Start Date	Maturity Date	Rate %
Close Brothers	1,000,000	26/01/16	10/04/19	1.00
Royal Bank of Scotland (RBS)	2,000,000	19/08/16	19/08/19	0.80/0.95/ 1.10
CCLA Property Fund	5,000,000			Between 4% & 5%
	8,000,000			

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

Investment returns expectations. . Bank Rate is forecast to stay flat at 0.50% until quarter 4 2018 and not to rise above 1.25% by quarter 1 2021. Bank Rate forecasts for financial year ends (March) are:

- 2017/18 0.50%
- 2018/19 0.75%
- 2019/20 1.00%
- 2020/21 1.25%

The suggested budgeted investment earnings rates for returns on investments placed for periods up to about three months during each financial year, as per Link Asset Services are as follows:

	Now
2017/18	0.40%
2018/19	0.60%
2019/20	0.90%
2020/21	1.25%
2021/22	1.50%
2022/23	1.75%
2023/24	2.00%
Later years	2.75%

The overall balance of risks to these forecasts is currently skewed to the upside and are dependent on how strong GDP growth turns out, how quickly inflation pressures rise and how quickly the Brexit negotiations move forward positively.

The Council's budgeted rate of return for 2018/19 is 1.14% based on 0.98% on funds that are already invested; 4.43% for the property fund (£5M); 0.66% for the remaining core balances; and 0.20% for short term cash flow derived balances. The total investment income budget for 2018/19 is £480,000. The budget is based on some investments of up to one year particularly in category's 4 & 7 and longer investments in Category 1, 2, 3 and 6. (Category 1 being the highest rated banks and 6 being part nationalised banks). Category 5; the Councils Bank (Lloyds) is a mixture of the above but also notice accounts have been introduced (32 Day Notice and 95 Day Notice) enabling the Council to achieve slightly enhanced rates compared to Money Market Funds (MMFs).

The Council currently uses two types of Pooled Funds, Property Funds and 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 of daily surplus of 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. Although these levels are picking up since the bank rate rise, they are at still at a low level (0.21 – 0.39%) . 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 Regulations were published in the EU Official Journal in July 2017. This formally begins the compliance process for new funds, however the regulation comes into force on 21st July 2018 in relation to existing funds. The Council will look to place investments in 2 types of MMF;

- CNAV – Constant net asset value and
- LVNAV – Low volatility NAV

Most CNAV funds will become Low Volatility NAV (LVNAV) funds. LVNAV MMFs are permitted to maintain a constant dealing NAV provided that certain criteria are met, including that the market NAV of the fund does not deviate from the dealing NAV by more than 20 basis points.

As well as the Money Market Reform, the Markets in Financial Instruments Directive II (MiFID) came into force 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 are all deemed to be "Retail" clients by default, but had the option to “opt-up” to “Professional” client status. In order to opt-up, the Council needed to meet qualitative and quantitative test criteria.

The Council chose to opt up, but is still waiting on decisions by some counterparties regarding being accepted as “professional” clients.

Investment treasury indicator and limit - total principal funds invested for greater than 365 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 > 365 days			
£m	**2018/19**	**2019/20**	**2020/21**
Principal sums invested > 365 days	22	18	15

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

4.7 Investment risk benchmarking

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

4.8 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.

4.9 Scheme of delegation

Please see Appendix 9.

4.10 Role of the section 151 officer

Please see Appendix 10.

Contact: Sian Southerton ext 37861 sian.southerton@arun.gov.uk

2. PROPOSAL(S):

To approve all 3 recommendations.		
3. OPTIONS: The Treasury Management Strategy is legislative and under the Local Government act 2003 and therefore the only option is follow the proposal.		
4. CONSULTATION:		
Has consultation been undertaken with:	**YES**	**NO**
Relevant Town/Parish Council		√
Relevant District Ward Councillors		√
Other groups/persons (please specify)	√ Treasury Advisors	
5. ARE THERE ANY IMPLICATIONS IN RELATION TO THE FOLLOWING COUNCIL POLICIES: **(Explain in more detail at 6 below)**	**YES**	**NO**
Financial	√	
Legal		√
Human Rights/Equality Impact Assessment		√
Community Safety including Section 17 of Crime & Disorder Act		√
Sustainability		√
Asset Management/Property/Land		√
Technology		√
Other (please explain)		
6. IMPLICATIONS: Approval will enable the Council to comply with legislation and provide a Treasury Service		

7. REASON FOR THE DECISION:

Statutory and the limits set, safeguard the Council against financial losses.

8. BACKGROUND PAPERS:

CIPFA'S Treasury Management in the Public Services: Code of Practice (2017)

(Link not available as copyright)

The Prudential Code for Capital Finance in Local Authorities (2017) Guidance notes (2013) *(Link not available as copyright)*

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

Prudential and treasury indicators

APPENDIX 1

1. PRUDENTIAL INDICATORS	2016/17	2017/18	2018/19	2019/20	2020/21
Extract from budget and rent setting report	**Actual**	**Probable outturn**	**Original**	**Original**	**Original**
	£'000	**£'000**	**£'000**	**£'000**	**£'000**
Capital Expenditure					
Non – HRA	4,624	10,057**	2,310	2.719	2,823
HRA	4,221	6,548***	8,047*	7,869*	7,942*
TOTAL	**6,845**	**16,605**	**10,357**	**10,587**	**10,766**
Ratio of financing costs to net revenue stream					
Non – HRA	-2.51%	-1.91%	-1.79%	-1.79%	-1.79%
HRA	32.63%	32.79%	33.17%	33.29%	32.29%
Capital Financing Requirement as at 31 March					
Non – HRA	-3,769	-3,982	-4,198	-4,394	-4,475
HRA	56,604	56,547	56,387	56,110	55,716
TOTAL	**52,835**	**52,565**	**52,189**	**51,716**	**51,241**
Annual change in Cap. Financing Requirement					
Non – HRA	1,209	-213	-216	-196	-81
HRA	-2,462	-57	-160	-277	-394
TOTAL	**-1,253**	**-270**	**-376**	**-473**	**-475**

**The increase in HRA Capital expenditure is due to £5m per year for Stock Development (2018 – 2021)*
***The increase in Non-HRA Capital expenditure is due to the LLC New Build (£3.5m) and The Arcade (£2m)*
**** Increase due to Wick/Glenlogie development (£2m)*

2. TREASURY MANAGEMENT INDICATORS	2016/17	2017/18	2018/19	2019/20	2020/21
	Actual	Probable outturn	Original	Original	Original
	£'000	£'000	£'000	£'000	£'000
Authorised Limit for external debt					
Borrowing	67,000	66,000	63,000	61,000	53,000
Other long term liabilities	0	0	0	0	0
TOTAL	**67,000**	**66,000**	**63,000**	**61,000**	**53,000**
Operational Boundary for external debt					
Borrowing	64,000	63,000	60,000	58,000	50,000
other long term liabilities	0	0	0	0	0
TOTAL	**64,000**	**63,000**	**60,000**	**58,000**	**50,000**
Actual external debt	62,040	53,180	53,180	53,180	44,320
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 365 days (£m)	**26**	**26**	**22**	**18**	**15**
-	- -	-	-		

Maturity structure of fixed rate borrowing - upper & Lower limits	Actual at 31/03/18	lower limit	upper limit
under 12 months	0%	0%	40%
12 months and within 24 months	16.66%	0%	40%
24 months and within 5 years	16.66%	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

1. Introduction

1.1 CLG's Guidance on Minimum Revenue Provision (issued in 2012 but currently out for consultation) 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. 2018/19 MRP Policy

For 2018/19 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 2017

Appendix 3

Type of Investment/Deposit	Reference no.	Counterparty	Issue Date	Maturity Date	Nominal	Current Interest Rate
Fixed Term Deposit	652	Santander	07/07/2017	11/01/2018	£2,000,000.00	0.70
Fixed Term Deposit	653	Goldman Sachs International	18/07/2017	11/01/2018	£1,000,000.00	0.595
Fixed Term Deposit	631	Goldman Sachs International	09/02/2017	08/02/2018	£2,000,000.00	0.905
Fixed Term Deposit	660	Qatar National Bank	10/11/2017	19/02/2018	£2,000,000.00	0.79
Fixed Term Deposit	661	Lloyds Bank PLC	10/11/2017	19/02/2018	£2,000,000.00	0.50
Fixed Term Deposit	632	Lloyds Bank PLC	08/03/2017	07/03/2018	£1,000,000.00	0.90
Fixed Term Deposit	633	Santander	08/03/2017	07/03/2018	£1,000,000.00	0.85
Fixed Term Deposit	635	Goldman Sachs International	28/03/2017	27/03/2018	£2,000,000.00	0.985
Fixed Term Deposit	662	Qatar National Bank	01/12/2017	12/04/2018	£2,000,000.00	0.84
Fixed Term Deposit	636	Goldman Sachs International	13/04/2017	12/04/2018	£2,000,000.00	0.95
Fixed Term Deposit	657	Barclays	23/10/2017	12/04/2018	£1,000,000.00	0.405
Fixed Term Deposit	658	Coventry Building Society	25/10/2017	12/04/2018	£1,000,000.00	0.40
Fixed Term Deposit	659	Close Brothers Ltd	27/10/2017	12/04/2018	£1,000,000.00	0.56
Fixed Term Deposit	638	Goldman Sachs International	09/05/2017	08/05/2018	£2,000,000.00	0.94
Fixed Term Deposit	640	Qatar National Bank	10/05/2017	09/05/2018	£1,000,000.00	0.83
Fixed Term Deposit	639	Lloyds Bank PLC	11/05/2017	10/05/2018	£1,000,000.00	0.80
Fixed Term Deposit	641	Goldman Sachs International	24/05/2017	23/05/2018	£2,000,000.00	0.87
Fixed Term Deposit	642	Skipton Building Society	24/05/2017	23/05/2018	£1,000,000.00	0.76
Fixed Term Deposit	643	Santander	24/05/2017	23/05/2018	£1,000,000.00	0.85
Fixed Term Deposit	644	Santander	24/05/2017	23/05/2018	£2,000,000.00	0.85
Fixed Term Deposit	572	Royal Bank of Scotland	29/05/2015	31/05/2018	£2,000,000.00	1.70*
Fixed Term Deposit	645	Lloyds Bank PLC	06/06/2017	05/06/2018	£2,000,000.00	0.800
Fixed Term Deposit	646	Qatar National Bank	06/06/2017	05/06/2018	£2,000,000.00	0.81
Fixed Term Deposit	647	Skipton Building Society	06/06/2017	05/06/2018	£1,000,000.00	0.75
Fixed Term Deposit	648	Santander	15/06/2017	14/06/2018	£2,000,000.00	0.85
Fixed Term Deposit	621	Close Brothers Ltd	24/08/2016	24/08/2018	£2,000,000.00	1.210
Fixed Term Deposit	654	Close Brothers Ltd	15/09/2017	17/09/2018	£1,000,000.00	0.80
Fixed Term Deposit	656	Lloyds Bank PLC	16/10/2017	24/09/2018	£1,000,000.00	0.75
Fixed Term Deposit	629	Close Brothers Ltd	26/01/2017	04/01/2019	£1,000,000.00	1.05
Fixed Term Deposit	599	Royal Bank of Scotland	31/03/2016	18/02/2019	£2,000,000.00	1.35**
Fixed Term Deposit	634	Close Brothers Ltd	17/03/2017	15/03/2019	£1,000,000.00	1.00
Fixed Term Deposit	637	Close Brothers Ltd	18/04/2017	10/04/2019	£1,000,000.00	1.00
Fixed Term Deposit	620	Royal Bank of Scotland	19/08/2016	19/08/2019	£2,000,000.00	0.95***
Property Fund	140000	CCLA (Churches, Charities and LA's)			£5,000,000.00	4.70
Money Market Fund	110000	Federated			£4,000,000.00	0.21
Money Market Fund	100500	CCLA (Churches, Charities and LA's)			£670,000.00	0.19
Callable deposit	88889	Lloyds Bank PLC			£5,839,443.77	0.15
Callable deposit	44446	Lloyds 95DN			£4,000,000.00	0.45
					£69,509,443.77	

*Yr 1- 1%, Yr 2 - 1.35%, Yr 3 - 1.70%
**Yr 1 -1.20%, Yr 2-1.35%, Yr 3-1.50%
*** Yr 1 - 0.8%, Yr 2 - 0.95%, Yr 3 - 1.10%

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.

Link Asset Services Interest Rate View	Mar-18	Jun-18	Sep-18	Dec-18	Mar-19	Jun-19	Sep-19	Dec-19	Mar-20	Jun-20	Sep-20	Dec-20	Mar-21
Bank Rate View	0.50%	0.50%	0.50%	0.75%	0.75%	0.75%	0.75%	1.00%	1.00%	1.00%	1.25%	1.25%	1.25%
3 Month LIBID	0.40%	0.40%	0.40%	0.60%	0.60%	0.60%	0.70%	0.90%	0.90%	1.00%	1.20%	1.20%	1.20%
6 Month LIBID	0.50%	0.50%	0.60%	0.80%	0.80%	0.80%	0.90%	1.00%	1.00%	1.10%	1.30%	1.30%	1.40%
12 Month LIBID	0.80%	0.80%	0.90%	1.00%	1.00%	1.10%	1.10%	1.30%	1.30%	1.40%	1.50%	1.50%	1.60%
5yr PWLB Rate	1.60%	1.60%	1.70%	1.80%	1.80%	1.90%	1.90%	2.00%	2.10%	2.10%	2.20%	2.30%	2.30%
10yr PWLB Rate	2.20%	2.30%	2.40%	2.40%	2.50%	2.60%	2.60%	2.70%	2.70%	2.80%	2.90%	2.90%	3.00%
25yr PWLB Rate	2.90%	3.00%	3.00%	3.10%	3.10%	3.20%	3.20%	3.30%	3.40%	3.50%	3.50%	3.60%	3.60%
50yr PWLB Rate	2.60%	2.70%	2.80%	2.90%	2.90%	3.00%	3.00%	3.10%	3.20%	3.30%	3.30%	3.40%	3.40%
Bank Rate													
Link Asset Services	0.50%	0.50%	0.50%	0.75%	0.75%	0.75%	0.75%	1.00%	1.00%	1.00%	1.25%	1.25%	1.25%
Capital Economics	0.50%	0.75%	1.00%	1.25%	1.25%	1.50%	1.50%	1.75%	2.00%	2.00%	2.25%	2.25%	-
5yr PWLB Rate													
Link Asset Services	1.60%	1.60%	1.70%	1.80%	1.80%	1.90%	1.90%	2.00%	2.10%	2.10%	2.20%	2.30%	2.30%
Capital Economics	1.70%	1.90%	2.10%	2.40%	2.40%	2.40%	2.40%	2.40%	2.40%	2.65%	2.65%	2.90%	-
10yr PWLB Rate													
Link Asset Services	2.20%	2.30%	2.40%	2.40%	2.50%	2.60%	2.60%	2.70%	2.70%	2.80%	2.90%	2.90%	3.00%
Capital Economics	2.20%	2.40%	2.60%	2.80%	2.80%	2.80%	2.80%	2.80%	2.80%	3.05%	3.05%	3.30%	-
25yr PWLB Rate													
Link Asset Services	2.90%	3.00%	3.00%	3.10%	3.10%	3.20%	3.20%	3.30%	3.40%	3.50%	3.50%	3.60%	3.60%
Capital Economics	2.60%	2.90%	3.10%	3.30%	3.30%	3.30%	3.35%	3.35%	3.35%	3.60%	3.60%	3.80%	-
50yr PWLB Rate													
Link Asset Services	2.60%	2.70%	2.80%	2.90%	2.90%	3.00%	3.00%	3.10%	3.20%	3.30%	3.30%	3.40%	3.40%

APPENDIX 5

ECONOMIC BACKGROUND

GLOBAL OUTLOOK. World growth looks to be on an encouraging trend of stronger performance, rising earnings and falling levels of unemployment. In October, the IMF upgraded its forecast for world growth from 3.2% to 3.6% for 2017 and 3.7% for 2018.

In addition, **inflation prospects are generally muted** and it is particularly notable that **wage inflation** has been subdued despite unemployment falling to historically very low levels in the UK and US. This has led to many comments by economists that there appears to have been a fundamental shift downwards in the Phillips curve (this plots the correlation between levels of unemployment and inflation e.g. if the former is low the latter tends to be high). In turn, this raises the question of what has caused this? The likely answers probably lay in a combination of a shift towards flexible working, self-employment, falling union membership and a consequent reduction in union power and influence in the economy, and increasing globalisation and specialisation of individual countries, which has meant that labour in one country is in competition with labour in other countries which may be offering lower wage rates, increased productivity or a combination of the two. In addition, technology is probably also exerting downward pressure on wage rates and this is likely to grow with an accelerating movement towards automation, robots and artificial intelligence, leading to many repetitive tasks being taken over by machines or computers. Indeed, this is now being labelled as being the start of the **fourth industrial revolution.**

KEY RISKS - central bank monetary policy measures
Looking back on nearly ten years since the financial crash of 2008 when liquidity suddenly dried up in financial markets, it can be assessed that central banks' monetary policy measures to counter the sharp world recession were successful. The key monetary policy measures they used were a combination of lowering central interest rates and flooding financial markets with liquidity, particularly through unconventional means such as Quantitative Easing (QE), where central banks bought large amounts of central government debt and smaller sums of other debt.

The key issue now is that that period of stimulating economic recovery and warding off the threat of deflation is coming towards its close and a new period has already started in the US, and more recently in the UK, on reversing those measures i.e. by raising central rates and (for the US) reducing central banks' holdings of government and other debt. These measures are now required in order to stop the trend of an on-going reduction in spare capacity in the economy, and of unemployment falling to such low levels that the re-emergence of inflation is viewed as a major risk. It is, therefore, crucial that central banks get their timing right and do not cause shocks to market expectations that could destabilise financial markets. In particular, a key risk is that because QE-driven purchases of bonds drove up the price of government debt, and therefore caused a sharp drop in income yields, this then also encouraged investors into a search for yield and into investing in riskier assets such as equities. This resulted in bond markets and equity market prices both rising to historically high valuation levels simultaneously. This, therefore, makes both asset categories vulnerable to a sharp correction. It is important, therefore, that central banks only gradually unwind their holdings of bonds in order to prevent destabilising the financial markets. It is also likely that the timeframe for central banks unwinding their holdings of QE debt purchases will be over several years. They need to balance their timing to neither squash economic recovery by taking too rapid and too strong action, or, alternatively, let inflation run away by taking action that was too slow and/or too weak. **The potential for central banks to get this timing and strength of action wrong are now key risks.**

There is also a potential key question over whether economic growth has become too dependent on strong central bank stimulus and whether it will maintain its momentum against a backdrop of rising interest rates and the reversal of QE. In the UK, a key vulnerability is the **low level of productivity growth**, which may be the main driver for increases in wages; and **decreasing consumer disposable income,** which is important in the context of consumer expenditure primarily underpinning UK GDP growth.

A further question that has come to the fore is whether **an inflation target for central banks of 2%**, is now realistic given the shift down in inflation pressures from internally generated inflation, (i.e. wage inflation feeding through into the national economy), given the above mentioned shift down in the Phillips curve.

- Some economists favour a shift to a **lower inflation target of 1%** to emphasise the need to keep the lid on inflation. Alternatively, it is possible that a central bank could simply ‘look through’ tepid wage inflation, (i.e. ignore the overall 2% inflation target), in order to take action in raising rates sooner than might otherwise be expected.
- However, other economists would argue for a **shift *UP* in the inflation target to 3%** in order to ensure that central banks place the emphasis on maintaining economic growth through adopting a slower pace of withdrawal of stimulus.
- In addition, there is a strong argument that central banks should **target financial market stability**. As mentioned previously, bond markets and equity markets could be vulnerable to a sharp correction. There has been much commentary, that since 2008, QE has caused massive distortions, imbalances and bubbles in asset prices, both financial and non-financial. Consequently, there are widespread concerns at the potential for such bubbles to be burst by exuberant central bank action. On the other hand, too slow or weak action would allow these imbalances and distortions to continue or to even inflate them further.
- Consumer debt levels are also at historically high levels due to the prolonged period of low cost of borrowing since the financial crash. In turn, this cheap borrowing has meant that **other non-financial asset prices**, particularly house prices, have been driven up to very high levels, especially compared to income levels. Any sharp downturn in the availability of credit, or increase in the cost of credit, could potentially destabilise the housing market and generate a sharp downturn in house prices. This could then have a destabilising effect on consumer confidence, consumer expenditure and GDP growth. However, no central

bank would accept that it ought to have responsibility for specifically targeting house prices.

UK. After the UK surprised on the upside with strong economic growth in 2016, **growth in 2017 has been disappointingly weak**; quarter 1 came in at only +0.3% (+1.8% y/y), quarter 2 was +0.3% (+1.5% y/y) and quarter 3 was +0.4% (+1.5% y/y). The main reason for this has been the sharp increase in inflation, caused by the devaluation of sterling after the EU referendum, feeding increases in the cost of imports into the economy. This has caused, in turn, a reduction in consumer disposable income and spending power and so the services sector of the economy, accounting for around 80% of GDP, has seen weak growth as consumers cut back on their expenditure. However, more recently there have been encouraging statistics from the **manufacturing sector** which is seeing strong growth, particularly as a result of increased demand for exports. It has helped that growth in the EU, our main trading partner, has improved significantly over the last year while robust world growth has also been supportive. However, this sector only accounts for around 10% of GDP so expansion in this sector will have a much more muted effect on the overall GDP growth figure for the UK economy as a whole.

While the Bank of England is expected to give forward guidance to prepare financial markets for gradual changes in policy, the **Monetary Policy Committee, (MPC), meeting of 14 September 2017** managed to shock financial markets and forecasters by suddenly switching to a much more aggressive tone in terms of its words around warning that Bank Rate will need to rise soon. The Bank of England Inflation Reports during 2017 have clearly flagged up that it expected CPI inflation to peak at just under 3% in 2017, before falling back to near to its target rate of 2% in two years' time. The Bank revised its forecast for the peak to just over 3% at the 14 September meeting. (Inflation actually came in at 3.1% in November so that may prove now to be the peak.) This marginal revision in the Bank's forecast can hardly justify why the MPC became so aggressive with its wording; rather, the focus was on an emerging view that with unemployment having already fallen to only 4.3%, the lowest level since 1975, and improvements in productivity being so weak, that **the amount of spare capacity in the economy was significantly diminishing** towards a point at which they now needed to take action. In addition, the MPC took a more tolerant view of low wage inflation as this now looks like a common factor in nearly all western economies as a result of automation and globalisation. However, the Bank was also concerned that the withdrawal of the UK from the EU would effectively lead to a *decrease* in such globalisation pressures in the UK, and so this would cause additional inflationary pressure over the next few years.

At Its 2 November meeting, the MPC duly delivered a 0.25% increase in Bank Rate. It also gave forward guidance that they expected to increase Bank Rate only twice more in the next three years to reach 1.0% by 2020. This is, therefore, not quite the 'one and done' scenario but is, nevertheless, a very relaxed rate of increase prediction in Bank Rate in line with previous statements that Bank Rate would only go up very gradually and to a limited extent.

However, some forecasters are flagging up that they expect growth to accelerate significantly towards the end of 2017 and then into 2018. This view is based primarily on the coming fall in inflation, (as the effect of the effective devaluation of sterling after the EU referendum drops out of the CPI statistics), which will bring to an end the negative impact on consumer spending power. In addition, a strong export performance will compensate for weak services sector growth. If this scenario was indeed to materialise, then the MPC would be likely to accelerate its pace of increases in Bank Rate during 2018 and onwards.

It is also worth noting the **contradiction within the Bank of England** between action in 2016 and in 2017 **by two of its committees**. After the shock result of the EU referendum, the **Monetary Policy Committee (MPC)** voted in August 2016 for emergency action to cut Bank Rate from 0.50% to 0.25%, restarting £70bn of QE purchases, and also providing UK banks with £100bn of cheap financing. The aim of this was to lower borrowing costs, stimulate demand for borrowing and thereby increase expenditure and demand in the economy. The MPC felt this was necessary in order to ward off their expectation that there would be a sharp slowdown in economic growth. Instead, the economy grew robustly, although the Governor of the Bank of England strongly maintained that this was *because* the MPC took that action. However, other commentators regard this emergency action by the MPC as being proven by events to be a mistake. Then in 2017, we had the **Financial Policy Committee (FPC)** of the Bank of England taking action in June and September over its concerns that cheap borrowing rates, and easy availability of consumer credit, had resulted in too rapid a rate of growth in consumer borrowing and in the size of total borrowing, especially of unsecured borrowing. It, therefore, took punitive action to clamp down on the ability of the main banks to extend such credit! Indeed, a PWC report in October 2017 warned that credit card, car and personal loans and student debt will hit the equivalent of an average of £12,500 per household by 2020. However, averages belie wide variations in levels of debt with much higher exposure being biased towards younger people, especially the 25 -34 year old band, reflecting their lower levels of real income and asset ownership.

One key area of risk is that consumers may have become used to cheap rates since 2008 for borrowing, especially for mortgages. It is a major concern that **some consumers may have over extended their borrowing** and have become complacent about interest rates going up after Bank Rate had been unchanged at 0.50% since March 2009 until falling further to 0.25% in August 2016. This is why forward guidance from the Bank of England continues to emphasise slow and gradual increases in Bank Rate in the coming years. However, consumer borrowing is a particularly vulnerable area in terms of the Monetary Policy Committee getting the pace and strength of Bank Rate increases right - without causing a sudden shock to consumer demand, confidence and thereby to the pace of economic growth.

Moreover, while there is so much uncertainty around the Brexit negotiations, consumer confidence, and business confidence to spend on investing, it is far too early to be confident about how the next two to three years will actually pan out.

EZ. Economic growth in the eurozone (EZ), (the UK's biggest trading partner), had been lack lustre for several years after the financial crisis despite the ECB eventually cutting its main rate to -0.4% and embarking on a massive programme of QE. However, growth picked up in 2016 and has now gathered substantial strength and momentum thanks to this stimulus. GDP growth was 0.6% in quarter 1 (2.1% y/y), 0.7% in quarter 2 (2.4% y/y) and +0.6% in quarter 3 (2.6% y/y). However, despite providing massive monetary stimulus, the European Central Bank is still struggling to get inflation up to its 2% target and in November inflation was 1.5%. It is therefore unlikely to start on an upswing in rates until possibly 2019. It has, however, announced that it will slow down its monthly QE purchases of debt from €60bn to €30bn from January 2018 and continue to at least September 2018.

USA. Growth in the American economy was notably erratic and volatile in 2015 and 2016. 2017 is following that path again with quarter 1 coming in at only 1.2% but quarter 2 rebounding to 3.1% and quarter 3 coming in at 3.2%. Unemployment in the US has also fallen to the lowest level for many years, reaching 4.1%, while wage inflation pressures, and inflationary pressures in general, have been building. The Fed has started on a gradual upswing in rates with four increases in all and four increases since December 2016; the latest rise was in December 2017 and lifted the central rate to 1.25 – 1.50%. There could then be another four increases in 2018. At its September meeting, the Fed said it would start in October to gradually unwind its $4.5 trillion balance sheet holdings of bonds and mortgage backed securities by reducing its reinvestment of maturing holdings.

CHINA. Economic growth has been weakening over successive years, despite repeated rounds of central bank stimulus; medium term risks are increasing. Major progress still needs to be made to eliminate excess industrial capacity and the stock of unsold property, and to address the level of non-performing loans in the banking and credit systems.

JAPAN. GDP growth has been gradually improving during 2017 to reach an annual figure of 2.1% in quarter 3. However, it is still struggling to get inflation up to its target of 2%, despite huge monetary and fiscal stimulus. It is also making little progress on fundamental reform of the economy.

<u>Brexit timetable and process</u>

- March 2017: UK government notifies the European Council of its intention to leave under the Treaty on European Union Article 50
- March 2019: initial two-year negotiation period on the terms of exit. In her Florence speech in September 2017, the Prime Minister proposed a two year transitional period after March 2019.
- UK continues as a full EU member until March 2019 with access to the single market and tariff free trade between the EU and UK. Different sectors of the UK economy will leave the single market and tariff free trade at different times during the two year transitional period.

- 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 could also exit without any such agreements in the event of a breakdown of negotiations.
- 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 full 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.

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	✓	✓	--	No limit	Liquid

Agency Deposit Facility (category 9)					
Collective Investment Schemes structured as Open Ended Investment Companies (OEICs)					
Money Market Funds (CNAV or LVNAV) (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

DBS Bank Ltd (SING)
HSBC Bank plc (UK)
Oversea-Chinese Banking Corp Ltd (SING)
Svenska Handelsbanken (SW)
United Overseas Bank Ltd (SING)
First Abu Dhabi Bank (U.A.E)

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)
Bank of Nova Scotia (CAN)
Standard Charted Bank (UK)
Qatar National Bank (Qatar)

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)
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 (Max of £11M term deposit)

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)

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

CCLA Investment Management Ltd (Public sector deposit fund)	AAAmmf	Stable NAV
Deutsche Banking Group	Aaa -mf	Stable NAV
Federated Investors Ltd (Fitch Ratings)	AAAmmf	Stable NAV
Fidelity Investments International (Moody's Rating)	Aaa -mf	Stable NAV
Standard Life (Fitch Ratings)	AAAmmf	Stable NAV
Northern Trust	Aaa -mf	Stable NAV

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

Category 9 - Debt Management Office
Debt management Account - NO LIMIT (UK Govt)

Category 10 - Bonds issued by multilateral development banks - 5 Years
Maximum investment £4 million

Category 11 – Property Funds - 25 Years
Maximum investment £6 million

CCLA

Appendix 8

Approved countries for investments

Based on a majority rule of available ratings.

AAA

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

AA+

- Finland
- Hong Kong

AA

- Abu Dhabi (UAE)
- France
- U.K.

AA-

- Qatar

Based on a majority rule of available ratings

APPENDIX 9

Treasury management scheme of delegation

(i) Full Council

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

(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 Group Head of Corporate Support.

(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 monitoring and outturn reports
- 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.

Changes in the Treasury and prudential codes mean a major extension of the S151 officer role as below, especially in respect of non-financial investments, (which CIPFA has defined as being part of treasury management).

- ensuring that the capital strategy is prudent, sustainable, affordable and prudent in the long term and provides value for money
- ensuring that due diligence has been carried out on all treasury and non-financial investments and is in accordance with the risk appetite of the authority
- ensure that the authority has appropriate legal powers to undertake expenditure on non-financial assets and their financing
- ensuring the proportionality of all investments so that the authority does not undertake a level of investing which exposes the authority to an excessive level of risk compared to its financial resources
- ensuring that an adequate governance process is in place for the approval, monitoring and ongoing risk management of all non-financial investments and long term liabilities
- provision to members of a schedule of all non-treasury investments including material investments in subsidiaries, joint ventures, loans and financial guarantees (We are unclear as to whether CIPFA requires this to be implemented in 2018/19. We are concerned that many local authorities could have difficulty in complying fully with this requirement at this late stage in the 2018/19 budget cycle.)
- ensuring that members are adequately informed and understand the risk exposures taken on by an authority

- ensuring that the authority has adequate expertise, either in house or externally provided, to carry out the above
- creation of Treasury Management Practices which specifically deal with how non treasury investments will be carried out and managed, to include the following (TM Code p54): -
    - Risk management (TMP1 and schedules), including investment and risk management criteria for any material non-treasury investment portfolios;
    - Performance measurement and management (TMP2 and schedules), including methodology and criteria for assessing the performance and success of non-treasury investments;
    - Decision making, governance and organisation (TMP5 and schedules), including a statement of the governance requirements for decision making in relation to non-treasury investments; and arrangements to ensure that appropriate professional due diligence is carried out to support decision making;
    - Reporting and management information (TMP6 and schedules), including where and how often monitoring reports are taken;
    - Training and qualifications (TMP10 and schedules), including how the relevant knowledge and skills in relation to non-treasury investments will be arranged.

AGENDA ITEM NO. 10

ARUN DISTRICT COUNCIL

AUDIT & GOVERNANCE COMMITTEE
22 FEBRUARY 2018

Decision Paper

Subject : Annual Internal Audit Plan 2018/19

Report by : Chief Internal Auditor Report date : 1 February 2018

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

At the end of August 2017, the resource of the section reduced from 2.4 to 2.0 FTE and a revised outline 2017/18 plan was presented to the Committee at its September meeting.

The Committee was advised that the section would operate with 2 FTE in the short-term, with the focus on mandatory and high priority work. This would allow time for the Council's revised structures / operations to be finalised before a longer-term resourcing solution could be decided upon.

At the start of 2018, a number of areas are still in the process of being restructured in order to transform services and make cost savings in line with the Vision 2020 Programme, with progress being reported to Members by the Chief Executive. A new ICT & Digital Strategy is to be developed and agreed by the Council in early 2018 and there will also be need to consider the long-term future of some of the key IT systems currently in use. Additional operational changes may be required to meet new and changed Government requirements /

legislation. Therefore, the considerable degree of uncertainty in the work that Internal Audit might be required to undertake in the year (as advised previously) still persists.

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 again 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 in 2016).

The plan is based upon the level of resource currently available. Once the future resourcing options for Internal Audit have been considered, any changes will be advised to the Committee and a revised plan presented.

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: **None**

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

Outline Internal Audit Plan for 2018/19

2/4/18- 31/3/19 (52 weeks)

Based upon the current 2.0 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	70
Computer Audit (including projects)	70
Business Systems Audit	136.5
Contract Audit	8
Follow-Ups	6
PSIAS / QAIP (includes reviewing & updating audit procedures)	2
Total Chargeable Days (Audit)	**292.5**
Governance / AGS	6
NFI	13
Corporate Fraud	3
Audit Advice	10
External Audit Liaison	4
Committee Representation	9
Planning & Control	23
Contingency (e.g. for special investigations)	7
Meetings (Corporate)	8
RIPA	4
FOI	2
Total Chargeable Days (Non-Audit)	**89**
Total Chargeable Days	**381.5**

(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. 11

ARUN DISTRICT COUNCIL

AUDIT & GOVERNANCE COMMITTEE 22 February 2018

Information Paper

Subject : Progress Against the Audit Plan

Report by : Chief Internal Auditor   Report date : 1 February 2018

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

An outline Audit Plan was presented to, and approved by, the Committee at its February 2017 meeting, with an updated version presented in September 2017 reflecting the reduction in resource available from August. The aim of the plan was to ensure that mandatory work is completed, that there is appropriate involvement in the progress of the Vision 2020 initiative and to progress audit work on the priority / highest risk areas identified.

However, the Committee was advised that with the recently implemented revised management structure and the requirement for further phases of the Vision 2020 work to be progressed, there is considerable uncertainty as to where audit resource may be required in the year.

The attached report identifies the main areas of work undertaken by the Internal Audit section to January 2018.

2. CONCLUSION

The Committee is requested to note the content of the progress report provided.

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

ARUN DISTRICT COUNCIL

Audit Progress

At the Audit & Governance Committee meeting of 23 February 2017, the Committee agreed an outline plan for the section for 2017/18.

Since the plan was provided to the Committee, work has been undertaken in the following areas:-

Code	Title	Work performed
RE03	Main Accounting	• Annual key controls testing on behalf of external audit (in 2016/17 Audit Plan) ***Results passed to E&Y 3/17*** • Discussions held as to the key control testing requirements for 17/18 – to be undertaken in 1-2/18 (although E&Y have subsequently advised that they will be required to perform their own substantive testing this year)
RE04	Purchase Ledger	
RE08	Payroll	
CS03	Housing Finance	
CS16	Housing Benefit (& Council Tax Reduction)	
CS17	Council Tax	
CS18	NDR	
CS19	Income: Sundry Debtors	
RE08	Payroll	• Monthly joiners and leavers checks
CS16	Housing Benefit (& Council Tax Reduction)	• Monthly sample checks on new HB claims for E&Y (as part of full-year sample)
CS17	Council Tax	• Annual test checks on CT precept calculations (next due 2/18)
CS18	NDR	• Brief data review for potentially invalid small business relief cases • Confirmation of testing / reconciliation by R&B of VOA 2017 full revaluation
CS19	Income: Sundry Debtors	• A brief review of the key controls in respect of the handling of unpaid debts via the new e5 system has been completed ***Reported to A&GC 22/2/18***
CP18	Vision 2020	• Ongoing liaison with Officer working group and involvement in 'due diligence' work e.g. risks, etc. in connection with the business case for the Local Property Company (LPC) *Relevant Officers presented Business Case to OSC 25 July, Cabinet 31 July and Special A&GC meeting 7 August. Decision taken at Full Council (13/9/17) to defer commencement of operation for further consideration* • A update on proposals across services to contribute

		towards the required cost savings has also been provided to Members by the CEO (to Cabinet on 16/10/17)
CP03 MS01	Corporate Governance Annual Governance Statement	• Annual review of compliance against the Council's local Code of Corporate Governance • Review of the requirements of the new CIPFA/SOLACE Code • Preparation of a revised Code of Corporate Governance and the Annual Governance Statement under the new Code ***Reviewed by G&R Group 18/5/17*** ***Reported to A&GC 29/6/17***
MS04	NFI	• Internal Audit involvement in review of reports received in 2/17 from the 10/16 exercise and liaison with service areas over potential issues (Benefits are responsible for review of most of the benefits-related matches) ***Information on the NFI is included in the Annual Counter-Fraud Report presented to A&GC*** • Supply of data extracts for the NFI Council tax Single Person discount exercise in 12/18. Reports have been received back and are awaiting review – an updated version of the Electoral Roll is awaited to assist in the identification of records that have already been altered
CP02	Information & Data Governance	• Liaison with relevant staff in respect of GDPR preparation requirements and review of draft policies / changes, prior to their presentation to CMT *Some policy updates presented to OSC and approved by Full Council with more being drafted* *Regular updates are being provided to CMT by the Group Head of Council Advice* • Review of data and documents held and destruction in line with agreed retention strategies
CS14	Information Security Policies	• Linked to GDPR, Information Security Group (ISG) discussion and review of policies e.g. Information Security Policy • Liaison with Service Development Manager on new Home Working Policy – Regular Non-Contracted *Presented to OSC 26/9/17*
PR07	FMS Support / Replacement	• Testing of reports set up for audit purposes in 2016 on the test Jasper system prior to its upgrade and confirmation they operate correctly after upgrade applied to the live system • Resolution of outstanding queries from external audit testing with Finance • A review of 'lessons learnt' from the implementation of the new e5 system is being progressed, together with consideration of changed budget preparation processes
IN02	Fraud & Corruption	• Compilation of data for publication to meet Government Data Transparency Code requirements • Compilation of data for annual fraud surveys • Preparation of Annual Counter-Fraud Report ***Reported to A&GC 29/6/17***

CP05	Fraud & Corruption	• An audit assessment of the Council's counter-fraud arrangements against the provisions of the CIPFA Code of Practice on managing the risk of fraud and corruption has been completed. This included consideration of other relevant strategies (e.g. Fighting Fraud & Corruption Locally) and requirements for any updates to relevant Council policies (The requirement for this outstanding review has been advised to the Committee in recent Annual Governance Statements) ***Reported to A&GC 7/12/17*** *Updates will be required to the Council's Anti-Fraud, Bribery & Corruption Policy – but some of these are dependent upon other changes being made to the Constitution and Codes of Conduct* • Brief review of items of relevance to Local Authorities in the United Kingdom Anti-Corruption Strategy 2017-2022
AD08	Audit Standards & Quality (PSIAS/QAIP)	• Update of appropriate Arun internal audit documents • Commencement of self-assessment to be used in Arun's future EQA • Undertaking the External Quality Assessment (EQA) for Rother DC and providing a report on the outcome (this is on a mutual support basis across the Sussex Audit Group) • Preparation for the EQA for Wealden DC, due in 2/18
ES01	Environmental Health	• Liaison with Project Manager over business requirements and tender process for new system *Cabinet decision to award contract for new IT system to preferred supplier 19/6/17* Software now being tested / developed and data prepared for migration to the new system – project has 2 staff from EH engaged in this until go-live in April 2018.
ES06	Leisure Strategy / Management	• An initial review of the project for the new leisure management contract, covering the progress on the contract letting process was undertaken and the A&GC updated in February 2016 • The new contract was subsequently let to Freedom Leisure from April 2016 and the project review has been completed after its first year of operation to consider the ongoing contract monitoring and reporting processes ***Reported to A&GC 28/9/17***
CS04	Council House Sales	• A review of the processes in place for council houses sales (under right to buy legislation) has been completed ***Reported to A&GC 28/9/17***
CS01	Housing Services - Homelessness	• A review of the processes in place for dealing with homeless cases has been completed and the draft report is currently being progressed
CP04	Risk Management	• Liaison with Governance & Risk Group in respect of changes to the Risk Management Policy Statement & Strategy

		Reported to A&GC 7/12/17 • Consideration of changing and emerging risks Liaison with Governance & Risk Group in respect of updates to the Council's Strategic Risk Register. Changes also reviewed by Deputy Leader and CEO (as lead Member and officer) ***Reported to A&GC 7/12/17***
MS03	RIPA	• Consideration of the consultation documents on proposed changes to the Codes of Practice
MS05	Contract Checking	• Sample checks on contract compliance with Council Standing Orders and contract management in respect of financials

AGENDA ITEM NO. 12

ARUN DISTRICT COUNCIL

AUDIT & GOVERNANCE COMMITTEE
22 FEBRUARY 2018

Information Paper

Subject : Summary of Findings From Reports Issued (Dec 2017 – Jan 2018)

Report by : Chief Internal Auditor Report date : 16 February 2018

EXECUTIVE SUMMARY

Each year Internal Audit is required to undertake 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. Part of this process is to monitor delivery of the plans and to receive summaries of reports issued.

1 INTRODUCTION

Please find attached:-

- A summary of the significant findings arising from audit reports issued between December 2017 and January 2018.

2. CONCLUSION

The Committee is requested to note the content of this report.

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

AGENDA ITEM NO.

Summary of Internal Audit Report Findings - Reports Issued 01/11/2017 To 25/01/2018

Audit Entity	Level Of Assurance From Audit	Recommendations	Priority	Responsibility	Management Response
CS19 2017/18 - Income: Sundry Debtors	Substantial	**Write Off Policy**	Medium		
		A separate policy specifically for Sundry Debtor write-offs should be established. The Authority to Write Off levels need to be updated to reflect the current structure. The values for write off and the associated delegated authorities within both policies should be reviewed to ensure that they remain appropriate.		Carolin Martlew	Agreed
CS19 2017/18 - Income: Sundry Debtors	Substantial	**Management Reports**	Medium		
		Monthly or quarterly reports should be provided to departments with detailing the status of debts outstanding for their department.		Alan Smith	Agreed

Note: Assurance Level may be Full, Substantial, Moderate, Limited or None

Item No. 13

Date of Meeting: 25 July 2018			
Statement of Accounts			
Agenda Items	**Subject**	**Lead Officer/Member**	**Comments**
1	Final Statement of Accounts 2017/18	Financial Services Manager	Draft version was provided to external audit and posted on the Council's website at 31 May 2018
2	Annual Governance Statement	Chief Internal Auditor	Draft version was considered by Chairman / Vice Chairman in May, provided to external audit and posted on the Council's website at 31 May 2018
External Audit			
3	Compliance With International Auditing Standards (statement from 'those charged with governance')	Committee Chairman	Letter agreed with (2017/18) Chairman and sent to external audit in April
4	Audit Results Report – ISA 260	Ernst & Young	
5	Fee Letter	Ernst & Young	
Governance Framework			
6	Local Code of Corporate Governance	Chief Internal Auditor	
Treasury Management			
7	Treasury Management Annual Report	Senior Accountant (Treasury Management)	Recommendations for approval by Full Council (12/9/18)
Internal Audit			
8	Annual Internal Audit Report & Opinion	Chief Internal Auditor	
9	Update on the work of Internal Audit	Chief Internal Auditor	
Other Items			
10	Annual Counter-Fraud Report	Chief Internal Auditor	Any urgent updates can be provided at other meetings
11	Chairman's Annual Report To Council	Chairman	To be presented to Full Council
12	Update on the progress of Council-owned companies	TBC	
Work Programme			
13	To agree the rolling work programme for 2018/2019	Chief Internal Auditor	Updates, etc.

Item No. 13

Date of Meeting: 15 November 2018			
Statement of Accounts			
Agenda Items	**Subject**	**Lead Officer/Member**	**Comments**
	There are no items currently planned for this meeting		
External Audit			
1	Annual Audit Letter	Ernst & Young	
Governance Framework			
2	Updated Strategic Risk Register	Chief Internal Auditor	
Treasury Management			
3	Treasury Management Interim Report	Senior Accountant (Treasury Management)	Recommendations for approval by Full Council (9/1/19)
Internal Audit			
4	Update on the work of Internal Audit	Chief Internal Auditor	
Other Items			
5	Policy reviews / updates (TBC)	TBC	
6	Update on the progress of Council-owned companies	TBC	
Work Programme			
7	To agree the rolling work programme for 2018/2019	Chief Internal Auditor	Updates, etc.

Item No. 13

Date of Meeting: 14 February 2019			
Statement of Accounts			
Agenda Items	**Subject**	**Lead Officer/Member**	**Comments**
1	Accounting Policies for 2018/19 Accounts	Financial Services Manager	If CIPFA advise of any changed requirements, then an update will be provided at the July meeting
External Audit			
2	Audit Plan (and Progress Report)	Ernst & Young	Covering the audit of the 2018/19 Accounts
3	Annual Certification Report 2017/18	Ernst & Young	Confirmation will also be provided as to future certification arrangements
Governance Framework			
	There are no items currently planned for this meeting		
Treasury Management			
4	Treasury Management Strategy Statement and Annual Investment Strategy	Senior Accountant (Treasury Management)	For approval by Full Council (13/3/19)
Internal Audit			
5	Annual Internal Audit Plan	Chief Internal Auditor	
6	Update on the work of Internal Audit	Chief Internal Auditor	
Other Items			
7	Update on the progress of Council-owned companies	TBC	
Work Programme			
8	To agree the rolling work programme for 2019/2020	Chief Internal Auditor	

February meeting has to be timed so that Treasury Management Strategy can be approved by Full Council before 31/3/19

<u>Other items to be considered in Work Programme:-</u>

Independent Members' Remuneration Panel

- **Recruitment / appointments**
- **Proposals for / progress of review**
- **Report on review / proposals for change to be passed by A&GC to Full Council**

Property Investment Fund

- **Progress reports, once it starts operating (Property & Estates Manager)**

Local Property Company

- **Progress reports, once it starts operating (S151 Officer / Cabinet)**

Governance & Risk Group updates

Relevant policy reviews, updates, etc.