Public Document Pack

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17 January 2019

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, 14 February at 6.00pm** and you are requested to attend.

Members: Councillors Chapman (Chairman), Mrs Oakley (Vice-Chairman), Ambler, Blampied, Brooks, Cates, Dendle, Mrs Porter, Purchese and Wheal.

A G E N D A

1. APOLOGIES FOR ABSENCE

2. DECLARATIONS OF INTEREST

Members and officers are invited to make any declarations of pecuniary, personal and/or prejudicial interests that they may have in relation to items on the 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 interest
c) the nature of the interest

3. MINUTES

To approve as a correct record the Minutes of the meeting held on 15 November 2018 (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. THE INDEPENDENT REMUNERATION PANEL'S EIGHTH REVIEW OF THE MEMBERS' ALLOWANCES SCHEME

The Independent Remuneration Panel will be attending the meeting to present its report on the eighth review undertaken of the Members' Allowances Scheme. The Panel's report will be circulated separately to the agenda.

6. ERNST & YOUNG - AUDIT PLAN & PROGRESS REPORT (Pages 1 - 38)

To be presented by Ernst & Young

7. ACCOUNTING POLICIES FOR 2018/19 ACCOUNTS (Pages 39 - 58)

The report allows the Audit and Governance Committee to consider and approve the accounting policies that will be applied to the Statement of Accounts 2018/19 for approval by the committee in July 2019.

8. CAPITAL STRATEGY (Pages 59 - 68)

The report allows the Audit and Governance Committee to consider and comment on the Council's Capital Strategy 2019/20 to 2021/22 before adoption by Full Council.

9. TREASURY MANAGEMENT STRATEGY STATEMENT AND ANNUAL INVESTMENT STRATEGY (Pages 69 - 116)

The purpose of this report is to present the Treasury Management Strategy Statement and Annual Investment Strategy 2019/2020 and to enable the Audit and Governance Committee to scrutinise the report prior to making comment to Full Council. Please note that this report is still in 'draft' format.

10. PROPERTY INVESTMENT FUND (PIF) UPDATE

Paul Broggi, Property & Estates Manager will be providing a verbal update.

11. UPDATE ON PROGRESS AGAINST THE RECOMMENDATIONS FROM THE PARTNERSHIPS AUDIT

A verbal update will be given by Jackie Follis – Group Head of Policy.

12. ANNUAL INTERNAL AUDIT PLAN (Pages 117 - 120)

Each year Internal Audit is required to develop an internal audit plan for the following financial year. The Committee is requested to approve the outline annual internal audit plan for 2019/20 attached.

13. REVISED STRATEGIC RISK REGISTER 2018/19 (Pages 121 - 140)

Second part of the Committee’s review of the updated Strategic Risk Register commenced at the meeting of 15 November 2918.

14. PROGRESS AGAINST THE AUDIT PLAN (Pages 141 - 146)

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 progress against the Audit Plan and to receive summaries of reports issued.

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

15. INFORMATION / ADVISORY DOCUMENTS RECEIVED (Pages 147 - 162)

E&Y Local Government Audit Committee Briefing – Dec 2018 - for information only

16. FUTURE WORK PLAN FOR THE AUDIT & GOVERNANCE COMMITTEE (Pages 163 - 166)

The Chief Internal Auditor will update the Committee on any changes to the rolling Work Plan for 2019/20.

17. EXEMPT INFORMATION

The Committee is asked to consider passing the following resolution:-

That under Section 100a (4) of the Local Government Act 1972, the public and accredited representatives of newspapers be excluded from the meeting for the following item of business on the grounds that they involve the likely disclosure of exempt information as defined in Part 1 of Schedule 12A of the Act by virtue of the paragraph specified against the item.

Note : *Indicates report is attached for all Members of the Council only and the press (excluding exempt items). Copies of reports can be obtained on request from the Committee Manager).

Note : Members are reminded that if they have any detailed questions would they please inform the Chairman and/or relevant Director in advance of the meeting.

Arun District Council

Audit planning report

Year ended 31 March 2019

January 2019

Building a better working world

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

10 January 2019

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 2018/19 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 14 February 2019 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

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Public Sector Audit Appointments Ltd (PSAA) issued the "Statement of responsibilities of auditors and audited bodies". It is available from the PSAA website (https://www.psaa.co.uk/audit-quality/statement-of-responsibilities/).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 and further guidance (updated April 2018)" 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 2018/19 audit strategy

Overview of our 2018/19 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
Inappropriate capitalisation of revenue expenditure	Fraud risk	New risk identified this year.	Under ISA240 there is a presumed risk that revenue may be misstated due to improper recognition of revenue. In the public sector, this requirement is modified by Practice Note 10, issued by the Financial Reporting Council, which states that auditors should also consider the risk that material misstatements may occur by the manipulation of expenditure recognition. Our judgement is the significant risk at the Council relates to the improper capitalisation of revenue expenditure.
Pension Liability Valuation	Inherent risk	No change in risk or focus.	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 asset is a material estimated balance and the Code requires that this asset be disclosed on the Council's balance sheet. The information disclosed is based on the IAS 19 report issued to the Council by the actuary 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.
Valuation of Land and Buildings	Inherent risk	No change in risk or focus.	The fair value of Property, Plant and Equipment (PPE) represents a significant balance in the Council's accounts and are subject to valuation changes, impairment reviews and depreciation charges. Management is required to make material judgements and apply estimation techniques to calculate the year-end balances recorded in the balance sheet.
HRA Depreciation	Inherent risk	New risk identified this year.	HRA depreciation is material in the financial statements and requires a number of assumptions and judgements. In the prior year we identified errors above our audit differences threshold.
New Accounting Standards	Inherent risk	New risk identified this year.	IFRS 9 (Financial Instruments) and IFRS 15 (Revenue from contracts) both apply from 1 April 2018. We will assess the impact of these new standards to determine whether they have been appropriately implemented by the Council.

Overview of our 2018/19 audit strategy

Materiality

Planning materiality £1,825k	Materiality has been set at £1,825k (2017/18: £1,704k), which represents 2% of the prior years gross expenditure on provision of services.
Performance materiality £1,369k	Performance materiality has been set at £1,369k (2017/18: £1,278k), which represents 75% of materiality.
Audit differences £91k	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 housing revenue account and collection fund) greater than £91k (2017/18: £85k). Other misstatements identified will be communicated to the extent that they merit the attention of the Audit and Governance Committee.

Overview of our 2018/19 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 2019 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.

02 Audit risks

Our response to significant risks

We have set out the significant risks 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.

Inappropriate capitalisation of revenue expenditure

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Financial statement impact

Misstatements that occur in relation to the risk of fraud in revenue and expenditure recognition could affect the income and expenditure accounts. We are focussing our testing on capital additions (£14.46m in 2017/18).

What is the risk?

Under ISA 240 there is a presumed risk that revenue may be misstated due to improper revenue recognition. In the public sector, this requirement is modified by Practice Note 10 issued by the Financial Reporting Council, which states that auditors should also consider the risk that material misstatements may occur by the manipulation of expenditure recognition.

We have identified an opportunity and incentive to capitalise expenditure under the accounting framework, to remove it from the general fund. This would result in funding expenditure that should properly be defined as revenue, through inappropriate sources such as capital receipts, capital grants, or borrowing.

As identified in ISA (UK) 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.

The manipulation of capitalising expenditure could occur through management override of controls.

What will we do?

Our approach will focus on:

- Journals testing – we will use our testing of Journals to identify transactions moved from revenue to capital.
- For significant additions we will examine invoices, capital expenditure authorisations, leases and other data that support these additions. We review the sample selected against the definition of capital expenditure in IAS 16.

To further respond to the risk of management override we will focus on:

- Testing the appropriateness of journal entries recorded in the general ledger and other adjustments made in the preparation of the financial statements.
- Reviewing accounting estimates for evidence of management bias.
- Evaluating the business rationale for significant unusual transactions

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?
<u>Pension Liability Valuation</u> 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 2018 this totalled £19,183k. 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 Pension Fund, to obtain assurances over the information supplied to the actuary in relation to West Sussex County Council. • Assess the work of the Pension Fund actuary (Hymans Robertson) including the assumptions they have used by relying on the work of PWC - Consulting Actuaries commissioned by Public Sector Auditor Appointments 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.
<u>Valuation of Land and Buildings</u> The fair value of Property, Plant and Equipment (PPE) represents a significant balance in the Council's accounts and are subject to valuation changes, impairment reviews and depreciation charges. Management is required to make material judgements and apply estimation techniques to calculate the year-end balances recorded in the balance sheet.	We will: • Consider the work performed by the Council's valuer, including the adequacy of the scope of the work performed, their professional capabilities and the results of their work; • Sample test key asset information used by the valuers in performing their valuation (e.g. floor plans to support valuations based on price per square metre) and challenge the key assumptions used by the valuer; • Consider the annual cycle of valuations to ensure that assets have been valued within a 5 year rolling programme as required by the Code for PPE. • Review assets not subject to valuation in 2018/19 to confirm that the remaining asset base is not materially misstated; and • Test accounting entries have been correctly processed in the financial statements.

Other areas of audit focus (continued)

What is the risk/area of focus?	What will we do?
<u>HRA Depreciation</u> HRA depreciation is material in the financial statements and requires a number of assumptions and judgements. In the prior year we identified errors above our audit differences threshold. 2017/18 was the first year where Authorities with HRA Housing Stock needed to account for depreciation using proper accounting practices so it is still a relatively new concept.	We will: • Review the depreciation calculation for HRA Housing Stock for accuracy. • Consider the work performed by the Council's valuer, including the adequacy of the scope of the work performed, their professional capabilities and the results of their work and understand the assumptions used in their calculation. • Sample test key asset information used by the valuers in performing their calculation (e.g. componentisation, remaining useful lives) and challenge the key assumptions used by the valuer. • Test accounting entries have been correctly processed in the financial statements.
<u>IFRS 9 Financial instruments</u> This new accounting standard is applicable for local authority accounts from the 2018/19 financial year and will change: • How financial assets are classified and measured; • How the impairment of financial assets are calculated; and • The disclosure requirements for financial assets. There are transitional arrangements within the standard; and the 2018/19 Cipfa Code of practice on local authority accounting provides guidance on the application of IFRS 9. However, until the Guidance Notes are issued and any statutory overrides are confirmed there remains some uncertainty on the accounting treatment.	We will: • Assess the authority's implementation arrangements that should include an impact assessment paper setting out the application of the new standard, transitional adjustments and planned accounting for 2018/19; • Consider the classification and valuation of financial instrument assets; • Review new expected credit loss model impairment calculations for assets; and • Check additional disclosure requirements.

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Other areas of audit focus (continued)

What is the risk/area of focus?	What will we do?
IFRS 15 Revenue from contracts with customers This new accounting standard is applicable for local authority accounts from the 2018/19 financial year. The key requirements of the standard cover the identification of performance obligations under customer contracts and the linking of income to the meeting of those performance obligations. The 2018/19 Cipfa Code of practice on local authority accounting provides guidance on the application of IFRS 15 and includes a useful flow diagram and commentary on the main sources of LG revenue and how they should be recognised. The impact on local authority accounting is likely to be limited as large revenue streams like council tax, non domestic rates and government grants will be outside the scope of IFRS 15. However where that standard is relevant, the recognition of revenue will change and new disclosure requirements introduced.	We will: • Assess the authority's implementation arrangements that should include an impact assessment paper setting out the application of the new standard, transitional adjustments and planned accounting for 2018/19; • Consider application to the authority's revenue streams, and where the standard is relevant test to ensure revenue is recognised when (or as) it satisfies a performance obligation; and • Check additional disclosure requirements.

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 2018/19 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.

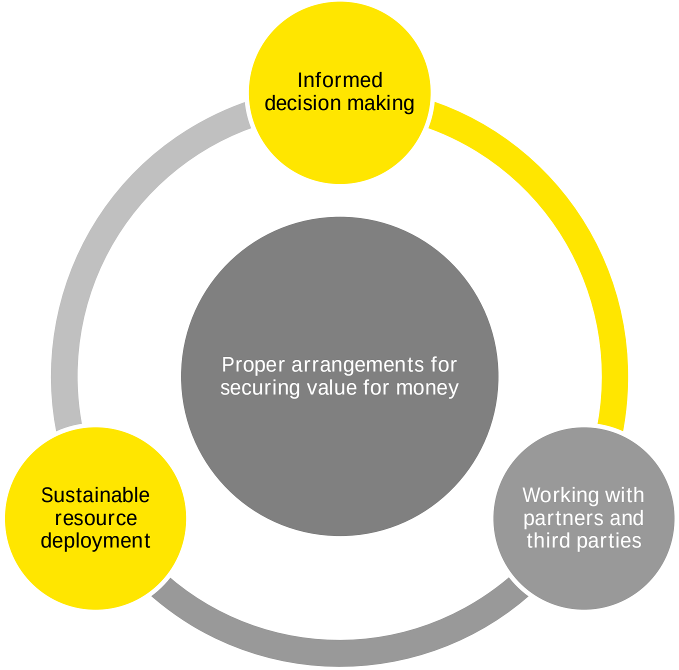
In considering your proper arrangements, we will draw on the requirements of the CIPFA/SOLACE framework for local government to ensure that our assessment is made against a framework that you are already required to have in place and to report on through documents such as your annual governance statement.

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. We consider business and operational risks insofar as they relate to proper arrangements at both sector and organisation-specific level. In 2018/19 this has included consideration of the steps taken by the Council to consider the impact of Brexit on its future service provision, medium-term financing and investment values. Although the precise impact cannot yet be modelled, we anticipate that Authorities will be carrying out scenario planning and that Brexit and its impact will feature on operational risk registers.

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. At the time of our planning, 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 Risks

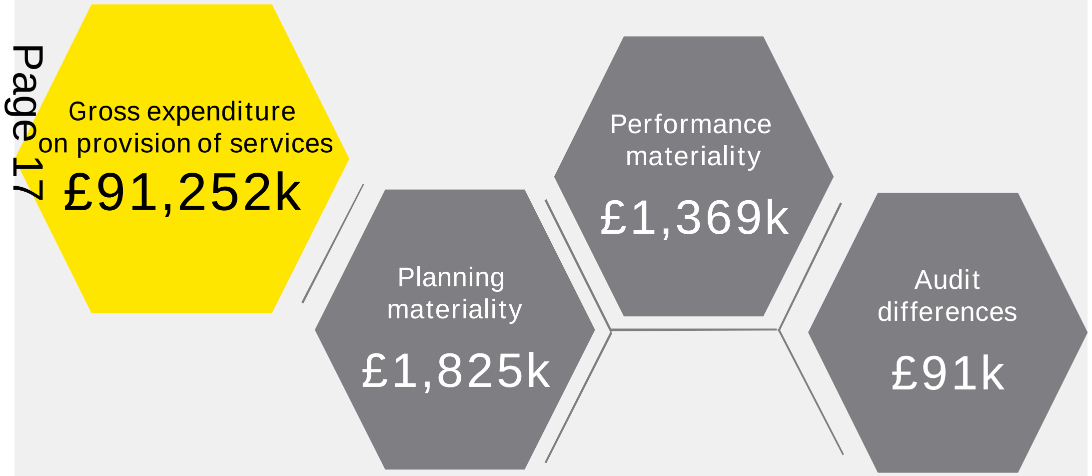
What is the significant value for money risk?	What arrangements does the risk affect?	What will we do?
Financial pressures in the public sector continue to mount. As a result of these pressures there is increased focus and wider public interest in the financial resilience of Local Government. The Council 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. The latest financial forecast has been prepared against a continuing backdrop of unprecedented uncertainty over Government funding and the economy. The Medium Term Financial Strategy (MTFS) uses the most recent information available to forecast the Council's income and expenditure over the next 5 years and the situation has deteriorated since the prior year principally due to a forecast that income from both New Homes Bonus (NHB) and business rates will reduce significantly. It is noted that the forecast is heavily dependent on both the future NHB scheme and the methodology that Central Government will use to reset the Business Rates baseline and that management aim to fine tune this assessment as more information becomes available. However, this remains a concern for the Council from a financial resilience perspective over the medium term.	Deploy resources in a sustainable manner	Our approach will focus on: • Reviewing achievement against the 2018/19 budget • Reviewing the reasonableness of the 2019/20 budget and five year Finance Strategy • Evaluating the progress made with and achievablility of efficiency and savings plans, including the purchase of the commercial property in Bognor Regis

04 Audit materiality

Materiality

Materiality

For planning purposes, materiality for 2018/19 has been set at £1,825k. This represents 2% of the Council's prior year gross expenditure on provision of services. It will be reassessed throughout the audit process. We have provided supplemental information about audit materiality in Appendix C.



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 £1,369k which represents 75% of planning materiality.

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, housing revenue account and 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

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).

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 Statement; 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.

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 2018/19 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.

Scope of our audit

Our Audit Process and Strategy (continued)

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 2018/19 financial year.
- Work with the Council to improve the use of 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.

06 Audit team

Use of specialists

When auditing key judgements, we are often required to rely on the input and advice provided by specialists who have qualifications and expertise not possessed by the core audit team. The area where either EY or third party specialists provide input for the current year audit is:

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 Council's 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 2018/19.

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.

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Audit phase	Timetable	Audit committee timetable	Deliverables
Planning: Risk assessment and setting of scopes.	November		
Walkthrough of key systems and processes	December		
	January		
	February	Audit and Governance Committee	Audit Planning Report
Testing of routine processes and controls 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
	August		
	Autumn	Audit and Governance Committee	Annual Audit Letter

08 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.

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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.

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.

None of the services are prohibited under the FRC's ES or the National Audit Office's Auditor Guidance Note 01 and the services have been approved in accordance with your policy on pre-approval. The ratio of non audit fees to audits fees is not permitted to exceed 70%.

At the time of writing, we have not undertaken any non-audit work. We plan to undertake the Housing Benefit Assurance Process, and the fee is less than the 70% limit. 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. From 2018-19, the Council is 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 has now been published and the Council has appointed EY as its reporting accountant from 2018-19 for a period of five years, subject to the agreement of an engagement letter.

The specific testing of individual benefit claims and associated subsidy calculations undertaken in respect of this Agreed Upon Procedure (AUP) engagement is distinct and separate to any work we have or will undertake on the financial systems of the Authority. The results of the AUP testing is not reflected in the amounts included/disclosed in the financial statements.

In respect of the checking of benefit system parameters, this work is common across our external audit procedures and this AUP engagement. However, our external audit is concluded prior to this AUP engagement. Therefore the external audit conclusion is therefore not reliant upon the conclusion of our AUP engagement.

No advice will be given in relation to accounting treatment. The report we provide will be prepared or given solely for the purposes of the agreed upon procedures engagement described above and will not be used or relied upon for any other purposes.

Relationships, services and related threats and safeguards

Management threats

Partners and employees of EY are prohibited from taking decisions on behalf of management of the Council. 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.

Other communications

EY Transparency Report 2018

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 2018 and can be found here:

http://www.ey.com/uk/en/about-us/ey-uk-transparency-report-2018

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.

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 requirements of the Code of Audit Practice and supporting guidance published by the National Audit Office, the financial reporting requirements set out in the Code of Practice on Local Authority Accounting published by CIPFA/LASAAC, and the professional standards applicable to auditors' work.

	Planned fee 2018/19	Scale fee 2018/19	Final Fee 2017/18
	£	£	£
Total Fee – Code work (1)	43,969	43,969	58,082
Total audit	43,969	43,969	58,082
Other non-audit services not covered above (Housing Benefits) (2)	10,379	10,379	10,100
Total other non-audit services	10,379	10,379	10,100
Total fees	54.348	54,348	68,182

All fees exclude VAT

Note:

(1) Our 2018/19 Code work includes additional planned procedures highlighted in section two of this report to address the new accounting requirements of IFRS 9 Financial Instruments and IFRS 15 Revenue from contracts with customers. As at the date of our planning report the Council is yet to evidence their assessment of the impact of these standards, and so we cannot currently quantify the expected scale fee variation for these additional procedures. We will agree this with management, depending on the identified impact of the new standards and any additional fee is subject to agreement by the PSAA.

(2) Our 2017/18 Housing Benefit Certification final fee includes £1,770 in respect of additional work required to review and capture extended testing undertaken due to errors identified during our testing and the impact on the qualification letter. The proposed additional fee is subject to approval by the PSAA.

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

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.	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

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Appendix B

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 B

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 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 B

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	• 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

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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, 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.

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.

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ARUN DISTRICT COUNCIL

REPORT TO AND DECISION OF AUDIT AND GOVERNANCE ON 14 FEBRUARY 2019

PART A: REPORT

SUBJECT: Approval of Accounting Policies 2018/19

REPORT AUTHOR: Carolin Martlew, Financial Services Manager
DATE: 15/01/2019
EXTN: 37568
PORTFOLIO AREA: Corporate Support

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 2018/19 for approval by the committee in July 2019.

RECOMMENDATIONS:

The Committee is requested to approve the accounting policies that will be applied to the Statement of Accounts 2018/19.

1. BACKGROUND:

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 2019.

1.2 The Statement of Accounts sets out the Council's income and expenditure for the year, and its financial position at 31 March 2019.

2. PROPOSAL(S):

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.

3. OPTIONS:

Accounting policies are a statutory requirement and therefore the Committee is requested to approve the accounting policies that will be applied to the Statement of Accounts 2018/19.

4. CONSULTATION:		
Has consultation been undertaken with:	**YES**	**NO**
Relevant Town/Parish Council		✓
Relevant District Ward Councillors		✓
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	✓	
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:

The Accounting Policies will be applied to the Statement of Accounts 2018/19

7. REASON FOR THE DECISION:

To ensure that the Statement of Accounts is prepared using proper accounting practices as required by the Local Government Act 2003.

8. BACKGROUND PAPERS:

The code of Practice on Local Authority on Local Authority Accounting in the United Kingdom 2018/19 Accounts (CIPFA)

Prudential Code (CIPFA)

LAAP Bulletin: Closure of the 2018/19 Accounts and Related Matters (CIPFA)

Note 1 - Accounting Policies

i. General Principles

The Statement of Accounts summarises the Council's transactions for the 2018/19 financial year and its position at the year-end of 31 March 2019. 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 2018/19, 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 contracts with service recipients, whether for services or the provision of goods, is recognised when (or as) the goods or services are transferred to the service recipient in accordance with the performance obligations in the contract.

- 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.

Where debtor balances for the above are identified as impaired because of the likelihood arising from a past event that payments due under statutory arrangements will not be made (fixed or determinable payments), 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. The impairment loss is measured as the difference between the carrying amount and the revised future cash flows.

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 pension's 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 39.

Financial Assets:

Financial assets are classified based on a classification and measurement approach that reflects the business model for holding the financial assets and their cash flow characteristics. The main classes of financial asset measured at:

- amortised cost
- fair value through profit of loss (PFPL).

The Council's business model is to hold investments to collect contractual cash flows. Financial assets are therefore classified as amortised cost, except for those whose contractual payments are not solely payment of principal and interest (i.e. where the cash flows do not take the form of a basic debt instrument).

Financial Assets Measured at Amortised Cost:

Financial assets measured at amortised cost are recognised on the Balance Sheet when the Council becomes 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 (CIES) for interest receivable are based on the carrying amount of the asset multiplied by the effective rate of interest for the instrument. For most of the financial assets held by the Council, this means that the amount presented in the Balance Sheet is the outstanding principal receivable (plus accrued interest) and interest credited to the CIES is the amount receivable for the year in the loan agreement.

Any gains and losses that arise on the derecognition of an asset are credited or debited to the Financing and Investment Income and Expenditure line in the CIES.

Expected Credit Loss Model:

The Council recognises expected credit losses on all of its financial assets held at amortised cost, either on a 12-month or lifetime basis. The expected credit loss model also applies to lease receivables and contract assets. Only lifetime losses are recognised for trade receivables (debtors) held by the Council.

Impairment losses are calculated to reflect the expectation that the future cash flows might not take place because the borrower could default on their obligations. Credit risk plays a crucial part in assessing losses. Where risk has increase significantly since an instrument was initially recognised, losses are assessed on a lifetime basis. Where risk has not increased significantly or remains low, losses are assessed on the basis of 12-month expected losses.

Financial Assets Measure at Fair Value through Profit and Loss:

Financial assets that are measured at FVPL are recognised on the Balance Sheet when the Council becomes party to the contractual provision of the financial instrument and are initially measured and carried at fair value. Fair value gains and losses are recognised as they arrive in the Surplus or Deficit on the Provision of Services.

The fair value measurements of the financial assets 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.

The inputs to the measurement techniques are categorised in accordance with three levels (see xxi Fair Value).

Any gains and losses that arise on the derecognition of the asset are credited or debited to the Financing and Investment Income and Expenditure line in the Comprehensive Income and Expenditure Statement.

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.

Business Improvement Districts

A Business Improvement District (BID) scheme applies to Bognor Regis. The scheme is funded by a BID levy paid by non-domestic ratepayers. The Council acts as a principal under the scheme, and accounts for income received and expenditure incurred (including contributions to the BID project) within the relevant services within the Comprehensive Income and Expenditure Statement.

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 Council 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 Council 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 Council 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 – depreciation is calculated by assuming a remaining useful life of 37 years for both houses and flats. These figures are based on weighted averages of the remaining useful lives of the key components of each dwelling (structure, roof, kitchen, bathroom, boiler and externals).

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: The basis of depreciation for HRA dwellings (37 years for both houses and flats) serves as a proxy for componentisation as the relevant useful lives are calculated by reference to the weighted average of the useful lives of the key components.

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.

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.

ARUN DISTRICT COUNCIL

REPORT TO AND DECISION OF AUDIT AND GOVERNANCE ON 14 FEBRUARY 2019

PART A: REPORT

SUBJECT: Capital Strategy 2019/20 to 2021/22

REPORT AUTHOR: Carolin Martlew, Financial Services Manager
DATE: 15/01/2019
EXTN: 37568
PORTFOLIO AREA: Corporate Support

EXECUTIVE SUMMARY:

The report allows the Audit and Governance Committee to consider and comment on the Council's Capital Strategy 2019/20 to 2021/22 before adoption by Full Council.

RECOMMENDATIONS:

The Committee is requested to recommend to **Full Council** that the Capital Strategy 2019/20 to 2021/21 be approved.

1. BACKGROUND:

1.1 This strategy forms the framework for capital investment decisions over the next three years and will inform the detailed annual capital budgets over this period. It is closely linked to the Treasury Management Strategy, the Investment Strategy and the Borrowing Strategy.

1.2 The strategy aims to balance capital expenditure needs and expectations (e.g. replacement of business critical IT systems) with the scarcity of available resources.

2. PROPOSAL(S):

2.1 The Treasury Management Code allows authorities to delegate the detailed management of Treasury Management, including the Capital Strategy, to a sub-committee and this responsibility is now delegated to the Audit and Governance Committee. This delegation will facilitate more active discussion of the Capital Strategy and its implementation though overall responsibility will at all times remain with the full Council.

2.2 Capital Strategy 2019/20 to 2021/22 for consideration is included in Appendix 1.

3. OPTIONS: To endorse the Capital Strategy 2019/20 to 2021/22.		
4. CONSULTATION:		
Has consultation been undertaken with:	**YES**	**NO**
Relevant Town/Parish Council		✓
Relevant District Ward Councillors		✓
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	✓	
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: The Capital Strategy will inform capital expenditure decisions.		

7. REASON FOR THE DECISION:

To ensure that the capital strategy 2019/20 to 2021/22 is considered before approval by Full Council.

8. BACKGROUND PAPERS:

Prudential Code (CIPFA)

ARUN DISTRICT COUNCIL

CAPITAL STRATEGY - 2019/20 to 2021/22

1. INTRODUCTION

1.1 Overview

This strategy forms the framework for capital investment decisions over the next three years and will inform the detailed annual capital budgets over this period. It is closely linked to the Treasury Management Strategy, the Investment Strategy and the Borrowing Strategy.
The strategy aims to balance capital expenditure needs and expectations (e.g. replacement of business critical IT systems) with the scarcity of available resources.

1.2 Member approval and review

The Treasury Management Code allows authorities to delegate the detailed management of Treasury Management, including the Capital Strategy, to a sub-committee and this responsibility is now delegated to the Audit and Governance Committee. This delegation will facilitate more active discussion of the Capital Strategy and its implementation though overall responsibility will at all times remain with the full Council.

1.3 Strategic Direction of the Council

A key driver of the Capital Strategy is the Council's 2020 Vision programme – "working together for a better future". This programme provides strategic direction to help the Council become more effective and sustainable and to enable it to meet the demands of the future. The strands of the Vision programme are :

- Offering a better customer experience
- Strengthening external relationships
- Providing more digital online services
- Becoming smaller and more effective

1.4 Capital Expenditure

Capital expenditure, defined in accordance with the Council's approved accounting policies and procedures, can be funded in a variety of ways;-

- Grants
- Section 106 contributions
- Capital receipts
- Direct Revenue contributions
- Borrowing

The method of funding for any particular scheme will depend on a number of factors and this is covered in more detail below.
It should be noted that the Council has extremely limited resources for the funding of capital expenditure, with the capital receipts balance having reduced significantly over recent years due to the planned use of these receipts for the delivery of the Littlehampton Wave project (Littlehampton's new sports and leisure facility).

1.5 Whole life costing for capital schemes

Whole life costing can be defined as "the systematic consideration of all relevant costs and revenues associated with the acquisition and ownership of an asset." In practical terms this means that any appraisal of a proposed capital project will need to consider not just the initial capital cost but all costs and income streams associated with the project that are likely to occur in future years, including possible replacement or disposal costs. This is vital to ensure that the Council is not committing itself to future liabilities that are unsustainable.

1.6 Scheme Evaluation and Risk

Any appraisal of proposed new capital schemes should include a full evaluation of risk, having regard to the whole life costing methodology set out above.

1.7 Monitoring of approved capital schemes

For approved capital schemes it is the responsibility of the relevant budget holder to manage costs and to provide explanations for any variations from the approved budget. Budget monitoring statements are presented to Corporate Management Team on a monthly basis and to Cabinet quarterly.

1.8 Separate capital programmes for the Housing Revenue Account and the General Fund

The capital programmes for the Housing Revenue Account (HRA) and the General Fund are considered in detail below. The HRA is a statutorily ring-fenced account covering income and expenditure relating to the Council's rented stock and the General Fund covers all other Council services. The ring-fence means that the HRA and the General Fund are completely separate entities, each having their own budget and financial model. For these reasons the HRA and General Fund capital programmes are considered separately.

2. HOUSING REVENUE ACCOUNT (HRA) PROGRAMME

2.1 Acquisition of new dwellings

The HRA capital programme for 2019/20 to 2021/22 will be driven by the approved HRA Business Plan. One of the key priorities of this plan is the acquisition of 250 new dwellings over the 10 year life of the plan, the acquisition to be funded from a mix of "1 for 1" Right to Buy receipts* (30%) and borrowing (70%). However, a recently published Government consultation paper proposed a number of changes to the way that retained Right to Buy receipts can be used and this could have significant implications for the planned programme.

*The receipts retained by agreement with the Government subject to these receipts being used for the provision of new social housing.

2.2 Other capital expenditure

The HRA Business Plan identified the need for significant investment in the existing housing stock as one of the primary concerns for the Housing Service. The two key issues in the short to medium term will be

- undertaking a reappraisal of the current improvements/capitalised repairs programme in the light of the outcome of the stock condition survey, and
- establishing and implementing a programme of improvements to some of the sheltered schemes

2.3 Affordability, borrowing and the abolition of the HRA debt cap

The HRA capital programme will need to be constantly reviewed to assess affordability. In particular, consideration will need to be given to the loan servicing costs of any new borrowing to ensure that these costs, together with the costs associated with existing, self-financing, debt can be sustained.

It is worth noting that due to Arun's policy of making prudent debt redemption provision the (recently abolished) HRA debt-cap has never been a barrier to additional borrowing.

3. GENERAL FUND PROGRAMME

3.1 Core annual programme

The Council has a core annual programme comprising asset management (all non HRA assets), Information Technology and Disabled Facilities Grants (DFG's).

DFG's pay for essential adaptations to help people with disabilities stay in their own homes. The DFG programme is entirely funded by Government Grant whereas the asset management and Information Technology programmes are funded by revenue contributions.

3.2 Property Investment Fund

A property investment fund has been established with the aim of acquiring properties to generate a return for the Council. Property acquisitions are funded by earmarking a proportion of the Council's capital receipts from land and property disposals. Acquisitions can only be made once a full business case has been completed and the risks fully understood and evaluated. Further details are set out in the Arun District Council Property Investment Strategy 2017–2022.

3.3 Other Schemes

In addition to the core annual programme other schemes will be considered subject to the criteria set out below. However, the key issue here is the lack of funding, as reflected in the Council's medium term financial strategy which envisages only a modest programme. It is therefore particularly important that any new schemes have a clear benefit to ensure that limited resources are used in the most effective possible way.

3.4 Prioritising new schemes

In common with other local authorities Arun is facing a challenging financial climate and it is therefore essential that systems are in place to ensure that scarce resources are allocated in the most effective possible way. New schemes will be assessed against the following criteria;-

- Link to the Council's strategic direction (the 2020 Vision programme)
- Availability of specific external funding
- Demonstration of a sound business case
- Whole life cost implications (see 1.5 above)
- Value for money

High priority will be given to the replacement of business critical IT systems.

3.5 Affordability and available resources

In addition to considering the merits of individual schemes the Council will need to assess the overall affordability of any new programme, having regard to the availability of resources, existing financial commitments and the projected level of balances forecast in the medium term financial strategy.

As outlined in 1.4 above, possible sources of funding for capital schemes are;-

- Grants
- Section 106 contributions
- Capital receipts
- Direct Revenue contributions
- Borrowing

3.6 Specific resource issues

Grants and Section 106 contributions are generally used to fund specific capital schemes linked to the conditions imposed by the relevant grant or section 106 contribution. There is little, if any, latitude in the way this funding can be applied.

Capital receipts are derived from the sale of the Council's assets, including council houses sold under the Right to Buy. It is the Council's policy to use these receipts (with the exception of "1 for 1"Right to Buy receipts which can only be used for the provision of new social housing) to support the General Fund capital programme. A specified proportion of these receipts will be earmarked for the Property Investment Fund (see 3.2 above).

Revenue contributions are a flexible source of funding but they put an immediate strain on the General Fund balance and can therefore only be used to a limited extent. Borrowing spreads the cost over a number of years but loan servicing costs and the overall level of debt exposure both need to be considered and clearly flagged in a business case.

3.7 Major schemes already approved and committed

The existing capital programme includes two major schemes which the Council is fully committed to delivering. These schemes will take priority over any others in terms of the allocation of resources. These schemes are "The Wave" – Littlehampton's new sports and leisure facility – and the Pavilion Park at Bognor Regis. It is extremely likely that these schemes will absorb the bulk of any available funding and, given that the schemes are the Council's stated priorities, it is vital that resources are not allocated to other non-priority schemes.

4. LINKS TO OTHER COUNCIL STRATEGIES

4.1 Treasury Management Strategy

The capital strategy is closely linked to the Treasury Management Strategy and it is essential that any investment decisions are informed by both strategies. In particular the assessment of affordability outlined in 3.5 above will need to have regard to the relevant elements of the Treasury Management Strategy including;-

- The incremental impact of capital investment on council tax and housing rent levels
- The borrowing strategy
- The authorised limit for external debt

4.2 Property Investment Strategy

This Strategy sets out the policies relating to the Property Investment Fund (see 3.2 and 3.6 above).

4.3 Asset Management Strategy

As outlined in 3.1 above, there is a core annual programme to cover capitalised repairs and improvements for all the Council's non HRA assets. The asset management strategy establishes the priorities for this programme having regard to the condition of the various assets and their respective priorities in terms of delivering Council services or generating rental income.

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2019/20 Capital, Asset Management and other projects budget   Appendix

General Fund

	£'000
Asset management	1,000
Disabled facilities grants	1,500
Information & Communications Technology	370
Keystone Centre	250
Pavilion Park	300
Play Areas	100
Total General Fund	**3,520**

Housing Revenue Account

	£'000
Aids and adaptations	410
Boiler Room Improvements	350
Domestic Heating Programme	600
Fire Precaution Works	300
Kitchen & Bathroom Replacement Programme	600
Rewiring	250
Reroofing Programme	643
Sheltered Schemes Programme	600
Windows and Doors	1,074
Other works	596
Total Housing Revenue Account	**5,423**

Total 2019/20 Budget   8,943

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ARUN DISTRICT COUNCIL

REPORT TO AUDIT AND GOVERNANCE COMMITTEE ON 14 February 2019

PART A: REPORT

SUBJECT: Treasury Management Strategy Statement and Annual Investment Strategy 2019/20

REPORT AUTHOR: Sian Southerton – Senior Accountant (Treasury)
DATE: January 2019
EXTN: 37861
PORTFOLIO AREA: Residential Services

EXECUTIVE SUMMARY:

The purpose of this report is to present the Treasury Management Strategy Statement and Annual Investment Strategy 2019/2020 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 2019/20;
(ii) approve the Annual Investment Strategy for 2019/20; and
(iii) approve the Prudential Indicators for 2019/20, 2020/2021 and 2021/22 as contained in appendix 1 and the body of the report.

BACKGROUND:

1 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.

The contribution the treasury management function makes to the authority is critical, as the balance of debt and investment operations ensure liquidity or the ability to meet spending commitments as they fall due, either on day-to-day revenue or for larger capital projects. The treasury operations will see a balance of the interest costs of debt and the investment income arising from cash deposits affecting the available budget. Since cash balances generally result from reserves and balances, it is paramount to ensure adequate security of the sums invested, as a loss of principal will in effect result in a loss to the General Fund Balance.

Whilst any commercial initiatives or loans to third parties will impact on the treasury function, these activities are generally classed as non-treasury activities, (arising usually from capital expenditure) and are separate from the day to day treasury management activities.

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."

Revised reporting is required for the 2019/20 reporting cycle due to revisions of the MHCLG Investment Guidance, the MHCLG Minimum Revenue Provision (MRP) Guidance, the CIPFA Prudential Code and the CIPFA Treasury Management Code. The primary reporting changes include the introduction of a capital strategy, to provide a longer-term focus to the capital plans, and greater reporting requirements surrounding any commercial activity undertaken under the Localism Act 2011. The capital strategy is being reported separately at this meeting and will go to Full Council on 13th March 2019.

1.2 Reporting Arrangements

1.2.1 Capital Strategy

The CIPFA revised 2017 Prudential and Treasury Management Codes require, for 2019-20, all local authorities to prepare an additional report, a capital strategy report, which will provide the following:

- a high-level long term 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 capital strategy is to ensure that all elected members on the full council fully understand the overall long-term policy objectives and resulting capital strategy requirements, governance procedures and risk appetite.

This capital strategy and the property Investment strategy are reported separately from the Treasury Management Strategy Statement; non-treasury investments will be reported through property Investment strategy. This ensures the separation of the core treasury function under security, liquidity and yield principles, and the policy and commercialism investments usually driven by expenditure on an asset. They will show:

- The corporate governance arrangements for these types of activities;
- Any service objectives relating to the investments;
- The expected income, costs and resulting contribution;
- The debt related to the activity and the associated interest costs;
- The payback period (MRP policy);
- For non-loan type investments, the cost against the current market value;
- The risks associated with each activity.

Where a physical asset is being bought, details of market research, advisers used, (and their monitoring), ongoing costs and investment requirements and any credit information will be disclosed, including the ability to sell the asset and realise the investment cash.

Where the Council has borrowed to fund any non-treasury investment, there should also be an explanation of why borrowing was required and why the MHCLG Investment Guidance and CIPFA Prudential Code have not been adhered to.

If any non-treasury investment sustains a loss during the final accounts and audit process, the strategy and revenue implications will be reported through the same procedure as the capital strategy.

To demonstrate the proportionality between the treasury operations and the non-treasury operation, high-level comparators are shown throughout this report.

1.2.2 Treasury Management reporting

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.

a. **Prudential and Treasury Indicators and Treasury Strategy** (this report) - The first and most important report is forward looking and 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).

b. **A Mid-Year Treasury Management Report** – This is primarily a progress report and will update members on 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.

c. **An Annual Treasury Report** – This is a backward looking review document providing 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.

1.3 Treasury Management Strategy for 2019/20

The strategy for 2019/20 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 Treasury Management Code, the CIPFA Prudential Code, MHCLG Investment Guidance and the MHCLG Minimum Revenue Provision (MRP) Guidance.

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 2018/19 Strategy (Appendix 2) 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.
Accordingly, 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 15th November 2018.

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. All decisions will be undertaken with regards to all available information, including, but not solely, our treasury advisers.

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.

The scope of investments within the Council's operations now includes both conventional treasury investments, (the placing of residual cash from the Council's functions), and more commercial type investments, such as investment properties. Any commercial type investments will require specialist advisers in relation to this activity.

2 <u>The Capital Prudential Indicators 2019/20 to 2021/22</u> (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 20th February 2019.

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 Linear Park development and Keystone Centre. 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. Any shortfall of resources results in a funding borrowing need;

Capital Expenditure	Actual 2017/18 £,000	Current Estimate 2018/19 £,000	Estimate 2019/20 £,000	Estimate 2020/21 £,000	Estimate 2021/22 £,000
Non HRA	10,957	14,224	3,520	5,596	3,230
HRA	6,226	3,714	10,423	8,647	3,647
HRA settlement	-	-	-	-	-
Total	**17,183**	**17,938**	**13,943**	**14,243**	**6,877**
Financed by:					
Capital receipts (1-4-1)	10,425	4,842	1,500	1,500	0
Capital grants	734	1,919	1,500	1,500	1,500
Capital reserves	2,861	1,396	5,393	3,617	3,617
Revenue	649	8,158	2,050	1,336	1,760
	14,669	**16,315**	**10,443**	**10,743**	**6,877**
Net financing need for the year	**2,514**	**1,623**	**3,500**	**3,500**	**0**

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 indebtedness and so its 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 2017/18 £,000**	**Current Estimate 2018/19 £,000**	**Estimate 2019/20 £,000**	**Estimate 2020/21 £,000**	**Estimate 2021/22 £,000**
Capital Financing Requirement					
General Fund	-3,594	-3,799	-4,009	-4,223	-4,442
HRA	55,401	53,694	52,425	52,305	52,069
Total CFR	**51,807**	**49,895**	**48,416**	**48,082**	**47,627**
Movement in CFR	**(1,030)**	**(1,912)**	**(1,479)**	**(334)**	**(455)**

Movement in CFR represented by					
New leasing arrangements (GF)	372	0	0	0	0
HRA unfinanced	2,340	1,837	2,275	3,500	3,500
Less MRP/VRP	(3,742)	(3,749)	(3,754)	(3,834)	(3,955)
Movement in CFR	**(1,030)**	**(1,912)**	**(1479)**	**(334)**	**(455)**

2.3 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	**2017/18 Actual £m**	**2018/19 Estimate £m**	**2019/20 Estimate £m**	**2020/21 Estimate £m**	**2021/22 Estimate £m**
Fund balances	17.3	13.0	11.7	9.0	7.4
Earmarked Reserves	18.4	19.1	18.2	17.2	16.2
Capital Receipts	5.0	2.6	2.9	2.2	1.5
Other	1.7	2.0	2.0	2.0	2.0
Total core funds	**42.4**	**36.7**	**34.8**	**30.4**	**27.1**
Under/over borrowing	18.3	23.3	11.2	8.6	-2.1
Expected investments	**60.7**	**60.0**	**46.0**	**39.0**	**25.0**

2.4 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).

MHCLG 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 MHCLG 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, but there is a requirement for a charge for depreciation to be made. 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 2019/20 HRA budget. If borrowing is taken out for general fund in 2019/20, the MRP policy will need to be reviewed.

MRP Overpayments - A change introduced by the revised MHCLG MRP Guidance was the allowance that any charges made over the statutory minimum revenue provision (MRP), voluntary revenue provision or overpayments, can, if needed, be reclaimed in later years if deemed necessary or prudent. In order for these sums to be reclaimed for use in the budget, this policy must disclose the cumulative overpayment made each year. Up until the 31 March 2019 their were no VRP overpayments.

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.

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 2017/18 %	Current Estimate 2018/19 %	Estimate 2019/20 %	Estimate 2020/21 %	Estimate 2021/22 %
Non-HRA	-2.24				

HRA	32.82				

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 and the Council's capital strategy. 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 2018 and 31 December 2018 summarised below;

TREASURY PORTFOLIO				
	actual	actual	current	current
	31.3.18	**31.3.18**	**31.12.18**	**31.12.18**
Treasury investments	£000	%	£000	%
banks	43,000	71%	48,000	86%
building societies - unrated	5,000	8%	0	0%
building societies - rated	0	0%	0	0%
local authorities	2,000	3%	2,000	4%
DMADF (H.M.Treasury)	0	0%	0	0%
money market funds	5,730	9%	710	1%
Total managed in house	**55,730**	**92%**	**50,710**	**91%**
property funds	5,000	8%	5,000	9%
Total managed externally	**5,000**	**8%**	**5,000**	**9%**
Total treasury investments	**60,730**	**100%**	**55,710**	**100%**
Treasury external borrowing				
PWLB	53,180	100%	53,180	100%
Total external borrowing	**53,180**	**100%**	**53,180**	**100%**
Net treasury investments / (borrowing)	**7,550**	**0**	**2,530**	**0**

The investments held at 31st December 2018 are shown in Appendix 3.

The Council's forward projections for borrowing are summarised below. The table shows the actual external debt, against the underlying capital borrowing need, (the Capital Financing Requirement - CFR), highlighting any over or under borrowing.

£m	2017/18 Actual	2018/19 Estimate	2019/20 Estimate	2020/21 Estimate	2021/22 Estimate
External Debt					
Debt at 1 April	53,180				
Expected change in Debt					
Other long-term liabilities (OLTL)					
Expected change in OLTL					
Actual gross debt at 31 March					
The Capital Financing Requirement					
Under / (over) borrowing					

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 2019/20 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 or speculative 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 currently exceeds its CFR.

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 £56M in Appendix 1 (2019/20).

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

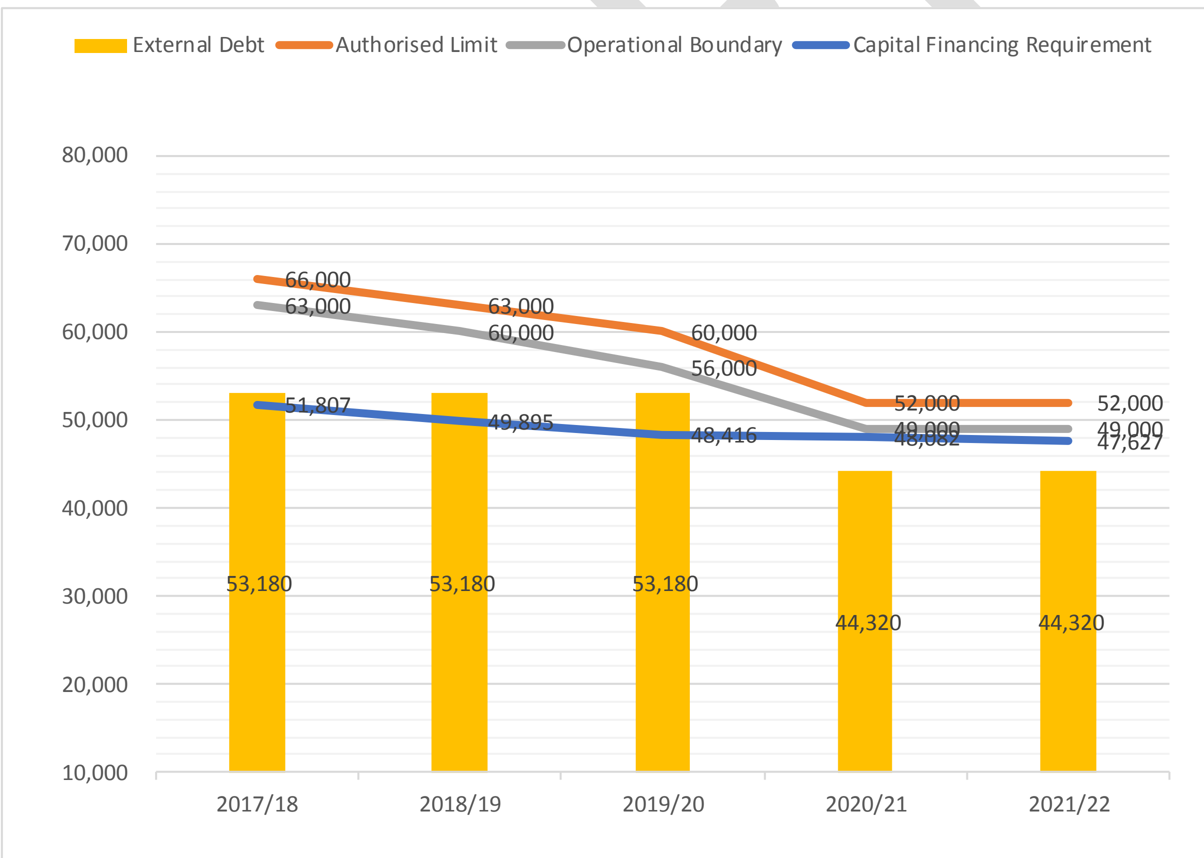
set or revised by the full Council. It reflects the level of external debt which, while not desired, could be afforded in the short term, but is not sustainable in the longer term.

(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 £60M (appendix 1 2019/20).

3.2.3 In October 2018 the Government announced the abolition of the HRA debt cap. Prior to this date there was a statutory limit to each housing authority's HRA CFR (Arun - £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 (£53M-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.

Link Asset Services Interest Rate View	Mar-19	Jun-19	Sep-19	Dec-19	Mar-20	Jun-20	Sep-20	Dec-20	Mar-21	Jun-21	Sep-21	Dec-21	Mar-22
Bank Rate View	0.75%	1.00%	1.00%	1.00%	1.25%	1.25%	1.25%	1.50%	1.50%	1.75%	1.75%	1.75%	2.00%
3 Month LIBID	0.90%	1.00%	1.10%	1.20%	1.30%	1.40%	1.50%	1.50%	1.60%	1.70%	1.80%	1.90%	2.00%
6 Month LIBID	1.00%	1.20%	1.30%	1.40%	1.50%	1.60%	1.70%	1.70%	1.80%	1.90%	2.00%	2.10%	2.20%
12 Month LIBID	1.20%	1.30%	1.40%	1.50%	1.60%	1.70%	1.80%	1.90%	2.00%	2.10%	2.20%	2.30%	2.40%
5yr PWLB Rate	2.10%	2.20%	2.20%	2.30%	2.30%	2.40%	2.50%	2.50%	2.60%	2.60%	2.70%	2.80%	2.80%
10yr PWLB Rate	2.50%	2.60%	2.60%	2.70%	2.80%	2.90%	2.90%	3.00%	3.00%	3.10%	3.10%	3.20%	3.20%
25yr PWLB Rate	2.90%	3.00%	3.10%	3.10%	3.20%	3.30%	3.30%	3.40%	3.40%	3.50%	3.50%	3.60%	3.60%
50yr PWLB Rate	2.70%	2.80%	2.90%	2.90%	3.00%	3.10%	3.10%	3.20%	3.20%	3.30%	3.30%	3.40%	3.40%

3.3.2

The flow of generally positive economic statistics after the quarter ended 30 June meant that it came as no surprise that the MPC came to a decision on 2 August to make the first increase in Bank Rate above 0.5% since the financial crash, from 0.5% to 0.75%. Growth became increasingly strong during 2018 until slowing significantly during the last quarter. At their November quarterly Inflation Report meeting, the MPC left Bank Rate unchanged, but expressed some concern at the Chancellor's fiscal stimulus in his Budget, which could increase inflationary pressures. However, it is unlikely that the MPC would increase Bank Rate in February 2019, ahead of the deadline in March for Brexit. On a major assumption that Parliament and the EU agree a Brexit deal in the first quarter of 2019, then the next increase in Bank Rate is forecast to be in May 2019, followed by increases in February and November 2020, before ending up at 2.0% in February 2022.

The overall longer run future trend is for gilt yields, and consequently PWLB rates, to rise, albeit gently. However, over about the last 25 years, we have been through a period of falling bond yields as inflation subsided to, and then stabilised at, much lower levels than before, and supported by central banks implementing substantial quantitative easing purchases of government and other debt after the financial crash of 2008. Quantitative easing, conversely, also caused a rise in equity values as investors searched for higher returns and purchased riskier assets. In 2016, we saw the start of a reversal of this trend with a sharp rise in bond yields after the US Presidential election in November 2016, with yields then rising further as a result of the big increase in the US government deficit aimed at stimulating even stronger economic growth. That policy change also created concerns around a significant rise in inflationary pressures in an economy which was already running at remarkably low levels of unemployment. Unsurprisingly, the Fed has continued on its series of robust responses to combat its perception of rising inflationary pressures by repeatedly increasing the Fed rate to reach 2.25 – 2.50% in December 2018. It has also continued its policy of not fully reinvesting proceeds from bonds that it holds as a result of quantitative easing, when they mature. We therefore saw US 10 year bond Treasury yields rise above 3.2% during October 2018 and also investors causing a sharp fall in equity

prices as they sold out of holding riskier assets. However, by early January 2019, US 10 year bond yields had fallen back considerably on fears that the Fed was being too aggressive in raising interest rates and was going to cause a recession. Equity prices have been very volatile on alternating good and bad news during this period.

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, emerging market developments and sharp changes in investor sentiment. 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.

Investment and borrowing rates

Investment returns are likely to remain low during 2019/20 but to be on a gently rising trend over the next few years.

Borrowing interest rates have been volatile so far in 2018-19 and while they were on a rising trend during the first half of the year, they have backtracked since then until early January. 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, (the difference between higher borrowing costs and lower investment returns), to any new long-term borrowing that causes a temporary increase in cash balances as this position will, most likely, incur a revenue cost.

3.4 Borrowing Strategy

3.4.1 As stated in 2.1, The Council has a significant capital programme including HRA acquisition/new build, Linear Park development and Keystone Centre.

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 especially as the Council no longer has an overdraft. The facility was removed as banking costs for this were increased considerably. The Treasury team maintain a daily balance of approx. £200k (earning interest at the bank of England base rate -10bp, currently 0.65%).

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

3.4.2 **Maturity structure of borrowing**

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:

Maturity structure of fixed interest rate borrowing 2019/20			
	Actual at 31/03/19	**Lower**	**Upper**
Under 12 months	16.66%	0%	40%
12 months and within 24 months	0%	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%

The Council currently has no variable rate borrowing and no plans to have in 2019/20.

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 switching from long-term debt to short-term debt. However any savings will need to be considered in the light of the current treasury position and the size of the cost of debt repayment (premiums 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 Full 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.

3 Annual Investment Strategy

4.1 Investment Policy – management of risk

The Council's investment policy has regard to the following: -

- MHCLG's Guidance on Local Government Investments ("the Guidance")
- CIPFA Treasury Management in Public Services Code of Practice and Cross

Sectoral Guidance Notes 2017 (“the Code”)

- CIPFA Treasury Management Guidance Notes 2018

The Council’s investment priorities will be security first, portfolio liquidity second and then yield, (return).

The above guidance from the MHCLG and CIPFA place a high priority on the management of risk. This authority has adopted a prudent approach to managing risk and defines its risk appetite by the following means: -

1. Minimum acceptable **credit criteria** are applied in order to generate a list of highly creditworthy counterparties. This also enables diversification and thus avoidance of concentration risk. The key ratings used to monitor counterparties are the short term and long-term ratings.

2. **Other information:** ratings will not be the sole determinant of the quality of an institution; 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 achieve this consideration 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.

3. **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.

4. This Council has defined the list of **types of investment instruments** that the treasury management team are authorised to use. There are two lists in appendix 6 under the categories of ‘specified’ and ‘non-specified’ investments.

    - **Specified investments** are those with a high level of credit quality and subject to a maturity limit of one year.

    - **Non-specified investments** are those with less high credit quality, may be for periods in excess of one year, and/or are more complex instruments which require greater consideration by members and officers before being authorised for use.

5. This authority will set a limit for the amount of its investments which are invested for **longer than 365 days**, (Appendix 1).

6. Investments will only be placed with counterparties from countries with a specified minimum **sovereign rating**, (Appendix 8).

7. All investments will be denominated in **sterling**.

8. As a result of the change in accounting standards for 2018/19 under **IFRS 9,** this authority will consider the implications of investment instruments which could result in an adverse movement in the value of the amount invested and resultant charges at the end of the year to the General Fund. ((In November 2018, the Ministry of

Housing, Communities and Local Government, [MHCLG], concluded a consultation for a temporary override to allow English local authorities time to adjust their portfolio of all pooled investments by announcing a statutory override to delay implementation of IFRS 9 for five years commencing from 1.4.18.)

9. The Council may invest in investments that are termed "alternative investments". These include, but are not limited to, things such as renewable energy bonds (Solar farms) and regeneration bonds. These are asset backed bonds, offering good returns, and will enable the Council to enter new markets, thus furthering the diversification of our investment portfolio with secured investments and enhancing yield. Any investments entered into of this type will be subject to a full due diligence review.

However, this authority will also pursue **value for money** in treasury management and will monitor the yield from investment income against appropriate benchmarks for investment performance, (see paragraph 4.5). Regular monitoring of investment performance will be carried out during the year

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 not till June 2019 (25bp).

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

This Council supplements credit ratings using the creditworthiness service provided by Link Asset Services. This service employs a sophisticated modelling approach utilising credit ratings from the three main credit rating agencies - Fitch, Moody's and Standard & Poor's. The credit ratings of counterparties are supplemented with the following overlays:

- credit watches and credit outlooks from credit rating agencies;
- CDS spreads 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.

- if a downgrade results in the counterparty / investment scheme no longer meeting the Council's minimum criteria, its further use as a new investment will be withdrawn immediately.
- in addition to the use of credit ratings the Council will be advised of information in movements in credit default swap spreads against the iTraxx benchmark and other market data on a daily basis via its Passport website, provided exclusively to it by Link Asset Services. Extreme market movements may result in downgrade of an institution or removal from the Council's lending list.

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.

UK banks – ring fencing

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

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

While the structure of the banks included within this process may have changed, the fundamentals of credit assessment have not. The Council will continue to assess the new-formed entities in the same way that it does others and those with sufficiently high ratings, (and any other metrics considered), will be considered for investment purposes.

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 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 £60M (as at 31 December 2018). These funds are partially cash-flow derived and there is a core balance of approximately £47M 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 £18.4M, £5M, £12.4M and £6.6M at 31 March 2018 respectively.

The Council currently only has the £5m in the CCLA property fund spanning the financial year and the are no forward commitments (deals) for the financial year 2019/20.

Investment returns expectations.
On the assumption that the UK and EU agree a Brexit deal in spring 2019, then Bank Rate is forecast to increase steadily but slowly over the next few years to reach 2.00% by quarter 1 2022. Bank Rate forecasts for financial year ends (March) are:

- 2018/19 - 0.75%
- 2019/20 - 1.25%
- 2020/21 - 1.50%
- 2021/22 - 2.00%

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

	Now
2018/19	0.75%
2019/20	1.00%
2020/21	1.50%
2021/22	1.75%
2022/23	1.75%
2023/24	2.00%
Later years	2.50%

- The overall balance of risks to economic growth in the UK is probably neutral.
- The balance of risks to increases in Bank Rate and shorter term PWLB rates, are probably also even and are dependent on how strong GDP growth turns out, how slowly inflation pressures subside, and how quickly the Brexit negotiations move forward positively.

The Council's budgeted rate of return for 2019/20 is 1.24% based on 1.19% on funds that are already invested; 4.35% for the property fund (£5M); 0.93% for the remaining core balances; and 0.65% for short term cash flow derived balances. The total investment income budget for 2019/20 is £596,000. The budget is based on investments 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 (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 have picked up, they are at still at a low level (0.65 – 0.76%) . The MMFs are "triple A" rated, liquid, and most will now be LVNAV (Low Volatility net asset value). This is a change from the previous constant net asset value (CNAV) as a result of the MMF reform where typically for every pound of principal invested you got 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 came into force on 21st July 2018 in relation to existing funds. The Council will look to place investments in MMF's as below; but most will now be LVNAV due to the reform;

- 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.

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	**2019/20**	**2020/21**	**2021/22**
Principal sums invested > 365 days	18	15	10

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.

4.6 Investment risk benchmarking

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

4.7 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.

4.8 Scheme of delegation

Please see Appendix 9.

4.9 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 (2018) *(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	2017/18	2018/19	2019/20	2020/21	2021/22
Extract from budget and rent setting report	**Actual**	**Probable outturn**	**Original**	**Original**	**Original**
	£'000	**£'000**	**£'000**	**£'000**	**£'000**
Capital Expenditure					
Non – HRA	10,957	14,224	3,520	5,596	3,230
HRA	6,226	3,714	10,423	8,617	3,647
TOTAL	**17,183**	**17,938**	**13,943**	**14,243**	**6,877**
Ratio of financing costs to net revenue stream					
Non – HRA	-2.24%	-X.xx%	-X.xx%	-X.xx%	-X.xx%
HRA	32.82%	Xx.xx%	Xx.xx%	Xx.xx%	Xx.xx%
Capital Financing Requirement as at 31 March					
Non – HRA	-3,594	-3,799	-4,009	-4,223	-4,442
HRA	55,401	53,694	52,425	52,305	52,069
TOTAL	**51,807**	**49,895**	**48,416**	**48,082**	**47,627**
Annual change in Cap. Financing Requirement					
Non – HRA	3,685	X,xxx	X,xxx	X,xxx	X,xxx
HRA	-1,172	xx	xx	xx	xx
TOTAL	**-2,513**	**X,xx**	**X,xx**	**X,xx**	**X,xx**

2. TREASURY MANAGEMENT INDICATORS	2017/18	2018/19	2019/20	2020/21	2021/22
	Actual	Probable outturn	Original	Original	Original
	£'000	£'000	£'000	£'000	£'000
Authorised Limit for external debt					
Borrowing	66,000	63,000	60,000	52,000	52,000
Other long term liabilities	0	0	0	0	0
TOTAL	**66,000**	**63,000**	**60,000**	**52,000**	**52,000**
Operational Boundary for external debt					
Borrowing	63,000	60,000	56,000	49,000	49,000
other long term liabilities	0	0	0	0	0
TOTAL	**64,000**	**60,000**	**56,000**	**49,000**	**49,000**
Actual external debt	53,180	53,180	53,180	44,320	44,320
Maximum HRA Debt Limit	81,630	N/a	N/a	N/a	N/a
Upper limit for total principal sums invested for over 365 days (£m)	**26**	**22**	**18**	**15**	**10**

Maturity structure of fixed rate borrowing - upper & Lower limits	Actual at 31/03/19	lower limit	upper limit
under 12 months	16.66%	0%	40%
12 months and within 24 months	0%	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 2018

Appendix 3

Type of Investment/Deposit	Reference no.	Counterparty	Issue Date	Maturity Date	Nominal	Current Interest Rate
Fixed Term Deposit	671	Goldman Sachs International	27/03/2018	03/01/2019	£1,000,000.00	1.175
Fixed Term Deposit	629	Close Brothers Ltd	26/01/2017	04/01/2019	£1,000,000.00	1.05
Fixed Term Deposit	663	Goldman Sachs International	11/01/2018	10/01/2019	£1,000,000.00	0.99
Fixed Term Deposit	684	Santander	06/07/2018	21/01/2019	£1,000,000.00	0.80
Fixed Term Deposit	665	Lloyds Bank PLC	31/01/2018	31/01/2019	£2,000,000.00	0.85
Fixed Term Deposit	687	Development Bank of Singapore (DBS	09/08/2018	11/02/2019	£1,000,000.00	0.91
Fixed Term Deposit	680	Qatar National Bank	05/06/2018	14/02/2019	£2,000,000.00	1.14
Fixed Term Deposit	686	Qatar National Bank	16/07/2018	14/02/2019	£1,000,000.00	1.20
Fixed Term Deposit	599	Natwest Markets (was RBS)	31/03/2016	18/02/2019	£2,000,000.00	1.50**
Fixed Term Deposit	667	Qatar National Bank	01/03/2018	28/02/2019	£1,000,000.00	1.20
Fixed Term Deposit	668	Close Brothers Ltd	02/03/2018	04/03/2019	£1,000,000.00	1.00
Fixed Term Deposit	689	Development Bank of Singapore (DBS	06/09/2018	06/03/2019	£3,000,000.00	0.95
Fixed Term Deposit	634	Close Brothers Ltd	17/03/2017	15/03/2019	£1,000,000.00	1.00
Fixed Term Deposit	670	Goldman Sachs International	19/03/2018	18/03/2019	£1,000,000.00	1.20
Fixed Term Deposit	672	Qatar National Bank	28/03/2018	27/03/2019	£1,000,000.00	1.32
Fixed Term Deposit	691	Development Bank of Singapore (DBS	01/10/2018	01/04/2019	£2,000,000.00	0.950
Fixed Term Deposit	637	Close Brothers Ltd	18/04/2017	10/04/2019	£1,000,000.00	1.00
Fixed Term Deposit	692	Development Bank of Singapore (DBS	22/10/2018	23/04/2019	£2,000,000.00	0.95
Fixed Term Deposit	693	Leeds County Council	26/10/2018	26/04/2019	£2,000,000.00	0.85
Fixed Term Deposit	675	Goldman Sachs International	08/05/2018	07/05/2019	£2,000,000.00	1.10
Fixed Term Deposit	676	Qatar National Bank	09/05/2018	09/05/2019	£1,000,000.00	1.31
Fixed Term Deposit	677	Goldman Sachs International	23/05/2018	22/05/2019	£1,000,000.00	1.10
Fixed Term Deposit	620	Natwest Markets (was RBS)	19/08/2016	19/08/2019	£2,000,000.00	1.10*
Fixed Term Deposit	688	Qatar National Bank	30/08/2018	30/08/2019	£2,000,000.00	1.35
Fixed Term Deposit	690	Close Brothers Ltd	17/09/2018	17/09/2019	£1,000,000.00	1.10
Fixed Term Deposit	694	Goldman Sachs International	08/11/2018	07/11/2019	£2,000,000.00	1.305
Fixed Term Deposit	695	Santander	16/11/2018	18/11/2019	£2,000,000.00	1.25
Fixed Term Deposit	696	Qatar National Bank	20/11/2018	19/11/2019	£2,000,000.00	1.49
Fixed Term Deposit	697	Qatar National Bank	06/12/2018	05/12/2019	£1,000,000.00	1.50
Fixed Term Deposit	698	Barclays	06/12/2018	05/12/2019	£2,000,000.00	1.04
Fixed Term Deposit	699	Close Brothers Ltd	19/12/2018	18/12/2019	£2,000,000.00	1.25
Fixed Term Deposit	700	Close Brothers Ltd	21/12/2018	20/12/2019	£1,000,000.00	1.25
Property Fund	140000	CCLA (Churches, Charities and LA's)			£5,000,000.00	4.4***
Money Market Fund	100500	Federated			£710,000.00	0.76
Callable deposit	44446	Lloyds 95DN			£2,000,000.00	0.80
					£55,710,000.00	

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

Interest Rate Forecast 2019 - 2022

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-19	Jun-19	Sep-19	Dec-19	Mar-20	Jun-20	Sep-20	Dec-20	Mar-21	Jun-21	Sep-21	Dec-21	Mar-22
Bank Rate View	0.75%	1.00%	1.00%	1.00%	1.25%	1.25%	1.25%	1.50%	1.50%	1.75%	1.75%	1.75%	2.00%
3 Month LIBID	0.90%	1.00%	1.10%	1.20%	1.30%	1.40%	1.50%	1.50%	1.60%	1.70%	1.80%	1.90%	2.00%
6 Month LIBID	1.00%	1.20%	1.30%	1.40%	1.50%	1.60%	1.70%	1.70%	1.80%	1.90%	2.00%	2.10%	2.20%
12 Month LIBID	1.20%	1.30%	1.40%	1.50%	1.60%	1.70%	1.80%	1.90%	2.00%	2.10%	2.20%	2.30%	2.40%
5yr PWLB Rate	2.10%	2.20%	2.20%	2.30%	2.30%	2.40%	2.50%	2.50%	2.60%	2.60%	2.70%	2.80%	2.80%
10yr PWLB Rate	2.50%	2.60%	2.60%	2.70%	2.80%	2.90%	2.90%	3.00%	3.00%	3.10%	3.10%	3.20%	3.20%
25yr PWLB Rate	2.90%	3.00%	3.10%	3.10%	3.20%	3.30%	3.30%	3.40%	3.40%	3.50%	3.50%	3.60%	3.60%
50yr PWLB Rate	2.70%	2.80%	2.90%	2.90%	3.00%	3.10%	3.10%	3.20%	3.20%	3.30%	3.30%	3.40%	3.40%
Bank Rate													
Link Asset Services	0.75%	1.00%	1.00%	1.00%	1.25%	1.25%	1.25%	1.50%	1.50%	1.75%	1.75%	1.75%	2.00%
Capital Economics	0.75%	1.00%	1.25%	1.50%	1.70%	1.75%	2.00%	2.00%	-	-	-	-	-
5yr PWLB Rate													
Link Asset Services	2.10%	2.20%	2.20%	2.30%	2.30%	2.40%	2.50%	2.50%	2.60%	2.60%	2.70%	2.80%	2.80%
Capital Economics	2.03%	2.15%	2.40%	2.65%	2.70%	2.75%	2.80%	2.85%	-	-	-	-	-
10yr PWLB Rate													
Link Asset Services	2.50%	2.60%	2.60%	2.70%	2.80%	2.90%	2.90%	3.00%	3.00%	3.10%	3.10%	3.20%	3.20%
Capital Economics	2.43%	2.55%	2.80%	3.05%	3.05%	3.05%	3.05%	3.05%	-	-	-	-	-
25yr PWLB Rate													
Link Asset Services	2.90%	3.00%	3.10%	3.10%	3.20%	3.30%	3.30%	3.40%	3.40%	3.50%	3.50%	3.60%	3.60%
Capital Economics	2.96%	3.08%	3.33%	3.58%	3.53%	3.48%	3.43%	3.38%	-	-	-	-	-
50yr PWLB Rate													
Link Asset Services	2.70%	2.80%	2.90%	2.90%	3.00%	3.10%	3.10%	3.20%	3.20%	3.30%	3.30%	3.40%	3.40%
Capital Economics	2.78%	2.90%	3.15%	3.40%	3.40%	3.40%	3.40%	3.40%	-	-	-	-	-

APPENDIX 5

GLOBAL OUTLOOK. World growth has been doing reasonably well, aided by strong growth in the US. However, US growth is likely to fall back in 2019 and, together with weakening economic activity in China and the eurozone, overall world growth is likely to weaken.

Inflation has been weak during 2018 but, at long last, unemployment falling to remarkably low levels in the US and UK has led to a marked acceleration of wage inflation. The US Fed has therefore increased rates nine times and the Bank of England twice. However, the ECB is unlikely to start raising rates until late in 2019 at the earliest.

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. A new period is well advanced in the US, and started more recently in the UK, of 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 a 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 also encouraged investors into a search for yield and into investing in riskier assets such as equities. Consequently, prices in both bond and equity markets rose to historically high valuation levels simultaneously. This meant that both asset categories were exposed to the risk of a sharp downward correction and we have indeed, seen a sharp fall in equity values in the last quarter of 2018. 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, conversely, 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.** At the time of writing, (early January 2019), financial markets are very concerned that the Fed is being too aggressive with its policy for raising interest rates and was likely to cause a recession in the US economy.

The world economy also needs to adjust to a sharp change in **liquidity creation** over the last five years where the US has moved from boosting liquidity by QE purchases, to reducing its holdings of debt, (currently about $50bn per month). In addition, the European Central Bank ended its QE purchases in December 2018.

UK. The flow of positive economic statistics since the end of the first quarter of 2018 has shown that pessimism was overdone about the poor growth in quarter 1 when adverse weather caused a temporary downward blip. Quarter 1 at 0.1% growth in GDP was followed by a return to 0.4% in quarter 2 and by a strong performance in quarter 3 of +0.6%. However, growth in quarter 4 is expected to weaken significantly.

At their November quarterly Inflation Report meeting, the MPC repeated their well-worn phrase that future Bank Rate increases would be gradual and would rise to a much lower equilibrium rate, (where monetary policy is neither expansionary of contractionary), than before the crash; indeed they gave a figure for this of around 2.5% in ten years time, but declined to give a medium term forecast. However, with so much uncertainty around Brexit, they warned that the next move could be up or down, even if there was a disorderly Brexit. While it would be expected that Bank Rate could be cut if there was a significant fall in GDP growth as a result of a disorderly Brexit, so as to provide a stimulus to growth, they warned they could also *raise* Bank Rate in the same scenario if there was a boost to inflation from a devaluation of sterling, increases in import prices and more expensive goods produced in the UK replacing cheaper goods previously imported, and so on. In addition, the Chancellor could potentially provide fiscal stimulus to support economic growth, though at the cost of increasing the budget deficit above currently projected levels.

It is unlikely that the MPC would increase Bank Rate in February 2019, ahead of the deadline in March for Brexit. Getting parliamentary approval for a Brexit agreement on both sides of the Channel will take well into spring 2019. However, in view of the hawkish stance of the MPC at their November meeting, the next increase in Bank Rate is now forecast to be in May 2019, (on the assumption that a Brexit deal is agreed by both the UK and the EU). The following increases are then forecast to be in February and November 2020 before ending up at 2.0% in February 2022.

Inflation. The Consumer Price Index (CPI) measure of inflation has been falling from a peak of 3.1% in November 2017 to 2.3% in November. In the November Bank of England quarterly Inflation Report, inflation was forecast to still be marginally above its 2% inflation target two years ahead, (at about 2.1%), given a scenario of minimal increases in Bank Rate. This inflation forecast is likely to be amended upwards due to the Bank's report being produced prior to the Chancellor's announcement of a significant fiscal stimulus in the Budget; this is likely to add 0.3% to GDP growth at a time when there is little spare capacity left in the economy, particularly of labour.

As for the **labour market** figures in October, unemployment at 4.1% was marginally above a 43 year low of 4% on the Independent Labour Organisation measure. A combination of job vacancies hitting an all-time high, together with negligible growth in total employment numbers, indicates that employers are now having major difficulties filling job vacancies with suitable staff. It was therefore unsurprising that wage inflation picked up to 3.3%, (3 month average regular pay, excluding bonuses). This meant that in real terms, (i.e. wage rates less CPI inflation), earnings are currently growing by about 1.0%, the highest level since 2009. This increase in household spending power is likely to feed through into providing some support to the overall rate of economic growth in the coming months. This tends to confirm that the MPC was right to start on a cautious increase in Bank Rate in August as it views wage inflation in excess of 3% as increasing inflationary pressures within the UK economy.

In the **political arena**, there is a risk that the current Conservative minority government may be unable to muster a majority in the Commons over Brexit. However, our central position is that Prime Minister May's government will endure, despite various setbacks, along the route to reaching an orderly Brexit in March 2019. If, however, the UK faces a general election in the next 12 months, this could result in a potential loosening of monetary and fiscal policy and therefore medium to longer dated gilt yields could rise on the expectation of a weak pound and concerns around inflation picking up.

USA. President Trump's massive easing of fiscal policy is fuelling a, (temporary), boost in consumption which has generated an upturn in the rate of strong growth which rose from 2.2%, (annualised rate), in quarter 1 to 4.2% in quarter 2 and 3.5%, (3.0% y/y), in quarter 3, but also an upturn in inflationary pressures. The strong growth in employment numbers and the reduction in the unemployment rate to 3.9%, near to a recent 49 year low, has fed through to an upturn in wage inflation which hit 3.2% in November, However, CPI inflation overall fell to 2.2% in November and looks to be on a falling trend to drop below the Fed's target of 2% during 2019. The Fed has continued on its series of increases in interest rates with another 0.25% increase in December to between 2.25% and 2.50%, this being the fifth increase in 2018 and the ninth in this cycle. However, they did also reduce their forecast for further increases from three to two. This latest increase compounded investor fears that the Fed is over doing the rate and level of increases in rates and that it is going to cause a US recession as a result. There is also much evidence in previous monetary policy cycles, of the Fed's series of increases doing exactly that. Consequently, we have seen stock markets around the world plunging under the weight of fears around the Fed's actions, the trade war between the US and China, an expectation that world growth will slow, Brexit etc.

The tariff war between the US and China has been generating a lot of heat during 2018, but it is not expected that the current level of actual action would have much in the way of a significant effect on US or world growth. However, there is a risk of escalation if an agreement is not reached soon between the US and China.

Eurozone. Growth was 0.4% in quarters 1 and 2 but fell back to 0.2% in quarter 3, though this was probably just a temporary dip. In particular, data from Germany has been mixed and it could be negatively impacted by US tariffs on a significant part of manufacturing exports e.g. cars. For that reason, although growth is still expected to be in the region of nearly 2% for 2018, the horizon is less clear than it seemed just a short while ago. Having halved its quantitative easing purchases of debt in October 2018 to €15bn per month, the European Central Bank ended all further purchases in December 2018. The ECB is forecasting inflation to be a little below its 2% top limit through the next three years so it may find it difficult to warrant a start on raising rates by the end of 2019 if the growth rate of the EU economy is on a weakening trend.

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. Progress has been made in reducing the rate of credit creation, particularly from the shadow banking sector, which is feeding through into lower economic growth. There are concerns that official economic statistics are inflating the published rate of growth.

Japan - has been struggling to stimulate consistent significant GDP growth and 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. It is likely that loose monetary policy will endure for some years yet to try to stimulate growth and modest inflation.

Emerging countries. Argentina and Turkey are currently experiencing major headwinds
and are facing challenges in external financing requirements well in excess of their reserves of foreign exchange. However, these countries are small in terms of the overall world economy, (around 1% each), so the fallout from the expected recessions in these countries will be minimal.

INTEREST RATE FORECASTS

The interest rate forecasts provided by Link Asset Services in paragraph 3.2 are predicated on an assumption of an agreement being reached on Brexit between the UK and the EU. In the event of an orderly non-agreement exit, it is likely that the Bank of England would take action to cut Bank Rate from 0.75% in order to help economic growth deal with the adverse effects of this situation. This is also likely to cause short to medium term gilt yields to fall. If there was a disorderly Brexit, then any cut in Bank Rate would be likely to last for a longer period and also depress short and medium gilt yields correspondingly. It is also possible that the government could act to protect economic growth by implementing fiscal stimulus.

The balance of risks to the UK

- The overall balance of risks to economic growth in the UK is probably neutral.
- The balance of risks to increases in Bank Rate and shorter term PWLB rates, are probably also even and are broadly dependent on how strong GDP growth turns out, how slowly inflation pressures subside, and how quickly the Brexit negotiations move forward positively.

One risk that is both an upside and downside risk, is that all central banks are now working in very different economic conditions than before the 2008 financial crash as there has been a major increase in consumer and other debt due to the exceptionally low levels of borrowing rates that have prevailed for ten years since 2008. This means that the neutral rate of interest in an economy, (i.e. the rate that is neither expansionary nor deflationary), is difficult to determine definitively in this new environment, although central banks have made statements that they expect it to be much lower than before 2008. Central banks could therefore either over or under do increases in central interest rates.

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

- **Brexit** – if it were to cause significant economic disruption and a major downturn in the rate of growth.
- **Bank of England monetary policy** takes action too quickly, or too far, 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.
- A resurgence of the **eurozone sovereign debt crisis**, possibly in **Italy**, due to its high level of government debt, low rate of economic growth and vulnerable banking system, and due to the election in March of a government which has made a lot of anti-austerity noise. The EU rejected the initial proposed Italian budget and demanded cuts in government spending which the Italian government initially refused. However, a fudge was subsequently agreed, but only by *delaying* the planned increases in expenditure to a later year. This can has therefore only been kicked down the road to a later time. The rating agencies have started on downgrading Italian debt to one notch above junk level. If Italian debt were to fall below investment grade, many investors would be unable to hold it. Unsurprisingly, investors are becoming increasingly concerned by the words and actions of the Italian government and consequently, Italian bond yields have risen – at a time when the government faces having to refinance large amounts of debt maturing in 2019.
- Weak capitalisation of some **European banks**. Italian banks are particularly vulnerable; one factor is that they hold a high level of Italian government debt - debt which is falling in value. This is therefore undermining their capital ratios and raises the question of whether they will need to raise fresh capital to plug the gap.
- **German minority government.** In the German general election of September 2017, Angela Merkel's CDU party was left in a vulnerable minority position dependent on the fractious support of the SPD party, as a result of the rise in popularity of the anti-immigration AfD party. Then in October 2018, the results of the Bavarian and Hesse state elections radically undermined the SPD party and showed a sharp fall in support for the CDU. As a result, the SPD is reviewing whether it can continue to support a coalition that is so damaging to its electoral popularity. After the result of the Hesse state election, Angela Merkel announced that she would not stand for re-election as CDU party leader at her party's convention in December 2018, (a new party leader has now been elected). However, this makes little practical difference as she is still expected to

aim to continue for now as the Chancellor. However, there are five more state elections coming up in 2019 and EU parliamentary elections in May/June; these could result in a further loss of electoral support for both the CDU and SPD which could also undermine her leadership.

- **Other minority eurozone governments.** Spain, Portugal, Ireland, the Netherlands and Belgium all have vulnerable minority governments dependent on coalitions which could prove fragile. Sweden is also struggling to form a government due to the anti-immigration party holding the balance of power, and which no other party is willing to form a coalition with. The Belgian coalition collapsed in December 2018 but a minority caretaker government has been appointed until the May EU wide general elections.
- **Austria, the Czech Republic and Hungary** now form a strongly anti-immigration bloc within the EU while **Italy,** in 2018, also elected a strongly anti-immigration government. Elections to the EU parliament are due in May/June 2019.
- Further increases in interest rates in the US could spark a **sudden flight of investment funds** from more risky assets e.g. shares, into bonds yielding a much improved yield. Throughout the last quarter of 2018, we saw sharp falls in equity markets interspersed with occasional partial rallies. Emerging countries which have borrowed heavily in dollar denominated debt, could be particularly exposed to this risk of an investor flight to safe havens e.g. UK gilts.
- There are concerns around the level of **US corporate debt** which has swollen massively during the period of low borrowing rates in order to finance mergers and acquisitions. This has resulted in the debt of many large corporations being downgraded to a BBB credit rating, close to junk status. Indeed, 48% of total investment grade corporate debt is now rated at BBB. If such corporations fail to generate profits and cash flow to reduce their debt levels as expected, this could tip their debt into junk ratings which will increase their cost of financing and further negatively impact profits and cash flow.
- **Geopolitical risks,** especially North Korea, but also in Europe and the Middle East, which could lead to increasing safe haven flows.

Upside risks to current forecasts for UK gilt yields and PWLB rates

- **Brexit** – if both sides were to agree a compromise that removed all threats of economic and political disruption.
- **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 QE, 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.
- 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,** whether domestically generated or imported, returning to sustained significantly higher levels causing an increase in the inflation premium inherent to gilt yields.

	specified	non-specified	Minimum Credit Criteria Fitch (and equivalent) / Minimum Criteria	Maximum Investment per Institution	Max. maturity period
Term deposits – Local Authorities (category 1)	✓	✓	--	£12M	5 years
Term deposits – banks and building societies (category 1)	✓	✓	Short-term F1+ Long-term AA-	£12M	5 years
Term deposits – banks and building societies (category 2)	✓	✓	Short-term F1 Long-term A+	£11M	3 years
Term deposits – banks and building societies (category 3)	✓	✓	Short-term F1 Long-term A-	£8M	2 years
Term deposits – building societies (Category 4)	✓	✓	Assets in Excess of £10 billion	£4M	1 year
Council's bank (for term deposits use appropriate category 1 to 3) (category 5)	✓	✓	n/a	No limit *Although category limit for term deposits*	As category 1 to 3
Term deposits – UK part nationalised banks (category 6)	✓	✓	Short-term F3 Long term BBB-	£11M	3 years
Callable deposits	✓	✓	As category 1,2,3,4,5 and 6	As category 1,2,3,4,5 and 6	As category 1,2,3,4,5 and 6
Forward deposits	✓	✓	As category 1,2,3,4,5 and 6	As category 1,2,3,4,5 and 6	As category 1,2,3,4,5 and 6
Bonds Issued by multilateral development banks (category 10)		✓	Long term AAA	£4M	5 years
Debt Management Agency Deposit Facility (category 9)	✓	✓	--	No limit	Liquid

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)
Nat Westminster Bank PLC (RFB) (UK)
The Royal Bank of Scotland PLC (RFB) (UK)

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

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

Barclays Bank plc (RFB & NRFB) (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)
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 (RFB)/National Westminster Bank plc (RFB) (Uk)(Nationalised)

<u>Category 7 - Collective Investment Schemes structured as Open Ended Investment</u> Companies (OEICs) MONEY MARKET FUNDS (CNAV, LVNAV & VNAV) and Government Liquidity Funds

Limit of £4million for each institution

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

<u>Category 8 - Collective Investment Schemes structured as Open Ended Investment Companies (OEICs)</u> – Enhanced Money Market Funds

Limit of £4million for each institution

<u>Category 9 - Debt Management Office</u>

Debt management Account - NO LIMIT (UK Govt)

<u>Category 10 - Bonds issued by multilateral development banks - 5 Years</u>

Maximum investment £4 million

<u>Category 11 – Property Funds - 25 Years</u>

Maximum investment £6 million

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

AA

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

AA-

- Belgium (S&P 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.

The above list of specific responsibilities of the S151 officer in the 2017 Treasury Management Code has not changed. However, implicit in the changes in both codes, is a major extension of the functions of this role, especially in respect of non-financial investments, (which CIPFA has defined as being part of treasury management.

- preparation of a capital strategy to include capital expenditure, capital financing, non-financial investments and treasury management, with a long-term timeframe
- 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
- 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.

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ARUN DISTRICT COUNCIL

REPORT TO AND DECISION OF AUDIT & GOVERNANCE COMMITTEE ON 14 FEBRUARY 2019

PART A : REPORT

SUBJECT: Annual Internal Audit Plan 2019/20

REPORT AUTHOR: Stephen Pearse, Chief Internal Auditor
DATE: February 2019
EXTN: 37561
PORTFOLIO AREA: Corporate Support

EXECUTIVE SUMMARY:

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

RECOMMENDATIONS:

Members of the Audit & Governance Committee are requested to agree the outline Annual Internal Audit Plan

1. BACKGROUND:

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 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.

The section continues to operate with 2 FTE in the short-term, with the focus on mandatory and high priority work. Now that the Council's revised structures / operations are largely finalised, consideration can be given to resourcing for the future).

As at the start of 2019, there are still a number of Council strategies (e.g. Customer Access, Digital, etc.) to be progressed that may result in work for the section. There also remains considerable uncertainty regarding a number of areas e.g.:-

- the Council's ongoing financial position, as impacted by central Government policy / funding changes and potential knock-on effects from cuts elsewhere e.g. WSCC
- the impact of Brexit arrangements once agreed by central Government and the

impact on the requirements for / provision of Council services
- potential change to political will as a result of the May 2019 District elections.

These may require further operational changes to meet new and changed requirements / legislation.

In view of this, an outline-only plan is attached for the agreement of the Committee and there will again need to be considerable flexibility through the year as to the assignment of resource to specific tasks. (NB - the outline plan has been prepared to be generally in line with the allocations that had been considered for the indicative common plan that had been drafted and included in the shared services business case in 2016). As agree with management, it is currently anticipated that work will be required (timing and scope to be agreed) at some stage in the year on e.g.:-

- the Housing service (after the restructure has been completed)
- the Office 365 implementation project
- the Northgate replacement / upgrade project (Revenues and Benefits software)
- the Council's Medium Term Financial Strategy, giving consideration to resilience and sustainability (linked to the issue of CIPFA's Financial Management Code which is expected later in 2019).

These will be accommodated within the proposed outline plan and reports on the progress of work being undertaken will be provided to meetings of the Audit & Governance Committee through the year, as is currently the case.

Should there be a significant change during the year in the work to be undertaken by the section or in the resource available to it, then a revised Plan will be prepared and advised to the Committee.

2. PROPOSAL(S):

It is proposed that the Committee agrees the outline Annual Internal Audit Plan for 2019/20

3. OPTIONS:

To agree the outline Annual Internal Audit Plan for 2019/20, or not

4. CONSULTATION:

Has consultation been undertaken with:	YES	NO
Relevant Town/Parish Council		✓
Relevant District Ward Councillors		✓
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		✓
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:

7. REASON FOR THE DECISION:

The Committee agrees the outline Annual Internal Audit Plan for 2019/20

8. BACKGROUND PAPERS:

N/A

<u>Outline Internal Audit Plan for 2019/20</u>

1/4/19- 39/3/20 (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	78
Computer Audit (including projects)	65
Business Systems Audit	125
Contract Audit	8
Follow-Ups	6
PSIAS / QAIP (includes reviewing & updating audit procedures)	2
Total Chargeable Days (Audit)	**284**
Governance / AGS	5
NFI	17
Corporate Fraud	3
Audit Advice	10
External Audit Liaison	4
Committee Representation	10
Planning & Control	23
Contingency (e.g. for special investigations)	7
Meetings (Corporate)	8
RIPA	2
FOI	2
Total Chargeable Days (Non-Audit)	**91**
Total Chargeable Days	**375**

(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)

ARUN DISTRICT COUNCIL

REPORT TO AND DECISION OF AUDIT & GOVERNANCE COMMITTEE ON 14 FEBRUARY 2019

PART A : REPORT

SUBJECT: Revised Strategic Risk Register 2018/19

REPORT AUTHOR: Stephen Pearse, Chief Internal Auditor
DATE: February 2019
EXTN: 37561
PORTFOLIO AREA: Corporate Support

EXECUTIVE SUMMARY:

The Council's Strategic Risk Register has been reviewed and revised to reflect changes since its last update in December 2017.

At its meeting of 15 November 2018, the Committee reviewed and approved the first half of the changes and agreed to complete the review process at this meeting.

RECOMMENDATIONS:

Members of the Audit & Governance Committee are requested to note and approve the remainder of the revised Strategic Risk Register

1. BACKGROUND:

The Council's Risk Management Strategy requires that the Strategic Risk Register (SRR) should be reviewed periodically and risks re-scored where necessary. It is also required to be reviewed at least annually by the Lead Officer and Lead Member for risk management. The Audit & Governance Committee has Member oversight of the risk management arrangements within the Council and last reviewed the SRR at its December 2017 meeting.

The SRR has been reviewed, updated and re-scored by the members of the Council's Governance & Risk Group in September 2018. The updated document has also been considered by the Corporate Management Team and by the Lead Officer and Lead Member for risk management.

The SRR update has considered significant changes that will affect the Council going forward, progress relating to risk areas identified (e.g. adoption of the Local Plan) and mitigating actions that are in place to reduce the level of the risks. It must, however, be recognised that the strategic risks are largely long-term and that the impact of external factors (e.g. Government policy and funding changes, etc.) remains uncertain.

The updated SRR document uses the same Excel format and scoring criteria as in recent years. However, it should be noted that the Council has now implemented new performance and risk management software (Pentana Performance) and it is anticipated that the format and content of the SRR and operational risk registers will be considered going forwards.

At its meeting of 15 November 2018, the Committee reviewed and approved a number of the risks and agreed to complete the process at its next meeting.

2. PROPOSAL(S):

It is proposed that the Committee notes and approves the remainder of the revised Strategic Risk Register

3. OPTIONS:

To note and approve the remainder of the revised Strategic Risk Register, or not

4. CONSULTATION:

Has consultation been undertaken with:	YES	NO
Relevant Town/Parish Council		✓
Relevant District Ward Councillors		✓
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		✓
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:

7. REASON FOR THE DECISION:

The Committee notes and approves the revised Strategic Risk Register

8. BACKGROUND PAPERS:

N/A

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ARUN DISTRICT COUNCIL – STRATEGIC RISK REGISTER 2018/19

ARUN DISTRICT COUNCIL – Risk Profile

Likelihood					
	4 Certain			16, 18	1, 6a
	3 Probable		6b	3	8, 13
	2 Possible		5,10	2, 4, 7, 9, 11	12
	1 Unlikely			14, 15	17
Impact		1 Insignificant	2 Marginal	3 Significant	4 Severe

The overall risk rating score is Likelihood x Impact

The matrix has 3 filters – red, amber and green:-

Red risks are those which cause the Council or service greatest concern, are in need of closer attention and may require more frequent scrutiny, review and reporting

Amber risks are those that should be reviewed periodically to determine if practical steps can be taken to reduce the scoring to 'green' and the control measures in operation regularly reviewed

Green risks are likely to require no further action but should still be subject to review

Risk No.	Risk Scenario Title
1	Finance
2	Change Management and Service Transformation
3	Regeneration and Economic Development
4	Contracts Management
5	Member Engagement and Capacity
6a	Homelessness
6b	Affordable Housing Development
7	Local Plan
8	Partnerships
9	Information and Data Security
10	Community Engagement and Customer Insight
11	Coastal Protection & Land Drainage
12	Corporate Business Continuity
13	Cybersecurity
14	New Littlehampton Leisure Centre
15	Local Authority Trading Companies
16	Corporate Stock Compliance Issues
17	Elections
18	Brexit Implications

Last updated in November 2018 – the Audit & Governance Committee partly reviewed the updated register at its meeting of 15 November 2018 and will complete the process at its next meeting in February 2019

No	Rating	Vulnerability	Trigger	Consequence	Current Controls / Mitigating Actions
1	16 ⇔	• Uncertainty around outcome on business rates changes • Uncertainty over future central government funding • CIL funding changes • Reduction in government grants going forward • Impact of changes in immigration rates • Impact of squeeze on HRA rents • Uncertainty around outcome of welfare reform • '2020 Vision' work fails to achieve required level of savings • Leaving the European Union – increased uncertainty over the economy • Possible multiple future borrowing requirements for General Fund and HRA • Significant external funding required to progress regeneration proposals	**Finance** The council faces a great deal of financial uncertainty which could result in budget deficits, loss of HRA & General Fund balance etc. Deficit worsens and balances reach minimum level in a shorter period of time Although Article 50 has been triggered, options and timescales for the progress of Brexit remain uncertain	• Financial insecurity and possible extra local funding to be found • Possible pressure to further outsource service areas • The council may fail to realise capital investment and/or income generation opportunities • Additional savings to be made in future years • National and institutional investment uncertainty – UK credit ratings reduced • Ongoing low interest rates, reducing treasury investment returns • Loss of EU grant funding (regeneration impact) • Further pressure on demand-led services e.g. benefits, homelessness, etc. • Possible negative impact on housebuilding, etc. • Interest and capital repayments to be made on borrowing • Ability to maintain minimum reserve level will be threatened • Major regeneration projects cannot be progressed	• ADC initially accepted the 10% loss in Council Tax Support funding. New scheme implemented for 2017-on and subject to review for 2019-on • Good culture of financial management previously = strong position going forward • Medium Term Financial Strategy (MTFS) regularly reviewed and reported to Cabinet • Strong asset management • Appetite to invest capital strategically • Treasury strategy / good investment performance – monitoring of available investment opportunities • Savings in 2020 Vision Plan being monitored • Outstanding 'review of service' programme areas to be completed – aim being better service, at reduced cost • Innovative schemes being considered to generate future revenue e.g. Property Investment Fund • Updated HRA Business Plan produced and monitored • Leader involvement in LGA and DCN lobbying, etc. • Monitoring of possible changes to Government policy, legislation, etc. • Other more innovative investment schemes being considered, but higher risk to obtain rewards • Efficiency Plan in place to obtain 4 year funding settlement • WSCC engaged with the Council to progress the Arun Growth Deal – more weight to requests to the LEP for funding
2	6	• Ineffective prioritisation in a	**Change Management and**	• Knowledge gaps are not filled	• The Arun Improvement Programme (AIP)

No	Rating	Vulnerability	Trigger	Consequence	Current Controls / Mitigating Actions
	⇔	smaller organisation • Residual '2020 Vision' work and management/operational restructures stretching resources and possibly leading to conflicting outcomes • Limited specialist project management staff for future major developments • Uncertainty surrounding Government's 'devolution' agenda	**Service Transformation** The council may not have the resource capacity (numbers, knowledge, expertise); and staff and members may have inherent resistance to change which will make it difficult to deliver the strategic outcomes	(loss of experienced managers / staff) • If capable staff are not developed internally and given opportunities they are more likely to leave – long term recruitment and retention issues • Lower morale and motivation (may increase in areas of potential outsourcing) • Possible increase in sickness absence, stress claims etc. • Potential governance issues in unfamiliar roles • Loss of strategic vision as operational duties (the day job) takes over • Political and management change harder to implement and embed • There may be lost opportunities for sharing services and work • Reliability of service delivery • Customer dissatisfaction / loss of trust or confidence within community • Potential reputational issues • More financial pressure on services • Projects / new initiatives fail to deliver desired outcomes • Limited budget for capital projects	reviews all major ICT and business change requests to ensure we invest in the right projects (board consists of officers and Members) • ICT Service Strategy being progressed in 2018 which will provide direction in terms of future capability • Separate Digital Strategy to be developed • Customer Access Strategy being reviewed and updated • Training and development plans considered in annual performance review • Senior Management Development Programme and New Manager programmes to be progressed • Short vs Long term sickness absence reported to Cabinet • Capital project plan agreed by Cabinet to allow for initial work load prioritisation • Outstanding 'review of service' programme areas to be completed – aim being better service, at reduced cost • Council will continue to investigate partnering opportunities with other Councils • Elements of shared services with other public bodies are working well • Council open to looking at more shared services and partnerships in future
3	9 ⇧	• Lack of visible progress with Bognor Regis developments • Failure to resource and implement the action plan to	**Regeneration and Economic Development** The plans to develop Bognor Regis and Littlehampton are	• Developers and investors could be deterred • Possible legal issues from developer plans submitted in	• Options for Regis Centre and Hothamton sites considered by consultants and outline design options agreed • Funding and development options being

No	Rating	Vulnerability	Trigger	Consequence	Current Controls / Mitigating Actions
		deliver the long term regeneration strategies (for Bognor Regis and generally throughout ADC) • Lack of funding to deliver major regeneration projects • Decisions not made swiftly enough – political will? • Lack of public/partner acceptance of, and buy-in to strategies • Legal challenges increase • Multiple major projects running simultaneously – resource stretched • Impact of growth of Butlins and Chichester University influencing local market conditions • Other Council borrowing priorities • Uncertainty surrounding major Government schemes impacting the area e.g. Arundel by-pass, Chichester by-pass	vulnerable to challenge and delays. The council may also be unable to agree a wider mid-long term strategy for economic development and regeneration across the district	advance of Council consideration of schemes • Missed opportunities to invest in areas of development potential • Reputational issues around non-delivery • Development of council land (car parks, etc.) could mean loss of income stream • Lack of growth • Increase in economic stagnation • Area turns into a commuter belt and is not regenerated leading to decline • Financial and reputational risk / poor publicity	progressed • Revised Sir Richard Hotham planning application rejected following Council determining its position as landowner, but approved on appeal • ADC leadership commitment to regeneration objectives to drive the project forward • Some capital spend projects progressed (East Bank, River Arun, Hotham Park café, etc.) • Bognor Regis Seafront Delivery Plan to progress • Further funding bid to be progressed for Littlehampton regeneration ideas • Central funding obtained and significant progress made on some regeneration schemes (Bognor Regis public realm, BR station) • National supermarket chains investing in the district • Rolls Royce investment programme at Bognor Regis Enterprise Zone • New planning applications for Salt Box site and bid to LEP for infrastructure grant • Bognor Regis Town Centre BID established • Continued working with key partners (e.g. Butlins, Chichester University) • Projects prioritised to best use available resource • Investment prospectus prepared for Bognor Regis • Investment Conference for Bognor Regis held in September 2017
4	6	• Major contracts let (waste collection, leisure, greenspace) -	**Contracts Management** The Council has recently let	• Tension between existing contractors and the council	• Contract specialists used for the re-tender processes

No	Rating	Vulnerability	Trigger	Consequence	Current Controls / Mitigating Actions
	⇔	contractors may not be making the expected savings, achieve the level of external investment, or provide service to the expected standard • Other major contracts under review/approaching re-tender • Public health transition may put leisure services under more pressure and scrutiny • Political commitment to weekly waste collections impacting future contract costs • Council may be reliant on third party (e.g. WSCC) timescales • Major IT systems due for re-tender	a number of its most significant contracts (leisure, waste management, grounds maintenance, services for the elderly)	through tendering / change periods • Poor publicity / reputational issues • Cost savings are not achieved • Service quality deteriorates • Possible major projects and operational changes required if it is decided to change long-established IT systems	• Procurement Strategy in place • Leisure management officer resource in place • Clearer communication of council's expectations of contractor(s) • Strategic view going forward • Leisure Management and Greenspace contracts awarded with significant savings and investment commitment • Waste management contract extended to allow additional savings • Services for activities for the elderly being progressed as joint procurement exercise with WSCC
5	4 ⇔	• Historically, some members have failed to engage wholeheartedly with processes (don't attend training, fail to embrace electronic working practices / revised IT systems, etc.) • Small opposition • Some lack of understanding of resource requirements and change issues • Unwillingness by many members to communicate unpopular changes and decisions to the public • Lack of interest by backbenchers • Some members are county councillors and Parish/Town Councillors leading to "twin-hatting or triple hatting" • Uncertainty concerning potential	**Member Engagement and Capacity** The complexity of current legislation could lead to some members not having the necessary skill-set to meet the demands of the changes and increasing financial and service delivery pressures facing the council	• Strained relationships between officers and members • Potential DPA / FOI issues • More vulnerability to governance and compliance failures • Decisions held up by process • Less ownership and leadership at local levels through lack of engagement	• Overall member desire to see council move forward • Common goals clearly understood and agreed – Member involvement in '2020 Vision' work and consideration of alternative service delivery mechanisms • Cabinet Working Party review of scheme of delegation of authority completed • Review of Constitution and Codes of Conduct progressing • Agreed Corporate Plan with focus on key issues (to act as a "temperature gauge") • Induction plan for new members to be developed in 2018 for May 2019 elections • New committees system and equipment approved by Full Council for use by Members post the 2019 elections

No	Rating	Vulnerability	Trigger	Consequence	Current Controls / Mitigating Actions
		future 'devolution'			
6a	16 ⇔	• Overarching homelessness strategy – but service needs to be more proactive • Increase in demands on the Council • 'Squeeze' on rents will have an impact on HRA, Council house building and RSLs in the area • Uncertainty over Government 'levies' (e.g. pay to stay, sale of high value properties, etc.) • Increase in immigration due to current EEC Policy on free movement and current crises in Middle East and Africa • Increase in demands from the Welfare Reform Act • Significant increase in university campus at Bognor will impact availability of accommodation • Uncertainty over government benefit changes – Universal Credit, etc. • Lack of internal officer capacity to deliver changes in addition to existing capital programme • Impact of HMO's becoming student or staff accommodation on local rental market stock • Additional responsibilities under the Homelessness Reduction Act 2017 • Continuing loss of HRA properties through Right To Buy (RTB) • Potential loss of WSCC funding	**Homelessness** The council may not be able to provide sufficient affordable housing and/or temporary accommodation, at a time when the community in general is under great pressure from the Welfare Reforms	• More vulnerable people and increase on council demands • Future increase in number of homeless • Less capacity within charities/voluntary organisations • Extra bed and breakfast costs being incurred again in future • Council may not fulfil statutory obligations • Universal Credit leading to tenancies ending & mortgage costs increasing leading to foreclosure • Increased demand on customer services – enquiries, complaints, etc. • Failure to increase Council housing stock • Increased borrowing • Poor publicity / reputational risk	• New strategy to cut waiting lists realistically including re-definition of the qualification criteria • More effective processes (including prevention) and additional software being obtained, leading to reduction in B&B costs incurred • New Housing & Homelessness Strategy being progressed • Housing contracts being examined and reviewed • Council commitment toward building new affordable homes and bringing empty homes into re-use • Purchase of properties by the Council in 2017 as part alternative to continued use of private bed & breakfast accommodation • Updated HRA Business Plan produced and monitored. Commitment to deliver 250 new homes in period to 2027/28 to offset RTB sales • Some additional Government grant funding • Council investigating development of General Fund land for .e.g. student accommodation to ease pressure on rental market • LGA/Councils lobbying Government regarding changes to RTB legislation/receipts • Council Chief Executives liaising with WSCC to identify impact and consequences on local Councils and voluntary organisations

No	Rating	Vulnerability	Trigger	Consequence	Current Controls / Mitigating Actions
		for 'commissioned services'/to voluntary organisations			
6b	**6** ⇔	• Lack of in depth internal development expertise for house building • Internal legal and finance teams capacity is stretched • Lack of available and fit for purpose properties (council able to build or buy but requirement is for smaller properties) • Lack of Council-owned land for further development • New developments vulnerable to challenge from members and community • Uncertainty over changes to Government Right to Buy Scheme and additional Government 'levies' • Reduction in the amount of stock from RTB release, leading to reduced rental income • Significant negative impacts of Government changes to national rent setting policy on HRA Business Plan • Reduction in HCA grants for affordable housing • Possible clawback of Right To Buy (RTB) 1:1 receipts if not used in time • Delay in new house build program • Government legislative changes not encouraging Local Authorities to build at social rents	**Affordable Housing Development** The council may not be able to fulfil the development targets for building new homes	• Reputational issues for council & revenue investment not maximised • Delays in building new Council housing / reduction in proposed scheme due to lack of finance • Reviews and changes are resource intensive • Impact on council legal team resource / extra costs of external resource • Significant reduction in HRA rent income until rent increases allowed • Development schemes are less economically viable and not progressed by landowners • Area is not seen as a viable market for development • Potential return to Government of 1:1 receipts • Forced sale of properties to meet Government requirements	• as 6A above • New Housing & Homelessness Strategy being progressed • Requirement for proportion of new developments to be affordable housing (e.g. via S106) • Review of Council-owned land for possible development • Engagement with appropriate partners to attract funding and development • Monitoring / reporting of RTB 1:1 receipts to CMT and Cabinet

No	Rating	Vulnerability	Trigger	Consequence	Current Controls / Mitigating Actions
		• Infrastructure deficit (e.g. GP reductions) could lead to lower take up of housing in the area			
7	6 ⇩	• Delivery delayed at recommendation of Planning Inspector – adopted by Full Council (subject to modifications required by the Inspector) in July 2018 • Housing numbers are a 'starting point', not a target. Land supply and Local Plan must be kept under review to ensure Housing Delivery Test and 5-Year Housing Land Supply requirements are met • Loss of planning led infrastructure investment funding from developers • Loss of funding from New Homes Bonus (NHB) to sustain Council's delivery of services • More neighbourhood plans are being developed at Parish/Town Council level • Council vulnerable to planning decisions being overturned on appeal • Loss of Community Infrastructure Levy contributions	**Local Plan** Although the Local Plan has been adopted, the Council could still be vulnerable to developers. There is also the possibility of loss of corporate identity & inward infrastructure funding	• If ongoing test and supply requirements are not met, there will be less ability to make strategic planning decisions, with random developments and no cohesion within the area, • Objectively Assessed Needs numbers already increased and are not a fixed target • Possible additional requirements transferred from neighbouring authorities • Increased staff and consultant costs • Wrong type of investment for area • Loss of corporate control and reputational damage • Financial risk – loss of CIL monies until charges are agreed and implemented Potentially significant financial shortfall if NHB is removed or reduced • Loss of developer funding • 'Made' Neighbourhood Plans may need redevelopment and referenda • Increased infrastructure deficit	• More information to members (seminars and workshops, etc.) to explain the issues & Government planning requirements and implications thereof • Planning department resource remains under review – LGA Peer Review in June 2018 • Revised studies and policies consulted on and agreed by Members, prior to submission to the Inspector • Schedule of Main Modifications (MM's) submitted to Inspector and being included in adopted Local Plan • Land supply and strategic sites to be kept under review • Funding for revision of 'made' Neighbourhood Plans once the Local Plan is agreed identified • CIL charging schedule being developed
8	12 ⇧	• Council may enter into arrangements which do not serve its longer-term best interests • Informal and voluntary partnership arrangements do not	**Partnerships** If key partnerships are not robustly governed, they may not offer the best longer-term value for ADC. There may	• There may be lost opportunities for sharing services and work • Reliability of service delivery • Customer dissatisfaction / loss of trust or confidence within	• The Council will continue to investigate partnering opportunities with other Councils • Engagement with external partner agencies

No	Rating	Vulnerability	Trigger	Consequence	Current Controls / Mitigating Actions
		produce benefits / synergy • Public health transition will mean partnership working with NHS clinical commissioning groups – significant local concerns in respect of GP practice closures and lack of overall co-ordination of activities within the NHS • Government impetus to share more, leading from funding reductions & potential lessening of political control • Lack of understanding of potential opportunities in the market places • Increased financial pressure on all parties • Increased partnership complexity – both contractually and through service delivery • Lack of definition surrounding the constitution of a partnership, grants and shared service • Reduction / lack of commitment from external partner agencies • Impact of Local Policing Plan putting greater pressure on specific Council services e.g. Community Safety, Environmental Health, Housing, etc. • Potential loss of WSCC funding for 'commissioned services'/to voluntary organisations	also be missed opportunities by not exploring enough options	community • Potential reputational issues • Lack of governance and clarity around objectives of partnerships • New responsibilities for council with the public health transition • Funding reductions means having to find different income streams • More financial pressure on services • Projects fail to deliver desired outcomes • Less capacity within charities/voluntary organisations	• Roles and responsibilities, priorities, finances, etc. defined as part of arrangements • 'Partnership' definition agreed by CMT to inform relevant discussions on Vision • Group Head of Policy to progress 2015 audit findings • Voluntary and support sector funding subject to ongoing review • Council Chief Executives liaising with WSCC to identify impact and consequences on local Councils and voluntary organisations
9	6 ⇩	• Increasing FOI and DPA requests (national issue) / complexity and limited resources	**Information Governance and Data Security** The council is facing an	• Increased vulnerability to breach of Data Protection Act / GDPR leading to reputational damage /	• Trained resource to handle FOI / DPA requests • DPA / FOI training programme progressed

No	Rating	Vulnerability	Trigger	Consequence	Current Controls / Mitigating Actions
		which are stretched • Council may be recording or have access to more data as a result of public health transition, etc. • More information sharing can lead to less control • Lack of Member awareness on information governance and data security requirements and standards. • Lack of formal mandatory training and staff awareness of new requirements • Increasing Cabinet standards in relation to information governance and data security • Additional burdens from EU General Data Protection Regulation (GDPR) – concern over resources available to meet these • Increase in home and mobile working • Limited specialist resource to investigate data braches – ICT support is not (formally) 24x7	increased risk of a breach of Data Protection Act / General Data Protection Regulation	financial penalties • Less time within Council Advice & Monitoring team to deal with issues could lead to mistakes, etc. • Lack of clarity around what information is where and who is responsible for it • Certain Council services being unable to function without PSN compliance • Potential ICO censure / financial costs from the GDPR • Poor publicity / reputational issues • Incident management of possible breaches will require corporate / CMT support and will impact existing work	for staff • Council networks reviewed by consultant and certification to Public Services Network (PSN) standard achieved (with annual re-certification being progressed) • ICO guidance on preparation for General Data Protection Regulation (GDPR) reviewed and Action Plan progressed. Additional, external advice obtained • Data audit conducted and policies updated for GDPR compliance • Data Protection Officer (DPO) appointed and trained • Policy updates being completed and regular briefings provided to CMT and staff • GDPR training provided to all staff and Members • Information Security Group (ISG) oversight of GDPR and security compliance • Incident management process to be developed and advised to staff / management • Additional skilled data protection resource to be obtained • Availability arrangements for ICT out-of-hours incident response accepted by CMT
10	**4** ⇔	• Understanding of customer/community "needs" vs "wants to have" can be patchy across the council • Council commitment to digital strategy, but direction unclear - over reliance on web-based systems could alienate public and councillors	**Community Engagement and Customer Insight** Risk of failure to engage effectively with the community, either by communicating the council's objectives and service plans or understanding and managing customer	• More difficult to formulate and deliver major initiatives that are effective and relevant (e.g. Local Plan, regeneration) • Difficulty communicating changes to service delivery • Failure to maximise opportunities within the community • Rural opportunities could be	• Your Council – service area objectives extended for 2018-2021 • Corporate Plan reviewed / updated for 2018-on • Customer Services changes resulting from Vision work / service transformation • Council commitment to providing more digital opportunities. Further work on website development and social media

No	Rating	Vulnerability	Trigger	Consequence	Current Controls / Mitigating Actions
		• Council not maximising social media and other communication methods • The next generation of council service users will have different needs and expectations and could become alienated by traditional methods of delivery of information • If changes not progressed effectively, then risk will be increased • Challenge / poor publicity surrounding housing proposals by developers	expectations	overlooked • Poor publicity / lack of community support	channels required, but delayed by 2016 consideration of possible shared service arrangements for IT and Customer Services. New Arun ICT Service Strategy 2018-2022 being progressed and a separate Digital Strategy is to be developed • Social media policies reviewed and updated • Customer Access Strategy to be reviewed • Planning Peer Review undertaken in 2018
11	6 ⇔	• Multiple agencies / property owners involved – requirement for individual decisions delaying actions • Bad weather increases rate of erosion / chances of flash flooding • Longer term – climate change and sea level rise Coastal Protection:- • Delays due to legislative / regulatory requirements e.g. environmental studies • Conflicting opinions as to required solution • Insufficient funding to deliver scheme(s) • Rapid deterioration of short-term improvements Land Drainage:-	**Coastal Protection & Land Drainage** Some areas of the District are subject to significant erosion issues, with a high risk to dwellings The Council must fulfil its responsibilities as landowner (riparian) under the Land Drainage Act to ensure that its part of the whole network functions effectively The Council has powers (under the Coastal protection Act) and also responsibilities for maintenance of assets on its controlled land	• Loss of residents' homes • Flood damage to property, land and infrastructure • H&S issues • Increased costs • Reputational issues / poor publicity • Need for temporary housing Coastal Protection:- • Increased risk of problem extending to neighbouring coastal areas • Environmental impact	Coastal Protection:- • Council installed additional short-term defences (heavy rocks and shingle recycling) • Engaging with residents and Parish Councils • Engaging with other relevant authorities (e.g. Environment Agency, Chichester DC) • Lobbying central government • Some partnership grant funding (flood and coastal erosion grant from the EA) provided to approved major flood and coastal risk management schemes • Pagham – spit breached in 2016 and the community now has an approved planning application to cut through the remaining part, although it currently unlikely if this work will proceed • The Council has a forward capital programme (informed by the Shoreline management Plan and Coastal Defence

No	Rating	Vulnerability	Trigger	Consequence	Current Controls / Mitigating Actions
		• All parties (across the network) need to be aware • Possible removal of Internal Drainage Boards may lead to responsibilities being passed back to the Council			Strategies) and a year-on-year revenue programme Land Drainage • Working with EA (automated flood warning) and WSCC (LLFA) • Monitoring weather forecasts and noting / responding to Met Office alerts • Engaging with Parishes and flood groups across the District • Emergency Planning engages with relevant bodies • Drainage Engineer appointed to progress Council land responsibilities and to assist other parties
12	8 ⇧	• Threat of loss of buildings / infrastructure through fire, flooding or other incident • Continued uncertainty over the future of BRTH, which would act as recovery site for the Civic Centre, as part of the ongoing Accommodation Strategy work	**Corporate Business Continuity** The Council is facing increased risk of cyber attack There is a risk to business continuity from a major incident either directly impacting the Council's infrastructure / services or the provision of key services, etc. by contractors / suppliers Mass loss of staff through illness e.g. pandemic	• Loss of buildings or access to buildings through fire damage, flooding or other serious environmental incident, etc. • Loss of major contractors / suppliers through a major incident affecting their infrastructure / staff • Inability to provide key services / reputational issues	• Advice obtained from Council's insurers • Corporate Business Continuity Plan under development • Service Business Impact Analysis (BIA) and Business Continuity Plans (BCP) being reviewed and updated in order to identify critical service and IT requirements • Revised evacuation / incident procedures due after Civic Centre bomb scare incident • Workspace recovery plans to address identified impacts and plans • Regular testing of 'Day 1 ' critical plans to be implemented • Procurement tender processes require major contractors to have business continuity plans in place
13	12 ⇔	• Increased threat of cyber attacks (viruses, malware, ransomware, etc.)	**Cybersecurity** The council is facing an	• Loss of key systems / inability to provide key services • Loss or corruption of data	• Proprietary security software in use on pc's, networks and mobile devices • ICT deploy appropriate security measures

No	Rating	Vulnerability	Trigger	Consequence	Current Controls / Mitigating Actions
		• Increased vulnerability through extended use of internet and cloud facilities • Poor working practices by staff / partners could lead to security breaches	increased risk of cyber threat	• Financial loss • Reputational damage • Costs / time spent to recover	to minimise cyber risks (e.g. firewalls, anti-virus checking, etc.) • Additional security products (e.g. using artificial intelligence) under review • Security and ICT usage policies in place and regularly updated • Rolling process is in place to patch all systems to the latest versions • Vulnerability testing undertaken to meet certification requirements • Additional education for staff being considered due to repeat nature of malware issues • Incident response and reporting mechanisms being reviewed • Cybersecurity certification being progressed • National initiatives (e.g. LGA cybersecurity ‘stocktake’) will be considered • Future use of ‘cloud’ services included in ICT Service Strategy, which will improve resilience
14	**3** ⇔	• Planned costs of project exceeded • Timescales for delivery not met • Unexpected additional work is required at the site	**New Littlehampton Leisure Centre** There is a risk to the Council from the size and complexity of the project to deliver the new facility	• Failure to provide key services • Additional costs • Financial loss • Reputational damage	• Development agreed by Full Council as part of wider Leisure Strategy and regular progress reporting to Members • Specialist advice obtained and dedicated resource allocated through all stages of delivering the project • Construction contract let and costs agreed following tendering, with approval of Full Council • Detailed risk register maintained by project management staff and risks / progress regularly reviewed with contractor • Liaising with key partners regarding construction issues and interim/future

No	Rating	Vulnerability	Trigger	Consequence	Current Controls / Mitigating Actions
					leisure activity provision
15	3 ⇔	• Lack of technical knowledge in the Council in respect of the establishment and operation of arms-length companies • Companies are poorly managed • Additional legal and operational requirements • Companies fail to deliver required services, income or cost savings • Substantial external borrowing may be required by the Council • Council liable for trading company debt	**Local Authority Trading Companies** There are risks to the Council from the establishment of arms-length trading companies in order to provide key services and / or to increase income streams / reduce costs	• Services are not provided • Lack of Council control • Financial loss • Non-repayment of loans • Reputational damage • Failure to meet additional legal requirements (e.g. Companies Act) • Companies eventually wound-down, leading to additional costs (e.g. redundancy)	• External advice obtained from other Councils / consultants regarding business cases • Specialist advice obtained e.g. regarding legal issues • Business cases being developed for approval by CMT and Members – Local Property Company currently dormant • Formal agreements to be put in place for trading companies, including financing, involvement of officers / members as Directors, etc. • Constitution changes made in respect of monitoring and reporting to the Council
16	12 *(New)*	• Lack of knowledge / management oversight of compliance issues • Inadequate Council monitoring systems • Lack of technically competent staff to complete checks • Recent restructure and staff losses • Compliance requirements differ across various areas of the Council	**Corporate Stock Compliance Issues** There are risks to the Council, its staff and its residents where key compliance checks have not been satisfactorily completed for social housing, corporate buildings, etc. and any issues addressed (e.g. fire, water, gas, etc.)	• Death or injury to staff or residents • Destruction / damage to corporate premises / housing stock • Regulatory censure / intervention • Corporate manslaughter prosecution • Reputational damage • Additional costs	• Different senior management now responsible under new structure • External consultant review undertaken and issues identified • Action plan agreed with Regulator of Social Housing • Data sources identified and new software obtained • Existing data being loaded • Program of work to be undertaken by competent staff / contractors to complete missing or out-of-date compliance checks
17	4 *(New)*	• Changing electoral registration practices • Potential future changes to voting processes being piloted UK • Disenfranchisement of voters • Challenge to election results • Electoral fraud • Lack of preparation for 'snap'	**Elections** There are risks to the Council and its staff when acting on behalf of the Government/Electoral Commission in the conduct of elections/referenda	• Legal action against Returning Officer • Reputational loss • Election petition or judicial review • Community unrest	• Detailed planning performed for elections • Electoral Commission regulatory issues and guidance reviewed • Detailed risk register maintained • Annual canvass progressed to update Electoral Roll • Experienced staff used where possible • Training provided to polling and count staff

No	Rating	Vulnerability	Trigger	Consequence	Current Controls / Mitigating Actions
		election • Increased burden for multiple Neighbourhood Plan referenda • Full District Council elections due in May 2019 • Insufficient and/or inexperienced elections staff available for poll/count			• Established processes for e.g. postal voting • Robust count and verification procedures established • Liaison with other relevant authorities where voting regions overlap (e.g. Parliamentary elections) or where results are regional rather than local
18	**12** *(New)*	• Significant revision of legislation to take place • Uncertainty over future EU funding available • Impact on availability/costs of consumer items is not known • Changes to procurement regulations • Uncertain impact on EU citizens in UK/breakdown of communities • Potential for delay of leaving date/second referendum • Potential for change of Government • Economic upheaval – changes to interest rates, inflation, etc.	**Brexit Implications** Although Article 50 has been triggered and the UK is due to leave the EU on 29 March 2019, there is still no agreement on how this will be achieved and the impact locally, on the UK, the EU and globally	• Legislative changes may impact Council services and operations • Increased costs • Negative impact on tourism • Changes required to Council processes and documentation • Lack of funding for projects e.g. infrastructure, regeneration • Lack of consumer items, leading to panic buying/stockpiling • Additional enquiries to Council staff • Changes to benefits regime • Loss of 'key' workers in some sectors • Potential increase in homelessness • Potential for further referendum/snap election • Protests/civil unrest	• Council monitoring progress towards leaving and advice from Government (e.g. on 'no deal' preparation) • Council monitoring advice from appropriate other sources e.g. LGA, CIPFA, etc. and any reports/initiatives obtained from e.g. other councils • Contingency plans for snap election, etc.

⇧ - risk score increased

⇩ - risk score reduced

⇔ - no change

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ARUN DISTRICT COUNCIL

REPORT TO AND DECISION OF AUDIT & GOVERNANCE COMMITTEE ON 14 FEBRUARY 2019

PART A : REPORT

SUBJECT: Progress Against the Audit Plan

REPORT AUTHOR: Stephen Pearse, Chief Internal Auditor
DATE: February 2019
EXTN: 37561
PORTFOLIO AREA: Corporate Support

EXECUTIVE SUMMARY:

Each year Internal Audit is undertakes its work against an annual audit plan, as approved by the Audit & Governance Committee prior to the start of the financial year

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

RECOMMENDATIONS:

Members of the Audit & Governance Committee are requested to note the content of the report on progress made against the outline Audit Plan agreed by the Committee at its February meeting

1. BACKGROUND:

An outline Audit Plan was presented to, and approved by, the Committee at its February 2018 meeting reflecting the resource currently available. The aim of the plan was to ensure that mandatory work is completed, that there is appropriate involvement in the progress of the 2020 Vision initiative / ongoing transformation and to progress audit work on the priority / highest risk areas identified.

However, the Committee was advised that, although the revised management structure has been finalised, some lower level organisational changes are still being progressed and there is still 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 February 2019.

2. PROPOSAL(S):

It is proposed that the Committee notes the content of the report on progress made

against the outline Audit Plan agreed by the Committee at its February meeting
3. OPTIONS: To note the contents of the report, or not
4. CONSULTATION:

Has consultation been undertaken with:	**YES**	**NO**
Relevant Town/Parish Council		✓
Relevant District Ward Councillors		✓
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		✓
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:

7. REASON FOR THE DECISION: The Committee notes the content of the report on progress made against the outline Audit Plan agreed by the Committee at its February meeting

8. BACKGROUND PAPERS: N/A

ARUN
DISTRICT COUNCIL

Audit Progress

At the Audit & Governance Committee meeting of 22 February 2018, the Committee agreed an outline plan for the section for 2018/19.

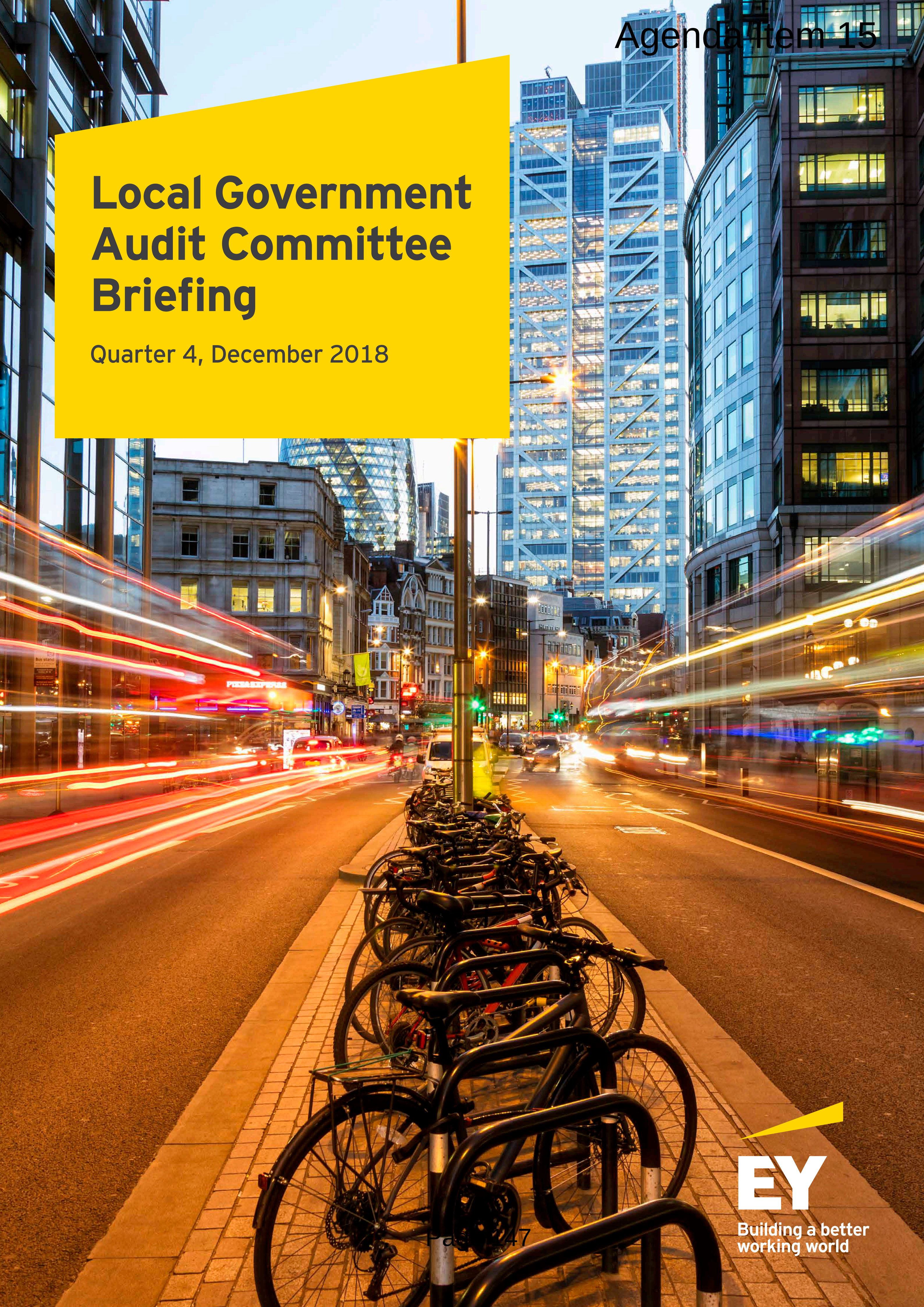
Since the plan was provided to the Committee, work has been undertaken in the following areas:-

Code	Title	Work performed
RE03	Main Accounting	• Audit review of Budget processes under the e5 system ***Reported to A&GC 26/7/18*** • Input to revised Financial Regulations progressed by Finance which have been reviewed by the Constitution Working Party and are due for approval by Full Council in July 2018 • (E&Y) Key controls testing completed
RE04	Purchase Ledger	• Review of processes for corporate credit cards ***Reported to A&GC 15/11/18*** • (E&Y) Key controls testing under way
RE08	Payroll	• Monthly joiners and leavers checks • Enhanced key control checks review being progressed • (E&Y) Key controls testing under way
CS16	Housing Benefit (& Council Tax Reduction)	• Liaison with Finance, Procurement, Benefits and external audit in respect of arrangements for future Housing Benefit Subsidy Claim certification • Monthly new claim calculation checks • (E&Y) Key controls testing under way
CS17	Council Tax	• Annual test checks on CT precept calculations • (E&Y) Key controls testing completed
CS18	NDR	• (E&Y) Key controls testing under way
CS19	Income: Sundry Debtors	• (E&Y) Key controls testing completed
CP03 MS01	Corporate Governance Annual Governance Statement	• Annual review of compliance against the Council's local Code of Corporate Governance • Identification of updates required to the Council's Code of Corporate Governance • Preparation of the updated Annual Governance Statement • Draft AGS published on website with draft Accounts (by 31 May) and provided to external audit ***Reviewed by G&R Group 4/18*** ***Reported to A&GC 26/7/18***
MS03	RIPA	• Advice provided to service areas in respect of queries

		concerning possible use of surveillance, whether this would fall within the scope of the RIPA legislation and other options available • Review of (Home Office) Code changes • Updates to Council's RIPA Policy being drafted
MS04	NFI	• The NFI Council Tax Single Person Discount exercise reports were received in December 2017. Review was delayed awaiting an updated version of the Electoral Roll to assist in the identification of records that have already been altered This has now been completed – large numbers of 'false' matches have been excluded and the remaining cases passed to Revenues for consideration. Revenues have removed SPD from 77 cases and re-billed c.£61k 'Rising 18' cases were also reviewed and a small number of queries passed to Revenues Information on the NFI is included in the Annual Counter-Fraud Report • Liaison with service areas / preparation for files to be submitted in October 2018. Checking of files received and liaison with service areas regarding issues prior to submission to the Cabinet Office (the reports from the main NFI exercise will be available for review in early 2019) • Council Tax and Electoral Roll files submitted for annual Single Person Discount exercise. Reports received from Cabinet Office in December 2018 and review progressing
RE07	Income Collection / Systems	• Notes drafted and circulated on electronic payment processing and PCI-DSS issues outstanding. AllPay contract is due to expire in 2020 and a corporate decision / project will be required to consider future electronic payment processing (currently mix of AllPay and Capita) in line with the ICT Service Strategy and the future Customer Access Strategy
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 *Regular updates are being provided to CMT by the Group Head of Council Advice & Monitoring Officer* • Consideration of the legal basis for Internal Audit holding and 'processing' personal data and relevant Privacy Notices (e.g. for the NFI) – published on Council website • Review of data and documents held by Internal Audit and destruction in line with agreed retention strategies
CP04	Risk Management	• Review of Strategic Risk Register and proposals for update for agreement by Governance & Risk Group • Updated SRR discussed with CMT and lead officer and member for risk • ***Updated SRR presented to A&GC 15/11/18 – to be completed 14/2/19***
CS12	Information Technology	• Review and update of the work performed in 2014 on Disclosure & Barring Service (DBS) checks for staff

		(linked to the Council's Public Services Network certification and use of DWP and GCSx services). Results were passed to the HR Manager for review and update • Draft ICT Service Strategy reviewed and comments provided • Attended initial presentations on Office 365 – consideration of 'cloud' security issues to be progressed. 'Early adopter' use of software and liaison with project regarding audit-specific software • Liaison with ICT & R&B regarding the project to upgrade the Northgate R&B system in 2019
CS14	Information Security Policies	• Linked to GDPR, Information Security Group (ISG) discussion and review of policies e.g. Information Security Policy and the Internet & Email Acceptable Usage Agreement • Review and update of policies for approval by CMT and ICM • Liaison with ICT staff regarding the processes for staff testing on the policies via e-form
CS15	PCI-DSS Compliance	• Confirmation with Contact Centre management that the Red Box software installed as part of the telephony upgrade operated effectively in muting call recording when card payments are being taken by telephone to meet PCI-DSS compliance requirements • Notes on outstanding PCI-DSS issues circulated – ICT to obtain a consultant update on the 2014 assessment, to consider the viability of potential alternative methods of handling payments (e.g. chip & pin, IVR, call hand-off, etc.)
PR07	FMS Support / Replacement	• A review of 'lessons learnt' from the implementation of the new e5 system has been progressed, together with consideration of changed budget preparation processes. (The draft report was discussed at CMT on 17/7/18) ***Reported to A&GC 15/11/18*** • As a result of this, a number of control issues regarding the alteration and re-authorisation of orders were discussed with staff in Procurement, Finance and a number of service areas. Data extracts were used to identify the extent of the issue and to identify the areas involved • Further monthly data testing on order amendment issues
IN02 CP05	Fraud & Corruption Fraud & Corruption	• Compilation of data for publication to meet Government Data Transparency Code requirements • Compilation and submission of data for CIPFA annual fraud survey • Preparation of Annual Counter-Fraud Report ***Reported to A&GC 26/7/18***
AD08	Audit Standards & Quality (PSIAS/QAIP)	• Update of appropriate Arun internal audit documents • Preparation of self-assessment to be used in Arun's future EQA • Undertaking the External Quality Assessment (EQA) for Wealden DC and providing a report on the outcome

		(this is on a mutual support basis across the Sussex Audit Group)
ES01	Environmental Health	• Liaison with Project Manager in respect of testing / development and preparation of data for migration to the new system The amount of work involved and resourcing issues required the implementation of Phase 1 of the project to be put back to September 2018 and Phase 2 is in progress
ES06	Leisure Strategy / Management	• A governance review of the new leisure centre project is being progressed
CP06	Ethics	• A review of ethical issues (as recommended by CIPFA) is being progressed
CP08	Travel & Subsistence	• Analytical review of car use / mileage commenced at the request of the CEO
CP13	Grants & External Funding	• Sample testing of disabled facilities grant cases in order to provide certification to WSCC on the use of the Integration and Better Care Fund: Disabled Facilities Grant Capital Determination 2017-18 • Liaison with Finance over proposals for County-wide pooling of DFG in 2020
CS01	Housing Services - Homelessness	• A review of the processes in place for dealing with homeless cases has been progressed and interim finding reported to Housing management. Further work is on hold, pending a restructure and review of processes in the area
CS02	Housing Repairs	• Liaison with senior management on progress of investigation and agreed action plan to address the issues raised by the Regulator of Social Housing • Liaison regarding the progress of the current management restructure of the Housing department
CS06	Human Resources	• At the request of the Human Resources Manager a review of the Council's Job Profiling scheme to ensure that it is being applied consistently / decisions was undertaken, in conjunction with Unison
MS05	Contract Checking	• Sample checks on contract compliance with Council Standing Orders and contract management in respect of financials
RE05	Value Added Tax	• Review and update of the work performed in 2015 on validity and recording of VAT Registration numbers (now in the e5 financial management system). Results were passed to the Council's Insurance & Risk Officer for review



Local Government Audit Committee Briefing

Quarter 4, December 2018

Building a better working world

Contents at a glance

This sector briefing is one of the ways that we support you and your organisation in an environment that is constantly changing and evolving.

It covers issues which may have an impact on your organisation, the Local Government sector, and the audits that we undertake.

The briefings are produced by our public sector audit specialists within EY's national Government and Public Sector (GPS) team, using our public sector knowledge, and EY's wider expertise across UK and international business.

The briefings bring together not only technical issues relevant to the Local Government sector but wider matters of potential interest to you and your organisation.

Links to where you can find out more on any of the articles featured can be found at the end of the briefing.

We hope that you find the briefing informative and should this raise any issues that you would like to discuss further, please contact your local audit team.

Government and economic news

EY Club Item

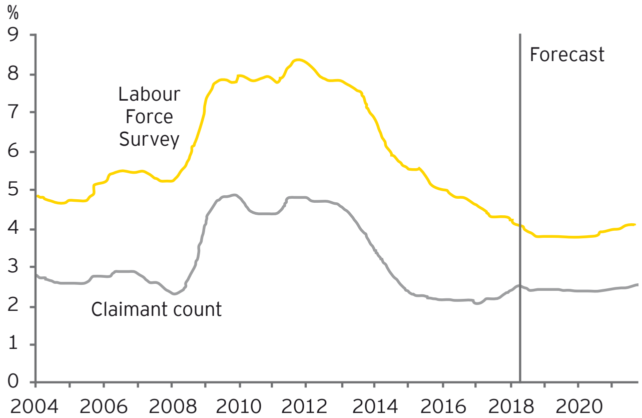
The latest EY ITEM Club forecast casts a cloudier outlook for the UK economy which will have implications for Local Authorities. This partly reflects increased uncertainties about Brexit, due to the elevated risk of the UK leaving the EU without a deal. It also reflects a more challenging global outlook, and continued pressures on consumer purchasing power.

The forecast has slightly downgraded the UK's economic prospects for 2018 and 2019, with GDP growth for 2018 trimmed from 1.4% to 1.3% — the slowest rate of expansion since 2009. While performance improved in Q2 and Q3, the outlook has since become less certain.

One positive note for UK economy is the robust growth in labour demand. The unemployment rate remained at 4.0% for the three months to July, the lowest level since February 1975. Over the same period, the number of vacancies in the UK rose to 833,000, highlighting the tightness in the labour market.

As shown in Figure 1, it appears that the spare capacity in the labour market created during the crisis has been largely absorbed. The Bank of England's (BoE) recent report about the labour market suggests that very limited slack remains — a BoE's regional Agents survey found that 40% of companies are finding it harder to recruit and retain staff compared to last year.

Figure 1
UK: Unemployment rate



Source: EY ITEM Club

The recruitment challenges facing employers are well known by local authorities. An expanding and ageing population will only add to the demand pressures, while the supply of workers may be at risk due to the impact of Brexit on migration of EEA workers.

Theory suggests that, with unemployment falling and vacancies rising, there is little scope for further labour market tightening without generating excess wage pressures. However, earnings growth has remained subdued in recent periods, and indeed relapsed in Q2 2018. Some firms appear keen to limit their costs in an uncertain environment, while fragile consumer confidence is likely deterring workers from pushing hard for pay rises.

These consumer pressures are manifesting in many areas of the economy, and notably in the housing market. Caution over engaging in major transactions has seen mortgage approvals at approximately 18.1% below their long-term (1993–2018) average. Given the earnings squeeze, and the faltering demand for private housing, the important role of social housing is likely to persist. There were 1.2 million households on a waiting list for social housing in England on 1 April 2017, exhibiting the significant excess demand. As a result, the announcement by the Government to scrap the HRA borrowing cap is welcome, and should go some way to meeting demand in the market.

As Brexit beckons, what is the impact that local authorities can expect across the UK?

With increasing focus on a potential extension to the Brexit transitionary period and the likelihood of a 'no-deal' scenario failing to diminish, local authorities are beginning to prepare for an array of potential impacts from the UK's departure from the EU. We look below at some of the key focus areas for local government in assessing the impact of Brexit.

The impact on social care provision:

The social care workforce is particularly susceptible to the impact of Brexit. Since the referendum in 2016, there has already been a decrease in the number of EU nationals taking jobs in the UK social care sector, and this is likely to be squeezed further with the end of freedom of movement. This has the potential to lead to labour cost inflation, increasing the financial pressure facing local authorities.

The effects described above will be exacerbated further due to challenges in the healthcare system. The NHS is similarly likely to suffer to workforce challenges and hence, funding challenges. This has the potential to increase the pressure on hospitals to discharge early, increasing the burden on the social care system's capacity. The government's winter crisis cash pledge to the system, is unlikely to mitigate such challenges.

The impact on supply chains and logistics:

Some coastal local authorities may face years of road traffic issues if border checks are applied following Brexit; authorities in the South East likely to be most significantly affected, due to the potential of border checks being applied at Dover.

Furthermore, investigations have been made by authorities such as Pembrokeshire Council into the ready availability of food and medicine in the event of road blockages and closures. Additionally, local authorities are struggling to make plans around international trade, as they await information on charges and how long waiting times at ports are likely to be. This is particularly important in the case of livestock and fresh foods being transported.

Changes to customs unions and physical borders may reduce the availability and increase the price of key goods required by local authorities, including adult social care supplies.

Consumer demand:

Brexit will impact the wider economy, and hence local authorities will need to be attuned to the impact on their local economies.

Brexit uncertainty is already beginning to influence the high street and local authorities need to consider the prospect of increasing voids. Furthermore, local economies that are heavily dependent on certain sectors that are vulnerable to the impact of Brexit, such as financial services and agriculture, may bear a greater brunt of the economic shock that Brexit may cause.

Local authorities may also be impacted more directly, especially those authorities that have embarked enthusiastically on commercial property investments, thereby creating direct exposure to certain sectors, especially the retail sector. In respect of this, CIPFA have issued a warning to councils outlining concerns over their commercial activity, suggesting that some have been guilty of putting public funds at 'unnecessary or unquantified risk'. Councils need to evaluate the proposed impact that they were hoping such investments may have on their financial position, along with other trading activity, in light of the potential economic impact of Brexit.

Impact on property and agricultural land prices.

Predictions that property prices in general are likely to fall following Brexit are well documented. Bank of England Governor Mark Carney has stated that UK house prices may fall by up to a third in the event of a 'no-deal' Brexit.

A reduction in property prices may not be perceived to be a bad outcome for all. Furthermore, the government's HRA borrowing cap announcement has the potential to allow councils to increase the supply of housing, further supporting a challenged housing market. However, such a reduction in property values is likely to create a shock that may create financial hardship for many as well as impacting the performance of certain sectors.

Budget 2018

On 29 October 2018 the Chancellor delivered the 2018 Autumn Budget to Parliament. Among the headline policy announcements, such as a new 2% tax on revenue for large digital companies, changes to the income tax threshold bands, and increase in funding to help departments prepare for Brexit, there were a number of announcements that will have a direct impact on local authorities. These key announcements include:

- Immediate abolition of the Housing Revenue Account (HRA) cap which restricts local authority borrowing for house building.
- £675mn Investment in the Future High Street Fund created to support local areas prepare long term strategies for their high streets and town centres, including investment in physical infrastructure. As part of this announcement, small retail businesses will see a 33% decrease in business rates and public lavatories will receive 100% business rate relief after April 2019.
- Increased staff costs for local authorities; as the national living wage is set to increase by 5% from £7.83 to £8.21 an hour.
- Allocation of additional £420mn to local authorities in 2018/19 to tackle potholes and repair damaged roads.
- Local authorities in England will receive a further £650mn in social care funding.

CIPFA's response to the budget was that while the additional short term support for the provision of services is welcomed, there are greater long term challenges that need to be addressed to embed sustainable funding. The July 2018 OBR's (OBR) projection, upon which the budget was based, forecasts that within 50 years the UK will not be able to afford anything more than debt interest, health, social care and pension payments. CIPFA is clear that there is not sufficient funding to sustain expectations of public services at the current levels of taxation.

The Local Government Association (LGA) analysis has estimated that local services face a funding gap of £7.8bn by 2024/25; the funding gap as of 2019/20 is estimated to be £3.9bn. The services where there are the greatest funding pressures include social care, homelessness and public health. However, the growing demand for these services has detrimentally impacted on other services that help maintain local communities including libraries, roads and welfare support.

An unexpected announcement made by Government during the budget was that it will no longer use Private Finance Initiative (PFI) schemes, or its successor PF2, because PFI schemes have been identified by the Office for Budget Responsibility (OBR) as a source of significant fiscal risk to the Government. It is unclear if this decision by central Government will impact on local authorities in future years.

CIPFA Investment Guidance

The media spotlight and public scrutiny surrounding local government finances has increased significantly over the past year due to increased pressures to deliver services from reduced funding. To help authorities better manage their finances CIPFA is updating its guidance on Treasury Management. The new key principle of guidance will be that 'Local authorities must not borrow more than or in advance of their needs purely in order to profit from the investment of the extra sums borrowed'.

During 2017/18 the rate at which English councils acquired land and buildings increased by 43% to a total of £4bn; whereas total borrowing increased from £4bn to £10bn (127 %). As such there is a growing concern that too many local authorities are investing heavily in commercial property at a rate that is disproportionate to their available resources. This exposes public funds to unquantified risks. This stands against the primary objective of a local authority's treasury management strategy to safeguard public money.

Accounting, auditing and governance

IFRS 9: Statutory Override update

The 2018/19 financial year will be the first year where the accounting standard IFRS 9 will be implemented by local government. IFRS 9 impacts on an authority's financial assets: the investments it holds; the amounts it has lent to others; and other monetary based assets it may have. It changes how these financial assets are classified and how movements in their value are accounted for. It also changes how these assets are impaired; based on the risk that the assets may not be recovered in full, or at all.

Following a consultation by the Ministry for Housing Communities and Local Government on the impact of IFRS 9, an initial statutory override has been granted for five years, despite 90% stakeholders opposing a time-limited period. This statutory override means that councils will still be required to account for fair value movements in financial instruments (in accordance with proper practices as set out in the code on local authority accounting); however these movements will not be charged to the revenue account.

The result of which is that statutory override will remove the potential burden that council tax payers or local authorities may have faced if fair value movements were unfavourable.

Public Sector Pension Scheme Valuation

The Government undertakes a valuation of public service pension schemes every four years, this year sees the first full assessment of these since the introduction of reformed schemes in 2015.

The Chief Secretary to the Treasury has stated that early indications would suggest that employers' contribution will need to increase as a result of a proposed decrease in the discount rate. The discount rate, known as the SCAPE rate, is based on the OBR projection of the short-term pay growth in terms of GDP. OBR has reduced this rate from 3.0% to 2.8% in 2016 and a further reduction has been proposed as of April 2019 to 2.4%. This discount rate is used to calculate the current costs of future payments and as the discount rate decreases, the pension liability increases. Given that employee rates are effectively fixed under scheme regulations, employer contributions will need to increase to meet the increased liability. Further details are to be announced later in the year in addition to further discussion taken forward as part of the spending review.

Local Public Audit – Expectations gap

For the public to gain trust and confidence in public spending, a framework of accountability, transparency, governance and ethics needs to be built. The ultimate responsibility lies with the government departments that delegate spending to local public bodies. These public bodies must then be able to demonstrate that the money has been spent efficiently and effectively.

One way the public can gain trust in public spending, is by relying on the external audit process to provide assurance on the financial statements and report by exception on the arrangements the public body has in place to secure economy, efficiency and effectiveness. However, the role of audit, is often misunderstood creating the audit expectation gap which is the difference between what an auditor actually does, as required by legislation and auditing standards, and what stakeholders think that the auditors' obligations might be and what they might do.

The Institute of Chartered Accountants in England and Wales (ICAEW) produced a report to raise awareness on the expectation gap and suggest some possible solutions. The report also discusses how issues faced by local public bodies such as financial difficulties, increasing demand from an ageing population, complex structures and weaknesses of accountability impacts the audit process and widens the expectation gap.

Some common concerns were noted in the report by interviews with Chief Financial Officers in different sectors and regulatory bodies:

1. Local authorities and health bodies are facing a difficult time with increasing pressure to deliver more services, become innovative and commercial with reduced financial support. This pressure could bring in concerns about behaviours that may not be in the best long-term interests of the public.
2. Reports produced by auditors are not being fully utilised by management and audit committees to build on successes and make improvements within the body where recommendations have been made.
3. Auditors are concerned that qualifications and issues identified in their opinions are not taken seriously enough by those charged with governance.
4. The reduction in audit fees has led to a perception by local bodies that they are receiving reduced scope of work compared to the previous regime (Audit Commission). The concerns are not in relation to compliance with auditing standards, but rather the lack of value added activities that was previously provided.
5. Chief Financial Officers expect more challenge and review of their forward-looking plans which underpin the financial resilience of the authority.
6. Other stakeholders are not getting sufficient assurance over the effectiveness of service delivery and performance in auditors' work.
7. Increased regulation and scrutiny against the reduced number of auditor firms in the local government market.
8. Local public auditors' power being limited by the removal of indemnity insurance and increased difficulty to recover costs.

The ICAEW has offered a number of potential solutions in the report to close this expectation gap including:

1. Chief Financial Officers could consider involving external support to assist them in their financial resilience work, such as challenging their budget assumptions and other key decision making factors, instead of relying on external auditors to provide other value added activities, as these may have some independence restrictions.
2. More broadly, consideration could be given to widen the scope of the audit to include for example a greater future-looking focus.

Regulation news

PSAA: Report on results of 2017/18 audits

PSAA (Public Sector Accounts Appointments) has reported its annual summary on the timeliness and quality of financial reporting in relation to audits for the 2017/18 financial year. A total of 431 (87 %) local government and fire authorities published their audited accounts by the deadline of 3 July 2018. 2017/18 was the first year that the accounts and audit deadline was brought forward from the 30 September to the 31 July. PSAA's Chief Officer stated that whilst these results were encouraging and reflect considerable efforts of both local government finance staff and auditors, there is still more work to be done in order for 100% of authorities to meet the new deadline.

The number of qualified 'Value for Money' conclusions is currently at 7% (compared to 8% for 2016/17); however there 30 conclusions still to be issued for 2017/18. The most common reasons for issuing a qualified Value for Money conclusion were corporate governance issues, financial stability concerns and contract management issues.

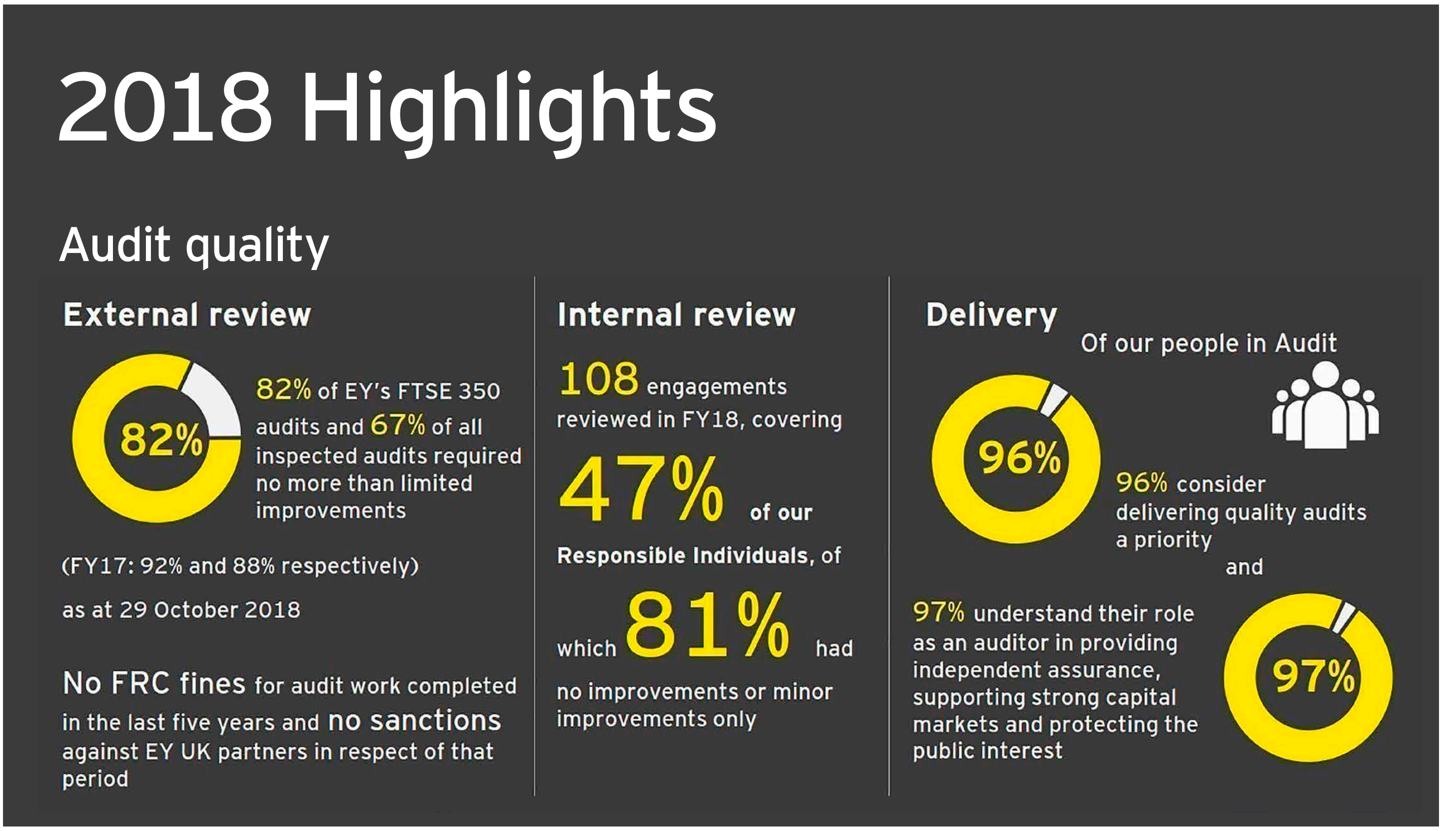
Other

EY 2018 Transparency Report

Our profession has come under scrutiny from policymakers and other stakeholders over the year, and the need for transparency has never been greater. Increasingly, the public is expecting more and more from the audit than its current remit requires. This difference is known as the 'audit expectation gap' which has been discussed above. We believe the time is right for all concerned in the corporate control ecosystem to seize the moment and consider deeply what society expects from businesses and the assurance it needs over their activity.

It's in our interests and the public's for EY UK to be as open and transparent as possible. The Transparency Report goes some way towards helping us achieve this, while also providing an opportunity to share a more balanced perspective on what we do and how we perform as a business. For example, it refers to our role in building trust and confidence in the capital markets and wider economies, by maintaining and developing positive relationships with our stakeholders. It explains what we do to make a difference to people's lives by helping to improve social mobility in the UK. It also shows how our people are supported in their role as auditors by making reference to our tools, technologies and training programmes. Details on internal and external surveys and inspections are included as well, to show how we are performing against our own expectations and — most importantly — those of our regulators.

We refer to this report in our audit planning reports to audit committees, and we summarise the key headlines below.



The result of the FRC's most recent review of out audits showed that 82% of our FTSE 350 audits were graded as requiring no more than limited improvement, against a 90% target. Overall 67% of all EY UK's audits inspected were graded as requiring no more than limited improvements. We are proud of the progress we have made in the UK since the launch of UK Sustainable Audit Quality (SAQ) programme a few years ago. But there is still more work to be done to consider audit quality from the viewpoint of key stakeholders: investors, audit committees, companies, regulators and our people. The work we have done to model the behaviours of our highest performing teams, using cognitive psychologists, will continue. In the year ahead we will prioritise the extent and consistency of the model's adoption. We aim to transform the behaviours that feature in the model into business-as-usual activity across all of our audit teams.

As organisations become more complex, so do audits, making access to different skills and capabilities more important than ever. The traditional audit has already been transformed by the use of technology and digital platforms, and the pace of change will only accelerate. These new capabilities enable us to search, sift and sort through large quantities of data, allowing us to identify potential areas of risk and understand an organisation's performance at a more granular level. The audit process is becoming more forward looking, with a focus on anticipating future risks. Our new capabilities are also providing insights into areas that were once thought to be impossible to measure, such as culture.

This unprecedented scrutiny and demand for change, can be seen as an incredible opportunity to focus our efforts on addressing the root cause, deliver sustainable high quality audit and gain the trust and confidence in the capital markets society needs and demands.

Find out more

EY Club Item

https://www.ey.com/uk/en/issues/business-environment/financial-markets-and-economy/item---forecast-headlines-and-projections

2018 Budget

https://www.gov.uk/government/news/budget-2018-24-things-you-need-to-know

https://www.local.gov.uk/about/news/lga-responds-budget-2018

https://www.cipfa.org/about-cipfa/press-office/latest-press-releases/cipfa-responds-to-budget-2018

https://www.local.gov.uk/sites/default/files/documents/Moving%20the%20conversation%20on%20-%20LGA%20Autumn%20Budget%20Submission%202018.pdf

CIPFA Investment Guidance

https://www.publicfinance.co.uk/news/2018/10/cipfa-investment-guidance-will-help-councils-steer-through-challenges

Local Public Audit — Expectations gap

https://www.icaew.com/about-icaew/regulation-and-the-public-interest/policy/public-sector-finances/local-public-audit-expectations-gap

https://www.icaew.com/-/media/corporate/files/about-icaew/policy/local-public-audit-expectation-gap.ashx?la=en

IFRS 9: Statutory Override

https://www.publicfinance.co.uk/news/2018/11/ifrs-9-override-last-five-years

Public Sector Pension Scheme Valuation

https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/738917/Technical_Bulletin_Public_Service_Pension_Schemes_Valuations.pdf

https://www.parliament.uk/business/publications/written-questions-answers-statements/written-statement/Commons/2018-09-06/HCWS945/

PSAA: Report on results of 2017/18 audits

https://www.psaa.co.uk/audit-quality/reports-on-the-results-of-auditors-work/

EY Transparency Report 2018

https://www.ey.com/uk/en/about-us/ey-uk-transparency-report-2018

https://www.ey.com/Publication/vwLUAssets/ey-uk-2018-transparency-report/$File/ey-uk-2018-transparency-report.pdf

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ED None

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AUDIT & GOVERNANCE COMMITTEE
WORK PROGRAMME – 2019/2020

Date of Meeting: 30 July 2019			
Statement of Accounts			
Agenda Items	**Subject**	**Lead Officer/Member**	**Comments**
1	Final Statement of Accounts 2018/19	Financial Services Manager	Draft version will be provided to external audit and posted on the Council's website at 31 May 2019
2	Annual Governance Statement	Chief Internal Auditor	Draft version will be considered by Chairman / Vice Chairman in May, provided to external audit and posted on the Council's website at 31 May 2019
External Audit			
3	Response to E&Y on annual assurance letter regarding governance arrangements	Committee Chairman	Letter will be agreed with (2019/20) Chairman and sent to external audit in April
4	Audit Results Report – ISA 260	Ernst & Young	
5	Annual Audit 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 (11/9/19)
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	Independent Remuneration Panel – update	TBC	
11	Annual Counter-Fraud Report	Chief Internal Auditor	Any urgent updates can be provided at other meetings
12	Chairman's Annual Report To Council	Chairman	To be presented to Full Council
13	Update on the progress of Council-owned companies	TBC	
14	Annual update on use of RIPA powers in the previous Municipal Year	Chief Internal Auditor	
Work Programme			
15	To agree the rolling work programme for 2019/2020	Chief Internal Auditor	Updates, etc.

AUDIT & GOVERNANCE COMMITTEE
WORK PROGRAMME – 2019/2020

Date of Meeting: 21 November 2019			
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	
2	Annual Certification Report 2018/19	Ernst & Young	Certification of the Housing Benefit Subsidy Claim
Governance Framework			
3	Updated Strategic Risk Register	Chief Internal Auditor	
Treasury Management			
4	Treasury Management Mid-Year Report	Senior Accountant (Treasury Management)	Recommendations for approval by Full Council (8/1/20)
Internal Audit			
5	Update on the work of Internal Audit	Chief Internal Auditor	
Other Items			
7	Independent Remuneration Panel – update	TBC	
8	Update on the progress of Council-owned companies	TBC	
Work Programme			
9	To agree the rolling work programme for 2019/2020	Chief Internal Auditor	Updates, etc.

AUDIT & GOVERNANCE COMMITTEE
WORK PROGRAMME – 2019/2020

Date of Meeting: 13 February 2020			
Statement of Accounts			
Agenda Items	**Subject**	**Lead Officer/Member**	**Comments**
1	Accounting Policies for 2019/20 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 2019/20 Accounts
Governance Framework			
3	Capital Strategy	Financial Services Manager	For approval by Full Council (18/3/20)
Treasury Management			
4	Treasury Management Strategy Statement and Annual Investment Strategy	Senior Accountant (Treasury Management)	For approval by Full Council (18/3/20)
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 31/3/20

AUDIT & GOVERNANCE COMMITTEE
WORK PROGRAMME – 2019/2020

<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 (Property & Estates Manager)**

Local Property Company

- **Progress reports, should it start operating (S151 Officer / Cabinet)**

Governance & Risk Group updates

Relevant policy reviews, updates, etc.