20 January 2020

AUDIT AND ETHICS COMMITTEE – 28 JANUARY 2020

A meeting of the Audit and Ethics Committee will be held at 6pm on Tuesday 28 January 2020 in Committee Room 1 at the Town Hall, Rugby.

Adam Norburn
Executive Director

A G E N D A

PART 1 – PUBLIC BUSINESS

1. Minutes

   To confirm the minutes of the meeting held on 22 October 2019.

2. Apologies

   To receive apologies for absence from the meeting.

3. Declarations of Interest

   To receive declarations of:

   (a) non-pecuniary interests as defined by the Council's Code of Conduct for Councillors;

   (b) pecuniary interests as defined by the Council's Code of Conduct for Councillors; and

   (c) notice under Section 106 Local Government Finance Act 1992 – non-payment of Community Charge or Council Tax.

   Note: Members are reminded that they should declare the existence and nature of their non-pecuniary interests at the commencement of the meeting (or as soon as the interest becomes apparent). If that interest is a pecuniary interest the Member must withdraw from the room unless one of the exceptions applies.

Membership of Warwickshire County Council or any Parish Council is classed as a non-pecuniary interest under the Code of Conduct. A Member does not need to declare this interest unless the Member chooses to speak on a matter relating to their membership. If the Member does not wish to speak on the matter, the Member may still vote on the matter without making a declaration.

4. Treasury Management Report 2019/20 – Progress Report

5. Capital Strategy 2020/21 incorporating Investment Strategy and Treasury Management Strategy

6. Requirements of the CIPFA Financial Management Code

7. Audit Progress Report and Sector Update (report to follow)

8. 2019/20 Internal Audit Plan – Progress Update

9. Development of Internal Audit Plan 2020/21

10. Motion to Exclude the Public under Section 100(A)(4) of the Local Government Act 1972

    To consider passing the following resolution:

    "Under Section 100(A)(4) of the Local Government Act 1972 the public be excluded from the meeting for the following items on the ground that they involve the likely disclosure of information defined in paragraphs 1, 2 and 3 of Schedule 12A of the Act."

PART 2 – EXEMPT INFORMATION

1. Limited Assurance Internal Audit Reports

2. Whistle Blowing Incidents – Standing Item – to receive any updates

3. Fraud and Corruption Issues – Standing Item – to receive any updates

Any additional papers or relevant documents for this meeting can be accessed here via the website.

Membership of the Committee: Mr P Dudfield (Chairman), Mr J Eves (Vice-Chairman), Councillors Cranham, McQueen, Mistry and Pacey-Day

Named Substitutes: Councillors Butlin, Mrs O'Rourke, Roodhouse and Stokes

If you have any general queries with regard to this agenda please contact Veronika Beckova, Democratic Services Officer (01788 533591 or e-mail veronika.beckova@rugby.gov.uk). Any specific queries concerning reports should be directed to the listed contact officer. If you wish to attend the meeting and have any special requirements for access please contact the Democratic Services Officer named above.

Agenda No 4

AGENDA MANAGEMENT SHEET

Report Title:	Treasury Management Report 2019/20 - Progress Report
Name of Committee:	Audit and Ethics Committee
Date of Meeting:	28 January 2020
Report Director:	Head of Corporate Resources and CFO
Portfolio:	Corporate Resources
Ward Relevance:	All
Prior Consultation:	Treasury Management Strategy 2019/20 – 2021/22 Cabinet 4 February 2019
Contact Officer:	Mannie Ketley, Head of Corporate Resources and Chief Financial Officer, 01788 533416 or mannie.ketley@rugby.gov.uk
Public or Private:	Public
Report Subject to Call-In:	No
Report En-Bloc:	No
Forward Plan:	No
Corporate Priorities: **(CR) Corporate Resources** **(CH) Communities and Homes** **(EPR) Environment and Public Realm** **(GI) Growth and Investment**	This report relates to the following priority(ies): ☒ To provide excellent, value for money services and sustainable growth ☒ Achieve financial self-sufficiency by 2020 ☒ Enable our residents to live healthy, independent lives ☒ Optimise income and identify new revenue opportunities (CR) ☐ Prioritise use of resources to meet changing customer needs and demands (CR) ☒ Ensure that the council works efficiently and effectively (CR) ☐ Ensure residents have a home that works for them and is affordable (CH) ☐ Deliver digitally-enabled services that residents can access (CH) ☐ Understand our communities and enable people to take an active part in them (CH) ☐ Enhance our local, open spaces to make them places where people want to be (EPR)

☐ Continue to improve the efficiency of our waste and recycling services (EPR)
☐ Protect the public (EPR)
☐ Promote sustainable growth and economic prosperity (GI)
☐ Promote and grow Rugby's visitor economy with our partners (GI)
☐ Encourage healthy and active lifestyles to improve wellbeing within the borough (GI)
☐ This report does not specifically relate to any Council priorities but

Statutory/Policy Background:	The Council's Treasury Management activities are strictly regulated by the Local Government Act 2003 and the CIPFA Code of Practice on Treasury Management. Scrutiny of Treasury Management activities is delegated to the Audit and Ethics Committee in accordance with best practice recommendations.
Summary:	The report (Appendix 1) sets out the Treasury Management activities for the first half of 2019/20.
Financial Implications:	The report ensures that the Council is aware of the current Treasury Management position.
Risk Management Implications:	There are no risk management implications arising from this report.
Environmental Implications:	There are no environmental implications arising from this report.
Legal Implications:	There are no legal implications arising from this report.
Equality and Diversity:	There are no equality and diversity implications arising from this report.
Recommendation:	The report at Appendix 1 be noted.
Reasons for Recommendation:	To provide Audit and Ethics Committee with an update on Treasury Management activities for the first half of 2019/20

Agenda No 4

Audit and Ethics Committee - 28 January 2020

Treasury Management Report 2019/20 - Progress Report

Public Report of the Head of Corporate Resources and CFO

Recommendation
The report at Appendix 1 be noted.

INTRODUCTION

On 2 December 2019, the Treasury Management Report 2019/20 – Progress Report at Appendix A was presented to Cabinet, including the following recommendations to Council:

- the amended Approved Counterparties Investment List be approved; and
- the amended Treasury Management Indicator for Principal sums invested for periods longer than 364 days be approved.

This is a report on the Treasury Management activities for the first half of 2019/20 (the mid-year report). Treasury Management is defined as:

"The management of the organisation's investments and cash flows, its banking, money market and capital market transactions; the effective control of the risks associated with those activities; and the pursuit of optimum performance consistent with those risks". *(CIPFA Code of Practice for Treasury Management in the Public Sector*)

In accordance with best practice recommendations the report is presented in full at Appendix 1 to provide an update on Treasury Management activities in 2019/20 to allow Audit and Ethics Committee to fulfil its scrutiny role as designated within the constitution.

Name of Meeting: Audit and Ethics Committee

Date of Meeting: 28 January 2020

Subject Matter: Treasury Management Report 2019/20 - Progress Report

Originating Department: Corporate Resources

DO ANY BACKGROUND PAPERS APPLY ☐ **YES** ☒ **NO**

LIST OF BACKGROUND PAPERS

Doc No	Title of Document and Hyperlink

The background papers relating to reports on planning applications and which are open to public inspection under Section 100D of the Local Government Act 1972, consist of the planning applications, referred to in the reports, and all written responses to consultations made by the Local Planning Authority, in connection with those applications.

☐ Exempt information is contained in the following documents:

Doc No	Relevant Paragraph of Schedule 12A

Agenda No

AGENDA MANAGEMENT SHEET

Report Title:	Treasury Management Report 2019/20 - Progress Report
Name of Committee:	Cabinet
Date of Meeting:	2 December 2019
Report Director:	Head of Corporate Resources and CFO
Portfolio:	Corporate Resources
Ward Relevance:	All
Prior Consultation:	Treasury Management Strategy 2019/20 – 2021/22 Cabinet 4 February 2019
Contact Officer:	Mannie Ketley, Head of Corporate Resources and Chief Financial Officer, 01788 533416 or mannie.ketley@rugby.gov.uk
Public or Private:	Public
Report Subject to Call-In:	Yes
Report En-Bloc:	Yes
Forward Plan:	Yes
Corporate Priorities: **(CR) Corporate Resources** **(CH) Communities and Homes** **(EPR) Environment and Public Realm** **(GI) Growth and Investment**	This report relates to the following priority(ies): ☒ To provide excellent, value for money services and sustainable growth ☒ Achieve financial self-sufficiency by 2020 ☒ Enable our residents to live healthy, independent lives ☒ Optimise income and identify new revenue opportunities (CR) ☐ Prioritise use of resources to meet changing customer needs and demands (CR) ☒ Ensure that the council works efficiently and effectively (CR) ☐ Ensure residents have a home that works for them and is affordable (CH) ☐ Deliver digitally-enabled services that residents can access (CH) ☐ Understand our communities and enable people to take an active part in them (CH) ☐ Enhance our local, open spaces to make them places where people want to be (EPR)

	☐ Continue to improve the efficiency of our waste and recycling services (EPR) ☐ Protect the public (EPR) ☐ Promote sustainable growth and economic prosperity (GI) ☐ Promote and grow Rugby's visitor economy with our partners (GI) ☐ Encourage healthy and active lifestyles to improve wellbeing within the borough (GI) ☐ This report does not specifically relate to any Council priorities but
Statutory/Policy Background:	The Council's Treasury Management activities are strictly regulated by the Local Government Act 2003 and the CIPFA Code of Practice on Treasury Management.
Summary:	The report sets out the Treasury Management activities for the first half of 2019/20.
Financial Implications:	The report ensures that the Council is aware of the current Treasury Management position.
Risk Management Implications:	There are no risk management implications arising from this report.
Environmental Implications:	There are no environmental implications arising from this report.
Legal Implications:	There are no legal implications arising from this report.
Equality and Diversity:	There are no equality and diversity implications arising from this report.
Recommendation:	(1) the report be noted; (2) the monitoring and review of the Treasury Management indicators be agreed; and IT BE RECOMMEDED TO COUNCIL THAT: (3) the amended Approved Counterparties Investment List (Appendix A) be approved; and (4) the amended Treasury Management Indicator for Principal sums invested for periods longer than 364 days be approved
Reasons for Recommendation:	To comply with the Code of Practice

Agenda No

Cabinet - 2 December 2019

Treasury Management Report 2019/20 - Progress Report

Public Report of the Head of Corporate Resources and CFO

Recommendation

1. the report be noted;
2. the monitoring and review of the Treasury Management indicators be agreed; and

IT BE RECOMMEDED TO COUNCIL THAT:

3. the amended Approved Counterparties Investment List (Appendix A) be approved; and
4. the amended Treasury Management Indicator for Principal sums invested for periods longer than 364 days be approved.

1.1 INTRODUCTION

On 26 February 2019, in accordance with the *CIPFA Code of Practice for Treasury Management in the Public Sector*, Council approved the Treasury Management Strategy for 2019/20 – 2021/22. The Code requires the Council to approve a treasury management strategy before the start of each financial year, a mid-year report, and an annual report after the end of each financial year.

This is a report on the Treasury Management activities for the first half of 2019/20 (the mid-year report). Treasury Management is defined as:

“The management of the organisation’s investments and cash flows, its banking, money market and capital market transactions; the effective control of the risks associated with those activities; and the pursuit of optimum performance consistent with those risks”.
(CIPFA Code of Practice for Treasury Management in the Public Sector)

In addition to its own resources (General Fund and Housing Revenue Account (HRA) balances, capital receipts, etc.) the Council also collects council tax on behalf of Warwickshire County Council, the Office of the Police and Crime Commissioner for Warwickshire, and Parish Councils. This means that at given points of time during the financial year, the Council has significant cash holdings which require management prior to scheduled payment dates to the preceptors. A summary of transactions, and the levels of investments and borrowings held, is contained within this report.

The Head of Corporate Resources and Chief Financial Officer is pleased to report that all treasury management activity undertaken during the period complied with the approved strategy, the *CIPFA Code of Practice*, and the relevant legislative provisions.

1.2 ECONOMIC REVIEW APRIL – SEPTEMBER 2019

UK. This first half year has been a time of upheaval on the political front as Theresa May resigned as Prime Minister to be replaced by Boris Johnson on a platform of the UK leaving the EU on or 31 October, with or without a deal. However, in September, his proroguing of Parliament was overturned by the Supreme Court and Parliament carried a bill to delay Brexit until 31 January 2020 if there is no deal by 31 October. MPs also voted down holding a general election before 31 October, though one is likely before the end of 2019. So far, there has been no majority of MPs for any one option to move forward on enabling Brexit to be implemented. At the time of writing the whole Brexit situation is highly fluid and could change radically by the day. Given these circumstances and the likelihood of an imminent general election, any interest rate forecasts are subject to material change as the situation evolves. If the UK does soon achieve a deal on Brexit agreed with the EU then it is possible that growth could recover relatively quickly. The MPC could then need to address the issue of whether to raise Bank Rate at some point in the coming year when there is little slack left in the labour market; this could cause wage inflation to accelerate which would then feed through into general inflation. On the other hand, if there was a no deal Brexit and there was a significant level of disruption to the economy, then growth could weaken even further than currently and the MPC would be likely to cut Bank Rate in order to support growth. However, with Bank Rate still only at 0.75%, it has relatively little room to make a big impact and the MPC would probably suggest that it would be up to the Chancellor to provide help to support growth by way of a fiscal boost by e.g. tax cuts, increases in the annual expenditure budgets of government departments and services and expenditure on infrastructure projects, to boost the economy.

The first half of 2019/20 has seen UK **economic growth** fall as Brexit uncertainty took a toll. In its Inflation Report of 1 August, the Bank of England was notably downbeat about the outlook for both the UK and major world economies. The MPC meeting of 19 September reemphasised their concern about the downturn in world growth and also expressed concern that prolonged Brexit uncertainty would contribute to a build-up of spare capacity in the UK economy, especially in the context of a downturn in world growth. This mirrored investor concerns around the world which are now expecting a significant downturn or possibly even a recession in some major developed economies. It was therefore no surprise that the Monetary Policy Committee (MPC) left Bank Rate unchanged at 0.75% throughout 2019, so far, and is expected to hold off on changes until there is some clarity on what is going to happen over Brexit. However, it is also worth noting that the new Prime Minister is making some significant promises on various spending commitments and a relaxation in the austerity programme. This will provide some support to the economy and, conversely, take some pressure off the MPC to cut Bank Rate to support growth.

As for **inflation** itself, CPI has been hovering around the Bank of England's target of 2% during 2019 but fell to 1.7% in August. It is likely to remain close to 2% over the next two years and so it does not pose any immediate concern to the MPC at the current time. However, if there was a no deal Brexit, inflation could rise towards 4%, primarily as a result of imported inflation on the back of a weakening pound.

With regard to the **labour market**, despite the contraction in quarterly GDP growth of -0.2% q/q, (+1.3% y/y), in quarter 2, employment continued to rise, but at only a muted rate of 31,000 in the three months to July after having risen by no less than 115,000 in quarter 2 itself: the latter figure, in particular, suggests that firms are preparing to expand output and suggests there could be a return to positive growth in quarter 3. Unemployment continued at a 44 year low of 3.8% on the Independent Labour Organisation measure in July and the participation rate of 76.1% achieved a new all-time high. Job vacancies fell for a seventh consecutive month after having previously hit record levels. However, with unemployment continuing to fall, this month by 11,000, employers will still be having difficulty filling job vacancies with suitable staff. It was therefore unsurprising that wage inflation picked up to a high point of 3.9% in June before easing back slightly to 3.8% in July, (3 month average regular pay, excluding bonuses). This meant that in real terms, (i.e. wage rates higher than CPI inflation), earnings grew by about 2.1%. As the UK economy is very much services sector driven, an 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. The latest GDP statistics also included a revision of the savings ratio from 4.1% to 6.4% which provides reassurance that consumers' balance sheets are not over stretched and so will be able to support growth going forward. This would then mean that the MPC will need to consider carefully at what point to take action to raise Bank Rate if there is an agreed Brexit deal, as the recent pick-up in wage costs is consistent with a rise in core services inflation to more than 4% in 2020.

In the **political arena**, the imminent general election may result in a potential loosening of monetary policy and therefore medium to longer dated gilt yields could rise on the expectation of a weak pound and concerns around inflation picking up although, conversely, a weak international backdrop could provide further support for low yielding government bonds and gilts.

1.3 OUTLOOK FOR INTEREST RATES

The Council's treasury advisor, Link Asset Services, has provided the following forecast.

(This forecast includes the increase in margin over gilt yields of 100bps introduced on 9.10.19.)

Link Asset Services Interest Rate View	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	0.75	0.75	0.75	1.00	1.00	1.00	1.00	1.00	1.25
3 Month LIBID	0.70	0.70	0.70	0.80	0.90	1.00	1.00	1.00	1.10	1.20
6 Month LIBID	0.80	0.80	0.80	0.90	1.00	1.10	1.10	1.20	1.30	1.40
12 Month LIBID	1.00	1.00	1.00	1.10	1.20	1.30	1.30	1.40	1.50	1.60
5yr PWLB Rate	2.30	2.50	2.60	2.70	2.70	2.80	2.90	3.00	3.00	3.10
10yr PWLB Rate	2.60	2.80	2.90	3.00	3.00	3.10	3.20	3.30	3.30	3.40
25yr PWLB Rate	3.30	3.40	3.50	3.60	3.70	3.70	3.80	3.90	4.00	4.00
50yr PWLB Rate	3.20	3.30	3.40	3.50	3.60	3.60	3.70	3.80	3.90	3.90

1.4 TREASURY MANAGEMENT STRATEGY STATEMENT AND ANNUAL INVESTMENT STRATEGY UPDATE

The Treasury Management Strategy Statement, (TMSS), for 2019/20 was approved by this Council on 26 February 2019.

An updated list for investment criteria is included at Appendix A. The principal change is an increase in investment limits for local authorities from £10m to £20m and for registered providers (housing associations) from £5m to £10m. The time limit for investments remains unchanged at 10 years. The Council is confident that as a sector local authorities are secure investments in the context of support from Central Government and the legal surcharging framework that guarantees debts will be paid. However, for any investment over one year the financial resilience of the relevant council will be assessed. Registered Providers of Social Housing formerly known as Housing Associations are bodies tightly regulated by Homes England and, as providers of public services, retain a strong likelihood of receiving government support if needed.

In addition to the above, treasury management indicator setting the limit on principal sums invested for more than 365 days be amended as follows:

	2019/20	2020/21	2021/22
Current Limit on principal invested beyond 365 days	£20.00m	£20.00m	£20.00m
Proposed Limit on principal invested beyond 365 days	£30.00m	£30.00m	£30.00m

The revision reflects the increasing cash flows impacting upon the Council's investment portfolio over time. It also facilitates matching cash inflows associated with major proposed schemes such as the redevelopment of the multi-storey flats sites and cash outflows to mitigate cost of carry on long term borrowing.

1.5 INTERIM INVESTMENT REPORT AND SUMMARY OF TRANSACTIONS

Interest earned on investments is an important source of income to the Council, and, like fees and charges, provides funding which would otherwise have to be met from increased council tax.

The average investment balance held between April and September 2019 was £88.818m and the average rate of return was 1.28%, 0.48% above the local authority benchmark of 0.80%. This generated investment income of £0.568m. The investment income received exceeded the budgeted to date figure by approximately £0.271m. Investment income is apportioned between General Fund, HRA, and other reserves (Section 106, Major Repairs Reserve, etc.) based on average balances and cash-flows during the course of the financial year.

The average debt balance held between April and September 2019 (General Fund and Housing Revenue Account) was £101.521m and the average rate paid was 2.12%, generating interest payable of £1.076m. Interest payable was slightly lower than the budgeted to date figure by approximately £0.022m.

The latest year end position for 2019/20 for the General Fund net cost of borrowing (interest paid less interest received) is to be £0.175m under budget[1]. This is based on the forecast for investment balances to fall during the next six months; for market interest rates to remain static or rise only slightly; and utilising the investment products prescribed in the revised 2019/20 – 2021/22 investment strategy.

The following table summarises the treasury management transactions undertaken during the first half of this financial year:

		Principal Amount £m	Interest Rate %
Investments	- as at 31st March 2019	69.629	1.34%
	- matured in period		
	- arranged in period		
	- as at 30th Sept 2019	**129.291**	1.22%
Debt	- as at 31st March 2019	93.509	2.40%
	- matured/repaid in period		
	- arranged in period		
	- as at 30th Sept 2019	**124.521**	2.25%
Net Investments at 31st March 2019		**-23.880**	
Net Investments at 30th September 2019		**4.770**	

No debt restructuring took place during the period 1 April 2019 to 30 September 2019.

1 Does not include interest received from non-investment sources – i.e. car loans

1.6 DEBT MANAGEMENT STRATEGY

The borrowing strategy approved (in February) did not identify a specific need for the Council to borrow this financial year to support the capital programme but highlighted the diminishing level of capital receipts available to finance the General Fund ‘standard’ capital programme from 2019/20 onwards. The Council will look to match financing with asset life where appropriate and has the option to utilise the Public Works Loan Board (PWLB), other authorities, financial institutions, or ‘internal borrowing’, that is cash supporting the Council’s reserves, balances and cash flow as a temporary measure. The Council continues to monitor the progress of the UK Municipal Bonds Agency (UKMBA), created by the Local Government Association with local authority shareholders.

The outlook for interest rates (see section 1.4) shows a rise in PWLB rates of up to 0.60% over the medium term. The Council has used flexibility to borrow funds this year from the PWLB (prior to the overnight rate change on 9th October 2019) and other local authorities for use in future years, subject to capital financing requirements. The Housing Revenue Account (HRA) Capital and Revenue estimates for 2020/21 and HRA medium term financial plan contained elsewhere on this agenda indicate that amounts previously set aside for the repayment of debt will now be utilised as revenue contributions to capital expenditure considering the redevelopment/refurbishment costs of the multi-storey flats highlighted to Council previously. Officers will continue to review the

HRA borrowing pool in light of this requirement and look to match any refinancing with the cash flow expectations contained within the revised HRA 30-year business plan.

In addition to borrowing from external sources the Council has the option of 'intra-fund' borrowing – that is, loans between the General Fund and Housing Revenue Account (HRA). In consultation with its treasury management advisors the Council will continue to look at this facility over the term of the General Fund Medium Term Financial Plan and the HRA Business Plan to ensure opportunities are maximised.

1.7 TREASURY MANAGEMENT INDICATORS

The Council measures its exposures to treasury management risks using the following indicators. Council is asked to note the following indicators as at 30th September 2019.

Security: average credit rating
To measure the security of its portfolio, the Council compares the historic risk of default of its investments against a maximum target rate.

As an example, based on historic data, a AAA (least risk) rated investment has 0% chance of default within 1 year and a 0.05% chance of default within 3 years. A BBB+ (most risk) rated investment has a 0.22% chance of default within 1 year and a 1.21% chance of default within 3 years. There have been no default events associated with any counterparties the Council has utilised within its investment portfolio since 2009 at the time of the Icelandic banking collapse. All funds and accrued interest held at that time were subsequently reclaimed via the administration process.

Using the criteria above, the Council's overall portfolio at 30 September 2019 had a 0.015% risk of default, equating to an estimated loss (weighted by length of investment of) of £19,076 in the event of default.

	Limit	Actual	Met?
Historic risk of default	0.25% (max)	0.015%	✓

Maturity structure of borrowing
This indicator is set to control the Council's exposure to refinancing risk – that all borrowing falls due for repayment at the same time. The repayment structure of fixed rate borrowing (loans of 12 months or longer) was:

	Upper Limit	Lower Limit	Actual	Met?
Under 12 months	50%	0%	41%	✓
12 months and within 24 months	50%	0%	9%	✓
24 months and within five years	60%	0%	17%	✓
Five years and within 10 years	60%	0%	11%	✓
10 years to 20 years	75%	0%	1%	✓
20 years to 30 years	75%	0%	5%	✓
30 years +	75%	0%	16%	✓

The maturity date of borrowing is the earliest date on which the lender can demand repayment.

Principal sums invested for periods longer than 364 days

The purpose of this indicator is to control the Council's exposure to the risk of incurring losses by seeking early repayment of its investments. It is used in conjunction with the liquidity indicator to ensure sufficient cash resources are available without penalty during the short to medium term. The total principal sums invested to final maturities beyond the year end were:

	2019/20	2020/21	2021/22
Limit on principal invested beyond year end	£20.00m	£20.00m	£20.00m
Actual principal invested beyond year end	£14.88m	£7.88m	£1.94m
Within limit?	✓	✓	✓

Name of Meeting: Cabinet

Date of Meeting: 2 December 2019

Subject Matter: Treasury Management Report 2018/19 - Progress Report

Originating Department: Corporate Resources

DO ANY BACKGROUND PAPERS APPLY ☒ **YES** ☐ **NO**

LIST OF BACKGROUND PAPERS

Doc No	Title of Document and Hyperlink
1	Cabinet 4 February 2020 Agenda Item 7 Capital Strategy/Treasury Management 2019/20 – 2021/22 https://www.rugby.gov.uk/meetings/meeting/917/cabinet

The background papers relating to reports on planning applications and which are open to public inspection under Section 100D of the Local Government Act 1972, consist of the planning applications, referred to in the reports, and all written responses to consultations made by the Local Planning Authority, in connection with those applications.

☐ Exempt information is contained in the following documents:

Doc No	Relevant Paragraph of Schedule 12A

14 **Approved counterparties**: The Council may invest with any of the counterparty types in the table below; subject to the cash limits (per counterparty) and the time limits shown:

Credit Rating	Banks Unsecured	Banks Secured	Government (non-UK)	Corporate	Registered Providers
AAA	£5m 5 years	£10m 20 years	£10m 50 years	£5m 10 years	£10m 20 years
AA+	£5m 5 years	£10m 10 years	£10m 25 years	£5m 7 years	£10m 10 years
AA	£5m 4 years	£10m 5 years	£10m 15 years	£5m 5 years	£10m 10 years
AA-	£5m 3 years	£10m 4 years	£10m 10 years	£5m 5 years	£10m 10 years
A+	£5m 2 years	£10m 3 years	£5m 5 years	£5m 5 years	£10m 5 years
A	£5m 13 months	£10m 2 years	£5m 5 years	£5m 5 years	£10m 5 years
A-	£5m 6 months	£10m 13 months	£5m 5years	£5m 5 years	£10m 5 years
None	£3m 6 months	n/a	n/a	£5m 5 years	£10m 3 year
UK Govt	Central government: £unlimited 50 years UK Local Authority: £20m 10 years				
Pooled Funds and real estate investment trusts			£5m per Fund or Trust		

This table must be read in conjunction with the notes below.

15 **Credit Rating**: Investment limits are set with reference to the lowest published long-term credit rating from Fitch, Moody's or Standard & Poor's. Where available, the credit rating relevant to the specific investment or class of investment is used, otherwise the counterparty credit rating is used. <u>However, investment decisions are never made solely based on credit ratings, and all other relevant factors including external advice will be taken into account.</u>

16 **Banks Unsecured**: Accounts, deposits, certificates of deposit and senior unsecured bonds with banks and building societies, other than multilateral development banks. These investments are subject to the risk of credit loss via a bail-in should the regulator determine that the bank is failing or likely to fail. See below for arrangements relating to operational bank accounts.

17 **Banks Secured**: Covered bonds, reverse repurchase agreements and other collateralised arrangements with banks and building societies. These investments are secured on the bank's assets, which limits the potential losses in the unlikely event of insolvency, and means that they are exempt from bail-in. Where there is no investment specific credit rating, but the collateral upon which the investment is secured has a credit rating, the highest of the collateral credit rating and the counterparty credit rating will be used to determine cash and time limits. The combined secured and unsecured investments in any one bank will not exceed the cash limit for secured investments.

18 **Building Societies**: Although the regulation of building societies is no longer any different to that of banks the Council takes additional comfort from building societies' business model. The Council will therefore consider investing with unrated building societies where independent credit analysis shows them to be suitably creditworthy. A minimum asset size of £250m applies and limits of £3m per Society apply for unrated societies.

19 **Government**: Loans, bonds and bills issued or guaranteed by national governments, regional and local authorities and multilateral development banks. These investments are not subject to bail-in, and there is an insignificant risk of insolvency. Investments with the UK Central Government may be made in unlimited amounts for up to 50 years and with a UK local government body up to £20m for up to 10 years. The Council is confident that as a sector local authorities are secure investments in the context of support from Central Government and the legal surcharging framework that guarantees debts will be paid. However, for any investment over one year the financial resilience of the relevant council will be assessed.

20 **Corporates**: Loans, bonds and commercial paper issued by companies other than banks and registered providers. These investments are exposed to the risk of the company going insolvent. Investments in these institutions and asset classes will only be undertaken following a review of risk/reward in consultation with the Council's treasury advisors. Specific consideration will be given to factors including: collateralisation, alternate asset classes, minimum term obligations, and potential impact of movement in asset valuations on Council balances. Where appropriate, criteria will be established to convene selection panels prior to the engagement of fund managers.

21 **Registered Providers**: Loans and bonds issued by, guaranteed by or secured on the assets of Registered Providers of Social Housing, formerly known as Housing Associations. These bodies are tightly regulated by the Homes England and, as providers of public services; they retain the likelihood of receiving government support if needed.

22 **Pooled Funds**: Shares in diversified investment vehicles consisting of the any of the above investment types, plus equity shares and property. These funds have the advantage of providing wide diversification of investment risks, coupled with the services of a professional fund manager in return for a fee. Short-term Money Market Funds that offer same-day liquidity and very low or no volatility will be used as an alternative to instant access bank accounts, while pooled funds whose value changes with market prices and/or have a notice period will be used for longer investment periods.

23 Bond, equity and property funds offer enhanced returns over the longer term but are more volatile in the short term. These allow the Council to diversify into asset classes other than cash without the need to own and manage the underlying investments. Because these funds have no defined maturity date, but are available for withdrawal after a notice period, their performance and continued suitability in meeting the Council's investment objectives will be monitored regularly. These types of funds were introduced in 2013/14 and have provided increased yield although their capital value has shown some volatility requiring continued monitoring. This class of pooled funds are subject to their own specific limits and in view of the possible level of investments in the longer term they have been increased to give the Council reasonable investment options.

24 **Real estate investment trusts (REITs)**: Shares in companies that invest mainly in real estate and pay the majority of their rental income to investors in a similar manner to pooled property funds. As with property funds, REITs offer enhanced returns over the longer term, but are more volatile especially as the share price reflects changing demand for the shares as well as changes in the value of the underlying properties. This is a new category that sits alongside Pooled Funds. The Council will carry out detail appraisal and take advice before any possible investment. As these trusts are subject to volatility and are new instrument to the Council a limit of £1m is set for them.

Agenda No 5

AGENDA MANAGEMENT SHEET

Report Title:	Capital Strategy 2020/21 incorporating Investment Strategy and Treasury Management Strategy
Name of Committee:	Audit and Ethics Committee
Date of Meeting:	28 January 2020
Report Director:	Head of Corporate Resources and CFO
Portfolio:	Corporate Resources
Ward Relevance:	All
Prior Consultation:	None
Contact Officer:	Mannie Ketley, Head of Corporate Resources and Chief Financial Officer, 01788 533416 or mannie.ketley@rugby.gov.uk
Public or Private:	Public
Report Subject to Call-In:	No
Report En-Bloc:	No
Forward Plan:	No
Corporate Priorities: **(CR) Corporate Resources** **(CH) Communities and Homes** **(EPR) Environment and Public Realm** **(GI) Growth and Investment**	This report relates to the following priority(ies): ☒ To provide excellent, value for money services and sustainable growth ☒ Achieve financial self-sufficiency by 2020 ☐ Enable our residents to live healthy, independent lives ☒ Optimise income and identify new revenue opportunities (CR) ☒ Prioritise use of resources to meet changing customer needs and demands (CR) ☒ Ensure that the council works efficiently and effectively (CR) ☐ Ensure residents have a home that works for them and is affordable (CH) ☐ Deliver digitally-enabled services that residents can access (CH) ☐ Understand our communities and enable people to take an active part in them (CH) ☐ Enhance our local, open spaces to make them places where people want to be (EPR)

☐ Enhance our local, open spaces to make them places where people want to be (EPR)
☐ Continue to improve the efficiency of our waste and recycling services (EPR)
☐ Protect the public (EPR)
☐ Promote sustainable growth and economic prosperity (GI)
☐ Promote and grow Rugby's visitor economy with our partners (GI)
☐ Encourage healthy and active lifestyles to improve wellbeing within the borough (GI)
☐ This report does not specifically relate to any Council priorities but

Statutory/Policy Background:	The Council's capital financing and treasury management activities are strictly regulated by the Local Government Act 2003 and the CIPFA Codes of Practice for Financial Management, Capital Finance and Treasury Management in Local Authorities.
Summary:	This report combines an overview of how capital expenditure, capital financing, treasury and other investment activity contribute to the provision of local public services along with how associated risk is managed and the implications for future financial sustainability. The strategies set limits and indicators that embody the risk management approach that the Council believes to be prudent. The strategies are set against the medium-term financial strategy, the context of the UK economy, and projected outlook on interest rates. The investment strategy in section 5 pulls together information on commercial property to explicitly show the Councils risk management approach in that area.
Financial Implications:	The capital finance and treasury management indicators are set to ensure that the Council is guided into making prudent decisions on treasury management activities.
Risk Management Implications:	There are no risk management implications arising from this report.
Environmental Implications:	There are no environmental implications arising from this report.
Legal Implications:	There are no legal implications arising from this report.

Equality and Diversity:	No new or existing policy or procedure has been recommended.
Options:	As this report complies with the Prudential and Treasury Management Codes of Practice, which have been approved by Council, no other options have been considered.
Recommendation:	IT BE RECOMMEDED TO COUNCIL THAT: (1) the Capital Strategy for 2020/21 as an overarching strategy for the Council be approved; (2) the Treasury Management Strategy for 2020/21 including associated limits and specific indicators (section 4 and Appendix B) be approved: (3) the Investment Strategy for 2020/21 and associated limits and specific indicators (section 5 and Appendix C) be approved; and (4) the Minimum Revenue Provision (MRP) – policy (Appendix A3) be approved.
Reasons for Recommendation:	To comply with the Codes of Practice

Agenda No 5

Audit and Ethics Committee - 28 January 2020

Capital Strategy 2020/21 incorporating Investment Strategy and Treasury Management Strategy

Public Report of the Head of Corporate Resources and CFO

Recommendation: IT BE RECOMMEDED TO COUNCIL THAT: 1. The Capital Strategy for 2020/21 as an overarching strategy for the Council be approved; 2. The Treasury Management Strategy including associated limits and specific indicators (section 4 and Appendix B) for 2020/21 – 2022/23 be approved; 3. The Investment Strategy for 2020/21 including associated limits and specific indicators (section 5 and Appendix C) be approved; and 4. The Minimum Revenue Provision (MRP) policy be approved.

1. Introduction

The purpose of this report

4.1. This report responds to a revised set of Codes and guidance introduced in 2019/20 that the Council must, by statute, have regard to. Section 3 gives a high-level overview of:

- how capital expenditure, capital financing and treasury management activity contribute to the provision of local public services;
- how associated risk is managed;
- and the implications for future financial sustainability.

4.2. The Treasury Management Strategy at section 4 is the report that Audit and Ethics Committee and/or Cabinet has traditionally considered. It covers management of the Council's cash flows, borrowing and investments, and the associated risks. The Investment Strategy at section 5 covers investments held for service purposes or for commercial profit which are not included in the Treasury Management Strategy.

4.3. The reporting of capital expenditure, treasury management and investment strategies in combination are designed to bring together areas which CIPFA and the Ministry for Housing, Communities and Local Government (MHCLG) consider should be regarded in the round. They are also a response to the increasing commercialisation of local government and especially the increasing investment in commercial property. The guidance requires the Capital and Investment strategies to be approved by the full Council while the Treasury Management Strategy can now be approved by Audit and Ethics Committee.

4.4. Sustainability - Due to the long-term nature of capital expenditure and financing, the revenue budget implications of expenditure incurred in the next few years will extend for up to 60 years into the future. The Head of Corporate Resources and Chief Finance Officer is satisfied that the proposed capital programme is prudent, affordable and sustainable because the net budget demand on the Council and the risks in the programme have been reviewed and fall within the Council's tolerances.

2. Background

Economic background (synopsis of commentary provided by the Council's treasury advisors, Link Asset Services)

2.1. **GDP growth** has taken a hit from Brexit uncertainty during 2019. The peak of Brexit uncertainty during the final quarter appears to have suppressed quarterly growth to probably around zero. The economy is likely to tread water in 2020, with tepid growth around about 1% until there is more certainty after the trade deal deadline is passed.

2.2. Possibly the biggest message that was worth taking note of from the most recent **Monetary Policy Report** produced by the Bank of England, was an increase in concerns among MPC members around weak global economic growth and the potential for Brexit uncertainties to become entrenched and so delay UK economic recovery. Consequently, the MPC voted 7-2 to maintain Bank Rate at 0.75% but two members were sufficiently concerned to vote for an immediate Bank Rate cut to 0.5%. The MPC warned that if global growth does not pick up or Brexit uncertainties intensify, then a rate cut was now more likely. Conversely, if risks do recede, then a more rapid recovery of growth will require gradual and limited rate rises. The speed of recovery will depend on the extent to which uncertainty dissipates over the final terms for trade between the UK and EU and by how much global growth rates pick up.

2.3. If economic growth were to weaken considerably, the MPC has relatively little room to make a big impact with Bank Rate still only at 0.75%. It would therefore, probably suggest that it would be up to the Chancellor to provide help to support growth by way of a fiscal boost by e.g. tax cuts, increases in the annual expenditure budgets of government departments and services and expenditure on infrastructure projects, to boost the economy. The Government has already made moves in this direction and it made significant promises in its election manifesto to increase government spending by up to £20bn p.a., (this would add about 1% to GDP growth rates), by investing primarily in infrastructure. This is likely to be announced in the next Budget, probably in March 2020. The Chancellor has also amended the fiscal rules in November to allow for an increase in government expenditure.

2.4. As for inflation itself, CPI has been hovering around the Bank of England's target of 2% during 2019 but fell again in both October and November to a three-year low of 1.5%. It is likely to remain close to or under 2% over the next two years and so, it does not pose any immediate concern to the MPC at the current time. However, if there was a hard or no deal Brexit, inflation could rise towards 4%, primarily because of imported inflation on the back of a weakening pound.

Statutory background

2.5. This report is part of the Council's legal obligation under the Local Government Act 2003 to have regard to both the CIPFA Code and the Ministry for Housing, Communities and Local Government (MHCLG) Guidance.

2.6. The regulatory background has been complicated by the revision to both CIPFA and MHCLG codes and guidance in 2018/19. Both CIPFA and the MHCLG state they do not seek to prescribe precisely how councils invest but they clearly have concerns that some councils are taking increasing commercial risks using borrowed money. This approach means that Members are asked to look at a more extensive strategy so that more of the risks that the Codes and guidance highlight are apparent to Members.

Relevant Council policy

2.7. The Council's constitution requires that the Council approve Prudential Code indicators and the Treasury Management Strategy. The Investment Strategy covering:

- commercial investments: property;
- service investments: loans;
- service investments: shares; and
- loan commitments and financial guarantees

has been split from the traditional Treasury Management Strategy here for ease of understanding as it deals with a different type of investment, but it can be considered to be encompassed in the definition of the Treasury Management Strategy as used by the Constitution.

2.8. The existing Treasury Management Strategy 2019/20 and Prudential indicators were approved by the Council on 26 February 2019 the former having been previously approved by the Audit and Ethics Committee.

3. Capital Expenditure and Financing

Capital Expenditure

3.1. Capital expenditure is where the Council spends money on assets, such as property or vehicles, that will be used for more than one year. In local government this includes spending on assets owned by other bodies, and loans and grants to other bodies enabling them to buy assets. All capital expenditure must be financed, either from external sources (government grants and other contributions), the Council's own resources (revenue, reserves and capital receipts) or debt (borrowing or leasing).

3.2. Service managers bid annually to include projects in the Council's capital programme. Bids are compiled using HM Treasury's *Better Business Cases* model and should include:

- the strategic case: Outlining the fit with relevant national and local policies and strategies; the strategic case should clearly state the objectives which are to be delivered in **SMART** terms – if the objective cannot be measured in this way how will it be monitored? If it cannot be monitored the proposal cannot be judged as good value for money;
- the economic and financial case: Demonstrating CHOICE – a wide range of options (including do nothing as the benchmark) has been appraised, and that the preferred option offers optimum VFM in relation to costs, benefits, dis-benefits and risks. Demonstrates AFFORDABILITY - realistic capital and revenue costs and savings over the life span of the investment; and FUNDING - agreed sources of external finance and support where applicable;
- the management case Outlining the governance, plans, and resources that are in place for **successful implementation** by referring to agreed systems and processes (e.g. PRINCE 2) based on proven best practice where applicable; and
- the commercial case Outlining the **procurement arrangements** that ensure supply side can deliver requirements on an efficient market basis.

Bids are then collated by the Financial Services team who calculate the financing cost (which can be nil if the project is fully externally financed). The Senior Management Team (SMT) appraises all bids based on a comparison of service priorities against financing costs and makes recommendations to the informal cabinet. The final capital programme is presented to Council in February each year.

3.3. The current projected capital programme is shown below. It includes current estimates for capital bids for 2020/21 and beyond. It will be revised if necessary, as the 2020/21 budget process develops. The final figures incorporated into the Budget in February 2020 constitute one of the prudential indicators required by the CIPFA.

Capital expenditure £m	2018/19 Actual	2019/20 Estimate	2020/21 Estimate	2021/22 Estimate	2022/23 Estimate
Non-HRA	**2.834**	**14.837**	**2.229**	**2.148**	**2.139**
HRA*	**6.866**	**15.569**	**6.184**	**4.595**	**2.868**
Total	**9.700**	**30.406**	**8.313**	**6.743**	**5.007**

Table 1 Capital Expenditure 2018/19 – 2022/23

** The council is currently undertaking options appraisal on the redevelopment of its multi-storey flat sites at Biart Place and Rounds Gardens. Formal approval for preliminary budgets (surveys, architectural plans, etc.) are included in the above. Full approval for complete project build costs will be sought via council reports when final designs have been assessed.*

<u>Further detailed information is located in Appendix A</u>

4. Treasury Management

4.1. Treasury management is defined as:
"The management of the organisation's investments and cash flows, its banking, money market and capital market transactions; the effective control of the risks associated with those activities; and the pursuit of optimum performance consistent with those risks". *(CIPFA Code of Practice for Treasury Management in the Public Sector*)

4.2. Treasury management is defined as:
<u>Borrowing strategy</u>: The Council will move to an under-borrowed position over the period of the medium-term financial plan. This means that the total capital borrowing need (*the Capital Financing Requirement*), will not have been fully funded with loan debt as cash supporting the Council's reserves, balances and cash flow is used as a temporary measure. This strategy is prudent whilst investment returns remain low and to mitigate counterparty risk.

4.3. Treasury management is defined as: Against this background and the risks within the economic forecast, caution will be adopted with the 2020/21 treasury operations. The Head of Corporate Resources and Chief Financial Officer will monitor interest rates in financial markets and adopt a pragmatic approach to changing circumstances:

- *if it was felt that there was a significant risk of a sharp FALL in long and short term rates* (e.g. due to a marked increase of risks around relapse into recession or of risks of deflation), then long term borrowings will be postponed, and potential rescheduling from fixed rate funding into short term borrowing will be considered.
- *if it was felt that there was a significant risk of a much sharper RISE in long and short term rates than that currently forecast,* perhaps arising from a greater than expected increase in US interest rates, or in world economic activity or a sudden increase in inflationary risks, then the portfolio position will be re-appraised with the likely action that fixed rate funding will be drawn whilst interest rates are still lower than they will be in the next few years.

4.4. Compared with the Capital Financing Requirement, guidance is that debt should remain below the Capital Financing Requirement, except in the short-term. Projected levels of the Council's total outstanding debt (which comprises borrowing and leases) are shown in **<u>Appendix B.</u>**

4.5. <u>Investment Strategy:</u> Given the very low returns anticipated from short-term unsecured bank investments based on interest rate forecasts, the Council aims to further diversify, following appropriate due diligence, into more secure and/or higher yielding asset classes during 2020/21. This is especially the case for the estimated £20m - £30m cash balances that are available for longer-term investment. This diversification will represent a continuation of the present strategy that has moved investment into pooled funds and other local authorities. Projected levels of the Council's total investment portfolio are shown in **<u>Appendix B</u>** with full details of its approved counterparty criteria.

4.6. On 31 December 2019 the Council held £163.521m of borrowing and £157.914m of investments at market value; broken down as follows:

	Principal £'000
Call Accounts	1.734
Other Local Authorities / Registered Providers	86.880
Banks / Building Societies	48.000
Pooled Funds	6.000
Bonds and Certificates of Deposit	15.300
Total Investments	**157.914**
PWLB	50.821
Other Long-Term Borrowing	68.700
Short Term Borrowing	44.000
Total Borrowing	**163.521**
Net Investments	**(5.607)**

Table 2 Breakdown of Net Investments 31 December 2019

5. Investment Strategy (loans, shares and property)

5.1. This section is the disclosure introduced by CIPFA and MHCLG in 2019/20. Both bodies have concerns over the increasing risks that they see in the sector as councils start their own companies and make large commercial property purchases.

5.2. <u>Commercial property investment, particularly the 'bricks and mortar' retail environment, has seen considerable volatility during recent years with the demise of many established high-street brands. This trend is expected to continue in the foreseeable future as the retail market adapts to the continuing growth of on-line markets. Additional in-depth due diligence will therefore be applied in considering direct or indirect (pooled funds, etc) investment in this sector to examine sensitivity around asset valuations, assumed rental yields, and tenant strength. Particular emphasis will be given to exit strategies and risks associated with asset obsolescence and/or changing market conditions.</u>

Investments for Service Purposes

5.3. The Council can make investments to assist local public services, including making loans to local service providers and any Council subsidiaries that provide services. Although at the time of writing there are no direct subsidiaries, Council agreed in September 2019 to a loan/equity of **£4.139m** as a Partner Council in the Materials Recycling Facility to be located in Coventry. In light of the public service objective, the Council is willing to take more risk than with treasury investments. However, it still plans for such investments to generate a profit after all costs to offset risk.

5.4. Decisions on service investments are made by the full Council after the relevant Head of Service has submitted a comprehensive analysis in consultation with the Head of Corporate Resources and Chief Financial Officer and must meet the criteria and limits. Most loans and shares are capital expenditure and purchases will therefore also be approved as part of the capital programme in the budget report or by full Council. Further details on service investments are in Appendix C with a limit of £20m on the total exposure to loans for service purposes and no exposure permitted for shares being held.

Commercial Activities

5.5. With central government financial support for local public services declining, the Council will invest in commercial property purely or mainly for financial gain. The Council has a legacy portfolio of investment property currently valued at £0.723m. These provide a net return after direct costs of 4% based on the last set of final accounts which value the assets at market value rather than historical value.

5.6. As financial return through rental income and/or capital appreciation is the main objective, the Council recognises the higher risk on commercial investment compared with treasury investments. The principal risk exposures include:

- individual vacancies;
- falls in market value; and
- changes in the overall and local economy.

5.7. Individual property risks are constantly monitored and managed by the Property Manager. In order that commercial investments remain proportionate to the financial capacity of the Council, these are subject to an overall maximum investment limit which is set at £60m. Should income not meet expectations the Council holds c.£8m of General Fund reserves available to balance the revenue budget in the short term while the Property Manager reviews the performance of the portfolio.

5.8. Decisions on new commercial investments are made by the Senior Management Team and Cabinet after recommendation from the Asset Management Strategy Group in line with the criteria and limits approved by the Council in this strategy. Property and most other commercial investments are also capital expenditure and purchases will therefore also be approved as part of the capital programme. Further details on commercial investments and limits on their use are in **Appendix C**.

Other Liabilities

5.9. The Council has set aside £5.552m to cover risks of Business Rates Appeals. The Council may also be at risk of having to pay for historic insurance claims from time to time but has not put aside any money because there is no reasonable assessment of the amount required. The Council is also committed to making future payments to cover its pension fund deficit should it arise.

5.10. Decisions on incurring new discretional liabilities are taken by the relevant Head of Service whose portfolio budget would cover the crystallisation of a liability. These would be discussed at the corporate risk management meeting and final decisions as to recognition taken by the Head of Corporate Resources and Chief Financial Officer. New liabilities will be reported to full Council for approval or notification as appropriate. Further details on liabilities are in note 41 of the 2018/19 statement of accounts.

Revenue Budget Implications

5.11. Although capital expenditure is not charged directly to the revenue budget, interest payable on loans and MRP **are** charged to revenue, offset by any investment income receivable. The net annual charge is known as financing costs. The table below compares these costs to the net revenue stream i.e. the amount funded from Council Tax, business rates, rents and general government grants.

%	2018/19 Actual	2019/20 Estimate	2020/21 Estimate	2021/22 Estimate	2022/23 Estimate
General Fund	13	14	12	15	13
HRA	24	21	22	25	28

Table 3 Financing Costs as a proportion of net revenue stream

5.12. The estimates of financing costs include current commitments and the proposals in the 2020/21 General Fund and HRA budget reports.

5.13. In the context of the General Fund, c45% of MRP/Interest charges relate to borrowing for the following 3 large schemes approved by Council in recent years:

- Queens Diamond Jubilee Leisure Centre;
- Rainsbrook Cemetery and Crematorium; and
- World Rugby Hall of Fame.

5.14. In the context of the Housing Revenue Account, all current financing costs relate to the borrowing undertaken at the point of self-financing in 2012. As part of the settlement the Council undertook borrowing of £72m replacing the previous annual negative subsidy payment of £4m which was forecast to rise to £8m annually over the course of the 30-year HRA planning period.

5.15. The Medium-Term Financial Strategy adopted by Council in April 2018 included the following policies in relation to New Homes Bonus (NHB): *"A proportion of the Council's NHB allocations be withdrawn from the base budget by the 2020, with the monies ring-fenced for revenue contributions to capital expenditure"*

5.16. This policy was adopted in order to achieve one of the Council's overarching corporate priorities: financial self-sufficiency. There remains ongoing uncertainty regarding the future of NTB and assumptions regarding its continuity beyond 2020/21 have been removed from forecast planning. The organisation will therefore need to taper its reliance on NHB within its core income budget and carefully consider the financing costs of future capital programme proposals as a consequence.

5.17. The ratio of financing costs within the HRA has fallen in the medium term as a consequence of diverting repayments of debt to revenue contribution to capital expenditure to commence works at Biart Place / Rounds Gardens.

Knowledge and Skills

5.18. The Council employs professionally qualified and experienced staff in senior positions with responsibility for making capital expenditure, borrowing and investment decisions. For example, the Head of Corporate Resources and Chief Financial Officer is a qualified accountant with over 15 years' experience and the Property Manager is a fellow of RICS with over 20 years of experience in commercial property. The Council will support junior staff to study towards relevant professional qualifications.

5.19. Where Council staff do not have the knowledge and skills required, use is made of external advisers that are specialists in their field. The Council currently employs Link Asset Services, Treasury Solutions as treasury management advisers and for any significant property investment would use property consultants with specialist knowledge of the appropriate property sector. This approach ensues access to right knowledge and skills and can be more cost effective than employing such staff directly. The overarching requirement is that the Council has access to knowledge and skills commensurate with its risk appetite.

6. Other courses of action considered but rejected

6.1. The MHCLG Investment Guidance and the CIPFA Codes of Practice do not prescribe any particular strategies for local authorities to adopt. The above strategy represents an appropriate balance between risk management and cost effectiveness. Some alternative strategies, with their financial and risk management implications, are listed below:

Alternative	Impact on income and expenditure	Impact on risk management
Adopt a narrower definition of "high credit quality" and/or shorter time limits	Interest income will be lower	Reduced risk of defaults leading to losses
Adopt a wider definition of "high credit quality" and/or longer time limits	Interest income will be higher	Increased risk of defaults leading to losses
Borrow additional sums at variable interest rates	Higher debt interest cost may be offset by higher investment income	Higher investment balance leading to a higher impact in the event of a default
Borrow additional sums at long-term fixed interest rates	Higher debt interest cost unlikely to be offset by higher investment income	Higher investment balance leading to a higher impact in the event of a default; however long-term interest costs will be more certain

Reduce level of borrowing	Saving on debt interest likely to exceed lost investment income	Reduced investment balance leading to a lower impact in the event of a default; however long-term interest costs will be less certain

7. Staffing consequences

7.1. There are no staffing consequences apart from the need for appropriate training.

8. Financial consequences

8.1. The budgeted treasury investment income in 2020/21is £0.964m (2019/20 £0.569m), which is equivalent to an average investment portfolio of £60m at an interest rate of 1.9%. The budget for debt interest paid in 2020/21 is £2.547m (2019/20 £2.196m).

Name of Meeting: Audit and Ethics Committee

Date of Meeting: 28 January 2020

Subject Matter: Capital Strategy 2020/21 incorporating Investment Strategy and Treasury Management Strategy

Originating Department: Corporate Resources

DO ANY BACKGROUND PAPERS APPLY ☒ **YES** ☐ **NO**

LIST OF BACKGROUND PAPERS

Doc No	Title of Document and Hyperlink
1	Cabinet 4 February 2019 Agenda Item 7 Capital Strategy/Treasury Management 2019/20 – 2021/22 https://www.rugby.gov.uk/meetings/meeting/917/cabinet

The background papers relating to reports on planning applications and which are open to public inspection under Section 100D of the Local Government Act 1972, consist of the planning applications, referred to in the reports, and all written responses to consultations made by the Local Planning Authority, in connection with those applications.

☐ Exempt information is contained in the following documents:

Doc No	Relevant Paragraph of Schedule 12A

Capital Strategy 2020/21 incorporating Investment and Treasury Management Strategy

List of Appendices

Appendix A – Capital Expenditure

A1.1 The current projected capital programme and financing is shown below. It includes current estimates for capital bids for 2020/21 and beyond. It will be revised if necessary, as the 2020/21 budget process develops and the final figures incorporated into the Budget in February 2020 will constitute one of the prudential indicators required by the CIPFA.

Capital expenditure £m	2018/19 Actual	2019/20 Estimate	2020/21 Estimate	2021/22 Estimate	2022/23 Estimate
Non-HRA	**2.834**	**14.837**	**2.229**	**2.148**	**2.139**
HRA*	**6.866**	**15.569**	**6.184**	**4.595**	**2.868**
Total	**9.700**	**30.406**	**8.313**	**6.743**	**5.007**

Table A1 Capital Expenditure 2018/19 – 2022/23

** The council is currently undertaking options appraisal on the redevelopment of its multi-storey flat sites at Biart Place and Rounds Gardens. Formal approval for preliminary budgets (surveys, architectural plans, etc.) are included in the above. Full approval for complete project costs will be sought via council reports when final designs have been assessed.*

A1.2 The table below summarises the above 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.

Financing of capital expenditure £m	2018/19 Actual	2019/20 Estimate	2020/21 Estimate	2021/22 Estimate	2022/23 Estimate
Total	**9.700**	**30.406**	**8.313**	**6.743**	**5.007**
To be financed by:					
Capital receipts	**1.231**	3.510	0.934	0.533	0.533
Capital grants/contributions	**1.770**	5.348	0.782	0.682	0.682
Capital reserves	**1.346**	2.342	3.070	2.820	1.093
Revenue	**4.551**	8.772	2.180	1.331	1.331
Net financing need for the year (prior to HRA CFR Multi Storey Flats)	**0.802**	**10.434**	**1.347**	**1.357**	**1.368**

Table A2 Financing of Capital Expenditure 2018/19 – 2022/23

A2 The Council's Borrowing Need (the Capital Financing Requirement)

A2.1 The second prudential indicator is the Council's Capital Financing Requirement (CFR). The CFR is simply the total historic outstanding capital expenditure which has not yet been paid for from either revenue or capital resources. It is essentially a measure of the Council's indebtedness and so its underlying borrowing need. Any capital expenditure above, which has not immediately been paid for through a revenue or capital resource, will increase the CFR.

A2.2 The CFR does not increase indefinitely, as minimum revenue provision (MRP) is a statutory annual revenue charge which broadly reduces the indebtedness in line with each asset's life, and so charges the economic consumption of capital assets as they are used.

The current CFR projections are included in Table A3 below:

£m	2018/19 Actual	2019/20 Estimate	2020/21 Estimate	2021/22 Estimate	2022/23 Estimate
Capital Financing Requirement					
CFR – non-housing	22.198	22.249	22,005	21.875	21.629
CFR – HRA	61.632	70.455	73.820	73.820	73.820
CFR – Multi Storey Flats	-	-	24.875	48.042	59.504
Total CFR	**83.830**	**92.704**	**120.700**	**143.737**	**154.953**
Movement in CFR	**(0.903)**	**8.874**	**27.996**	**23.037**	**11.216**

Movement in CFR represented by					
Net financing need for the year inc. CFR movement for Multi storey flats	0.802	10.434	29.585	24.524	12.830
Less MRP/VRP and other financing movements	1.705	1.560	1.589	1.487	1.614
Movement in CFR	**(0.903)**	**8.874**	**27.996**	**23.037**	**11.216**

Table A3 Capital Financing Requirement 2018/19 – 2022/23

A3 Minimum Revenue Provision (MRP) Policy Statement

A3.1 The Council is 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).

A3.2 MHCLG regulations have been issued which require the Council to approve an MRP Statement in advance of each year. A variety of options are provided to councils, so long as there is a prudent provision.

For capital expenditure incurred before 1 April 2008 or which in the future will be Supported Capital Expenditure, (*central government support for local authority capital expenditure is the amount of expenditure towards which revenue support grant will be paid to a local authority on the cost of its borrowing*) MRP will be charged on a 2% straight line basis.

From 1 April 2008 for all unsupported borrowing (*capital expenditure for which no direct central government support is available and is undertaken with reference to the Prudential Code*) (including PFI and finance leases) the MRP policy will be:

- **Asset life (annuity) method –** MRP will be based on the estimated life of the assets, in accordance with the regulations (this option must be applied for any expenditure capitalised under a Capitalisation Direction)

A3.3 These options provide for a reduction in the borrowing need over approximately the asset's life.

A3.4 There is no requirement on the HRA to make a minimum revenue provision but there is a requirement for a charge for depreciation to be made.

B1 Introduction

B1.1 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 low risk appetite, providing adequate liquidity initially before considering investment return.

B1.2 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 occasion, when it is prudent and economic, any debt previously drawn may be restructured to meet Council risk or cost objectives.

B1.3. 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.

B2 Cash Resources

B2.1 The table below demonstrates that, over the term of the medium-term financial planning period, the Council will be relying more on internal borrowing i.e. using reserves and other cash resources that it holds rather than borrow from external sources. From projections of the capital programme and use of reserves this strategy is seen as sustainable in the medium term although the Head of Corporate Resources and Chief Financial Officer will monitor the actual position against the projections in order to be ready to respond should long-term external borrowing become advisable.

£m	2020/21 Estimate	2021/22 Estimate	2022/23 Estimate
Debt at 1 April	133.422	114.922	139.022
Expected change in Debt	(18.500)	24.100	(7.300)
Actual gross debt at 31 March	**114.922**	**139.022**	**131.722**
The Capital Financing Requirement (inc. HRA multi story flats redevelopment)	**120.700**	**143.737**	**154.953**

Table B1 Debt Forecast 2020/21 – 2022/23

B3 Affordable borrowing limit

B3.1 Irrespective of plans to borrow or not, the Council is legally obliged to set an *affordable borrowing limit* (also termed the authorised limit for external debt) each year. In line with statutory guidance, a lower "operational boundary" is also set as a warning level should debt approach the limit.

B3.2 In most cases, this would be a similar figure to the CFR. However, in the event that substantial central government support is not available to assist with financing for the redevelopment/refurbishment of multi-storey flats within the borough, the boundary has been set at a level to facilitate the additional borrowing requirement to meet cost estimates for the schemes noted in reports to council to date and in line with the local HRA limit on indebtedness indicator.

Operational boundary £m	2019/20 Estimate	2020/21 Estimate	2021/22 Estimate	2022/23 Estimate
Debt	145.000	180,000	180,000	180,000

Table B2 Operational Boundary 2019/20 – 2022/23

Authorised limit £m	2019/20 Estimate	2020/21 Estimate	2021/22 Estimate	2022/23 Estimate
Debt	155.000	190,000	190,000	190,000

Table B3 Authorised Limit 2019/20 – 2022/23

B3.3 The Council's policy on treasury investments is to prioritise security and liquidity over yield that is to focus on minimising risk rather than maximising returns. Cash that is likely to be spent in the near term is invested securely, for example with the government, other local authorities or selected high-quality banks and building societies, to minimise the risk of loss. Money that will be held for longer terms is invested more widely, including in bonds and property, to balance the risk of loss against the risk of receiving returns below inflation. Both near-term and longer-term investments may be held in pooled funds, where an external fund manager makes decisions on which investments to buy and the Council may request its money back at short notice.

B4 Governance

B4.1 Decisions on treasury management investment and borrowing are made daily and are therefore delegated to the Head of Corporate Resources and Chief Financial Officer and staff, who must act in line with the Treasury Management Strategy as approved by the Council. The Audit and Ethics Committee receives a mid-year and full year report and is responsible for scrutinising treasury management decisions made.

B5 Borrowing Strategy

B5.1 The Council will move to an under-borrowed position over the period of the medium-term financial plan. This means that the total capital borrowing need (the Capital Financing Requirement), will not have been fully funded with loan debt as cash supporting the Council's reserves, balances and cash flow is used as a temporary measure. This strategy is prudent whilst investment returns remain low and to mitigate counterparty risk.

B5.2 Against this background and the risks within the economic forecast, caution will be adopted with the 2020/21 treasury operations. The Head of Corporate Resources and Chief Financial Officer will monitor interest rates in financial markets and adopt a pragmatic approach to changing circumstances:

- *if it was felt that there was a significant risk of a sharp FALL in long and short term rates (e.g. due to a marked increase of risks around relapse into recession or of risks of deflation), then long term borrowings will be postponed, and potential rescheduling from fixed rate funding into short term borrowing will be considered*.
- *if it was felt that there was a significant risk of a much sharper RISE in long and short term rates than that currently forecast, perhaps arising from a greater than expected increase in US interest rates, or in world economic activity or a sudden increase in*

inflationary risks, then the portfolio position will be re-appraised with the likely action that fixed rate funding will be drawn whilst interest rates are still lower than they will be in the next few years.

B5.3 Any decisions will be reported to the appropriate decision-making body at the next available opportunity.

B6 Sources of Borrowing

B6.1 The approved sources of long-term and short-term borrowing are:

- Public Works Loan Board and any successor body
- Any institution approved for investments (see below)
- Any other bank or building society authorised to operate in the UK
- UK public and private sector pension funds
- Capital market bond investors
- UK Municipal Bond Agency and other special purpose companies created to enable joint local authority bond issues

B6.2 In addition, capital finance may be raised by the use of leases and hire purchase that are not borrowing but may be classed as other debt liabilities.

B6.3 The Council has previously raised most of its long-term borrowing from the PWLB, but it will, if required, investigate other sources of finance amongst the sources listed above, that may be available at more favourable rates.

B6.4 Short-term and variable rate loans leave the Council exposed to the risk of short-term interest rate rises and are therefore subject to the limit on the net exposure to variable interest rates in the treasury management indicators below.

B7 Treasury Investment Strategy

B7.1 The Council holds significant funds, representing income received in advance of expenditure plus balances and reserves held. In the past year, the Council's total investments have ranged between £70m and £150m and although the level of reserves is expected to reduce in the longer term, there will still be significant short to medium-term cash flow surpluses leading to larger sums being held than the core reserves of the Council would indicate.

B7.2 Both the CIPFA Code and the MHCLG Guidance require the Council to invest its funds prudently, and to have regard to the security and liquidity of its investments before seeking the highest rate of return, or yield. The Council's objective when investing money is to strike an appropriate balance between risk and return, minimising the risk of incurring losses from defaults and the risk of receiving unsuitably low investment income. Where balances are expected to be invested for more than one year, the Council will aim to achieve a total return that is equal or higher than the prevailing rate of inflation, in order to maintain the spending power of the sum invested.

B7.3 Negative interest rates: If the UK enters into a recession in 2020/21, there is a small chance that the Bank of England could set its Bank Rate at or below zero, which is likely to feed through to negative interest rates on all low risk, short-term investment options. This situation already exists in many other European countries. In this event, security will be measured as receiving the contractually agreed amount at maturity, even though this may be less than the amount originally invested.

B7.4 Given the increasing risk and very low returns from short-term unsecured bank investments, the Council aims to further diversify into more secure and/or higher yielding asset classes during 2020/21. This is especially the case for the estimated £20m - £30m cash balances that are available for longer-term investment. This diversification will represent a continuation of the present strategy that has moved investment into pooled funds and other local authorities.

B7.5 Business models: Under the IFRS 9 standard introduced in 2018/19, the accounting for certain investments depends on the Council's "business model" for managing them. The Council aims to achieve value from its internally managed treasury investments by a business model of collecting the contractual cash flows rather than buying and selling investments and therefore, where other criteria are also met, these investments will continue to be accounted for at amortised cost.

B8 Approved Counterparties

B8.1 The Council may invest with any of the counterparty types in the table below; subject to the cash limits (per counterparty) and the time limits shown in Table B4. The limits remain unaltered from those approved in 2019/20.

Credit Rating	Banks Unsecured	Banks Secured	Government	Corporate	Registered Providers
AAA	£5m 5 years	£10m 20 years	£10m 50 years	£5m 10 years	£10m 20 years
AA+	£5m 5 years	£10m 10 years	£10m 25 years	£5m 7 years	£10m 10 years
AA	£5m 4 years	£10m 5 years	£10m 15 years	£5m 5 years	£10m 10 years
AA-	£5m 3 years	£10m 4 years	£10m 10 years	£5m 4 years	£10m 10 years
A+	£5m 2 years	£10m 3 years	£10m 5 years	£5m 3 years	£10m 5 years
A	£5m 13 months	£10m 2 years	£10m 5 years	£5m 2 years	£10m 5 years
A-	£5m 6 months	£10m 13 months	£10m 5years	£5m 1 year	£10m 5 years
None	£3m 6 months	n/a	n/a	£1m 1 year	£10m 3 year
UK Govt	Central government: £unlimited 50 years UK Local Authority: £20m 10 years				
Pooled Funds and real estate investment trusts			£5m per Fund or Trust		

Table B4 Counterparty Limits

Table B4 must be read in conjunction with the notes below.

a. **Credit Rating**: Investment limits are set with reference to the lowest published long-term credit rating from Fitch, Moody's or Standard & Poor's. Where available, the credit rating relevant to the specific investment or class of investment is used, otherwise the counterparty credit rating is used. However, investment decisions are never made solely based on credit ratings, and all other relevant factors including external advice will be taken into account.

b. **Banks Unsecured**: Accounts, deposits, certificates of deposit and senior unsecured bonds with banks and building societies, other than multilateral development banks. These investments are subject to the risk of credit loss via a bail-in should the regulator determine that the bank is failing or likely to fail. See below for arrangements relating to operational bank accounts.

c. **Banks Secured**: Covered bonds, reverse repurchase agreements and other collateralised arrangements with banks and building societies. These investments are secured on the bank's assets, which limits the potential losses in the unlikely event of insolvency, and means that they are exempt from bail-in. Where there is no investment specific credit rating, but the collateral upon which the investment is secured has a credit rating, the highest of the collateral credit rating and the counterparty credit rating will be used to determine cash and time limits. The combined secured and unsecured investments in any one bank will not exceed the cash limit for secured investments.

d. **Building Societies**: Although the regulation of building societies is no longer any different to that of banks the Council takes additional comfort from building societies' business model. The Council will therefore consider investing with unrated building societies where independent credit analysis shows them to be suitably creditworthy.

e. **Government**: Loans, bonds and bills issued or guaranteed by national governments, regional and local authorities and multilateral development banks. These investments are not subject to bail-in, and there is an insignificant risk of insolvency. Investments with the UK Central Government may be made in unlimited amounts for up to 50 years and with a UK local government body up to £20m for up to 10 years. The Council is confident that as a sector local authorities are secure investments in the context of support from Central Government and the legal surcharging framework that guarantees debts will be paid. However, for any investment over six months the financial resilience of the relevant council will be assessed.

f. **Corporates**: Loans, bonds and commercial paper issued by companies other than banks and registered providers. These investments are exposed to the risk of the company going insolvent. Loans to unrated companies will only be made either following an external credit assessment as part of a diversified pool in order to spread the risk widely.

g. **Registered Providers**: Loans and bonds issued by, guaranteed by or secured on the assets of Registered Providers of Social Housing, formerly known as Housing Associations. These bodies are tightly regulated by the Homes and Communities Agency and, as providers of public services; they retain the likelihood of receiving government support if needed.

h. **Pooled Funds**: Shares in diversified investment vehicles consisting of the any of the above investment types, plus equity shares and property. These funds have the advantage of providing wide diversification of investment risks, coupled with the services of a professional fund manager in return for a fee. Short-term Money Market Funds that offer same-day liquidity and very low or no volatility will be used as an alternative to instant access bank accounts, while pooled funds whose value changes with market prices and/or have a notice period will be used for longer investment periods.

i. **Bond, equity and property funds** offer enhanced returns over the longer term but are more volatile in the short term. These allow the Council to diversify into asset classes other than cash without the need to own and manage the underlying investments. Because these funds have no defined maturity date, but are available for withdrawal after a notice period, their performance and continued suitability in meeting the Council's investment objectives will be monitored regularly. These types of funds were introduced in 2013/14 and have provided increased yield although their capital value has shown some volatility requiring continued monitoring. This class of pooled funds are subject to their own specific limits and in view of the possible level of investments in the longer term they have been increased to give the Council reasonable investment options.

k. **Real estate investment trusts (REITs)**: Shares in companies that invest mainly in real estate and pay the majority of their rental income to investors in a similar manner to pooled property funds. As with property funds, REITs offer enhanced returns over the longer term, but are more volatile especially as the share price reflects changing demand for the shares as well as changes in the value of the underlying properties. This is a new category that sits alongside Pooled Funds. The Council will carry out detail appraisal and take advice before any possible investment. As these trusts are subject to volatility and are new instrument to the Council a limit of £3m is set for them.

l. **Operational bank accounts**: The Council may incur exposure though its current accounts to any UK bank with credit ratings no lower than BBB- and with assets greater than £25 billion. The Bank of England has stated that in the event of failure, banks with assets greater than £25 billion are more likely to be bailed-in than made insolvent, increasing the chance of the Council maintaining operational continuity. The Council currently banks with Lloyds Banking Group rated A-.

m. **Long Term investments**: Alongside pooled funds the Council may use long term investments when they are appropriately secure over the term of the investment. A limit of £30m has been set total long term (over a year) investments.

n. **Risk Assessment and Credit Ratings**: Credit ratings are monitored by the Council's treasury advisors, who will notify changes in ratings as they occur. Where an entity has its credit rating downgraded so that it fails to meet the approved investment criteria then:

- no new investments will be made,
- any existing investments that can be ended at no cost will be; and
- full consideration will be given to the recall or sale of all other existing investments with the affected counterparty.

Where a credit rating agency announces that a rating is on review for possible downgrade (also known as "rating watch negative" or "credit watch negative") so that it may fall below the approved rating criteria, then no investments other than call investments will be made with that organisation until the outcome of the review is announced. This policy will not apply to negative outlooks, which indicate a long-term direction of travel rather than an imminent change of rating.

B9 Investment Security and Borrowing

B9.1 The Council understands that credit ratings are good, but not perfect, predictors of investment default. Full regard will therefore be given to other available information on the credit quality of the organisations in which it invests, including credit default swap prices, financial statements and reports in the quality financial press. No investments will be made with an organisation if there are substantive doubts about its credit quality, even though it may meet the Council's credit rating criteria.

B9.2 When deteriorating financial market conditions affect the creditworthiness of all organisations, as happened in 2008 and 2011, this is not generally reflected in credit ratings, but can be seen in other market measures. In these circumstances, the Council will restrict its investments to those organisations of higher credit quality and reduce the maximum duration of its investments to maintain the required level of security. The extent of these restrictions will be in line with prevailing financial market conditions. If these restrictions mean that insufficient commercial organisations of high credit quality are available to invest the Council's cash balances, then the surplus will be deposited with the UK Government via the Debt Management Office or invested in government treasury bills for example, or with other local authorities. This will cause a reduction in the level of investment income earned but will protect the principal sum invested.

B9.3 **Investment limits**: The Council's revenue reserves available to cover investment losses are forecast to be in the region of £8m on 31 March 2020. A group of banks under the same ownership will be treated as a single organisation for limit purposes. Limits will also be placed on fund managers, investments in brokers' nominee accounts, foreign countries and industry sectors as below. Investments in pooled funds and multilateral development banks do not count against the limit for any single foreign country, since the risk is diversified over many countries.

B9.4 **Cash flow management:** The Council's officers maintain a detailed cash flow forecast for each coming year revising it as more information is available. This informs the short-term investments such as those to cover precept payments. The forecast is compiled on a prudent basis, with receipts under-estimated and payments over-estimated, creating a buffer to minimise the risk of the Council being forced to borrow on unfavourable terms to meet its financial commitments. Long term investment strategy is based on the Council's medium term financial strategy.

B9.5 Treasury Management Indicators

B9.5.1 **Security benchmark**: The Council has adopted a voluntary measure of its exposure to credit risk by monitoring the historic risk of default of its investments against a maximum target rate.

As an example, based on historic data, a AAA (least risk) rated investment has 0% chance of default within 1 year and a 0.05% chance of default within 3 years. A BBB+ (most risk) rated investment has a 0.23% chance of default within 1 year and a 1.20% chance of default within 3 years.

	Target
Historic risk of default	0.25% (max)

Table B5 Security Benchmark Target

The historic risk of default on the Council's current portfolio (as at 15th January 2020) is 0.018%

B9.5.2 **Maturity structure of borrowing:** This indicator is set to control the Council's exposure to refinancing risk. The upper and lower limits on the maturity structure of fixed rate borrowing are shown below.

Maturity structure of fixed interest rate borrowing		
	Lower	**Upper**
Under 12 months	0%	75%
12 months to 2 years	0%	75%
2 years to 5 years	0%	75%
5 years to 10 years	0%	75%
10 years to 20 years	0%	75%
20 years to 30 years	0%	75%
30 years to 40 years	0%	75%
40 years to 50 years	0%	75%

Table B6 Limits on maturity structure of borrowing

B9.5.3 **Principal sums invested for periods longer than a year:** The purpose of this indicator is to control the Council's exposure to the risk of incurring losses by seeking early repayment of its investments. The limits on the total long-term principal sum invested to final maturities beyond the period end will be:

Maximum principal sums invested > 364 days			
£m	**2019/20**	**2020/21**	**2021/22**
Principal sums invested > 364 days	£30m	£30m	£30m

Table B7 Maximum Principal Invested more than 364 days

B9.5.4 Other Treasury Management Issues The CIPFA Code requires the Council to include the following in its treasury management strategy.

B9.5.4.1 **Financial Derivatives**: Local authorities have previously made use of financial derivatives embedded into loans and investments both to reduce interest rate risk (e.g. interest rate collars and forward deals) and to reduce costs or increase income at the expense of greater risk (e.g. LOBO loans and callable deposits). The general power of competence in Section 1 of the Localism Act 2011 removes much of the uncertainty over local authorities' use of standalone financial derivatives (i.e. those that are not embedded into a loan or investment).

The Council will only use standalone financial derivatives (such as swaps, forwards, futures and options) where they can be clearly demonstrated to reduce the overall level of the financial risks that the Council is exposed to. Additional risks presented, such as credit exposure to derivative counterparties, will be taken into account when determining the overall level of risk. Embedded derivatives, including those present in pooled funds and forward starting transactions, will not be subject to this policy, although the risks they present will be managed in line with the overall treasury risk management strategy.

Financial derivative transactions may be arranged with any organisation that meets the approved investment criteria. The current value of any amount due from a derivative counterparty will count against the counterparty credit limit and the relevant foreign country limit.

B9.5.4.2 **Markets in Financial Instruments Directive**: The Council has opted up to professional client status with its providers of financial services, including advisers, banks, brokers and fund managers, allowing it access to a greater range of services but without the greater regulatory protections afforded to individuals and small companies. Given the size and range of the Council's treasury management activities, the Head of Corporate Resources and Chief Financial Officer believes this to be the most appropriate status.

B10 Economic Background

B10.1 **GDP growth** has taken a hit from Brexit uncertainty during 2019. The peak of Brexit uncertainty during the final quarter appears to have suppressed quarterly growth to probably around zero. The economy is likely to tread water in 2020, with tepid growth around about 1% until there is more certainty after the trade deal deadline is passed.

B10.2 Possibly the biggest message that was worth taking note of from the most recent **Monetary Policy Report** produced by the Bank of England (November 2019), was an increase in concerns among MPC members around weak global economic growth and the potential for Brexit uncertainties to become entrenched and so delay UK economic recovery. Consequently, the MPC voted 7-2 to maintain Bank Rate at 0.75% but two members were sufficiently concerned to vote for an immediate Bank Rate cut to 0.5%. The MPC warned that if global growth does not pick up or Brexit uncertainties intensify, then a rate cut was now more likely. Conversely, if risks do recede, then a more rapid recovery of growth will require gradual and limited rate rises. The speed of recovery will depend on the extent to which uncertainty dissipates over the final terms for trade between the UK and EU and by how much global growth rates pick up.

B10.3 If economic growth were to weaken considerably, the MPC has relatively little room to make a big impact with Bank Rate still only at 0.75%. It would therefore, probably suggest that it would be up to the Chancellor to provide help to support growth by way of a fiscal boost by e.g. tax cuts, increases in the annual expenditure budgets of government departments and services and expenditure on infrastructure projects, to boost the economy. The Government has already made moves in this direction and it made significant promises in its election manifesto to increase government spending by up to £20bn p.a., (this would add about 1% to GDP growth rates), by investing primarily in infrastructure. This is likely to be announced in the next Budget, probably in March 2020. The Chancellor has also amended the fiscal rules in November to allow for an increase in government expenditure.

B10.4 As for inflation itself, CPI has been hovering around the Bank of England's target of 2% during 2019 but fell again in both October and November to a three-year low of 1.5%. It is likely to remain close to or under 2% over the next two years and so, it does not pose any immediate concern to the MPC at the current time. However, if there was a hard or no deal Brexit, inflation could rise towards 4%, primarily because of imported inflation on the back of a weakening pound.

B11 Credit Outlook

B11.1 The big four UK banking groups have now divided their retail and investment banking divisions into separate legal entities under ring-fencing legislation. Bank of Scotland, Barclays Bank UK, HSBC UK Bank, Lloyds Bank, National Westminster Bank, Royal Bank of Scotland and Ulster Bank are the ring-fenced banks that now only conduct lower risk retail banking activities. Barclays Bank, HSBC Bank, Lloyds Bank Corporate Markets and NatWest Markets are the investment banks. Credit rating agencies have adjusted the ratings of some of these banks with the ring-fenced banks generally being better rated than their non-ring-fenced counterparts.

B11.2 European banks are considering their approach to Brexit, with some looking to create new UK subsidiaries to ensure they can continue trading here. The credit strength of these new banks remains unknown, although the chance of parental support is assumed to be very high if ever needed. The uncertainty caused by protracted negotiations between the UK and EU is weighing on the creditworthiness of both UK and European banks with substantial operations in both jurisdictions.

%	Mar 20	Jun 20	Sep 20	Dec 20	Mar 21	Jun 21	Sep 21	Dec 21	Mar 22
Bank Rate	0.75	1.00	1.00	1.00	1.00	1.25	1.25	1.50	1.50
5yr PWLB Rate	2.10	2.20	2.20	2.30	2.30	2.40	2.50	2.50	2.60
10yr PWLB Rate	2.50	2.60	2.70	2.70	2.80	2.90	2.90	3.00	3.10
25yr PWLB Rate	3.00	3.10	3.10	3.20	3.30	3.30	3.40	3.50	3.50
50yr PWLB Rate	2.80	2.90	2.90	3.00	3.10	3.10	3.20	3.30	3.30

Table B8 Interest Rate Forecast March 2020 – March 2022

B12 Present Position and Forecast

B12.1 On 31 December 2019 the Council held £163.521m of borrowing and £157.914m of investments at market value; broken down as follows:

	Principal £m
Call Accounts	1.734
Other Local Authorities / Registered Providers	86.880
Banks / Building Societies	48.000
Pooled Funds	6.000
Bonds and Certificates of Deposit	15.300
Total Investments	**157.914**
PWLB	50.821
Other Long-Term Borrowing	68.700
Short Term Borrowing	44.000
Total Borrowing	**163.521**
Net Investments	**(5.607)**

Table B9 Net Investments Summary 31 December 2019

Taking the forecasts within the capital strategy, the balance sheet of the Council can be projected to estimate the amounts available for investments. Below is the current projected analysis of the balance sheet to illustrate the trajectory of the Council's funds.

Year End Resources £m	2018/19 Actual	2019/20 Estimate	2020/21 Estimate	2021/22 Estimate	2022/23 Estimate
Fund balances / reserves	35.653	32.275	21.193	20.747	19.948
Capital receipts	8.941	6.031	5.846	5.746	6.146
Total core funds	**44.594**	**38.306**	**27.039**	**26.493**	**26.094**
Working capital*	**14.767**	**14.767**	**14.767**	**14.767**	**14.767**
(Under)/over borrowing**	**9.692**	**8.307**	**(5.778)**	**(4.715)**	**(23.231)**
Expected Investments	**69.053**	**61.380**	**36.028**	**36.545**	**17.630**

Table B10 Balance Sheet Analysis 2018/19 – 2022/23

Appendix C – Investment Strategy

C1 Introduction

C1.1 This Investment Strategy for 2020/21 meets the requirements of statutory guidance issued by the Government in January 2018 and focuses on the support of local public services by lending to or buying shares in other organisations or its own subsidiaries (service investments) and commercial property investment income.

Commercial Activity

C1.2 Commercial property investment, particularly the ‘bricks and mortar’ retail environment, has seen considerable volatility during recent years with the demise of many established high-street brands. This trend is expected to continue in the foreseeable future as the retail market adapts to the continuing growth of on-line markets. Additional in-depth due diligence will therefore be applied in considering direct or indirect (pooled funds, etc) investment in this sector to examine sensitivity around asset valuations, assumed rental yields, and tenant strength. Particular emphasis will be given to exit strategies and risks associated with asset obsolescence and/or changing market conditions.

C2 Service Investments: Loans

C2.1 The Council can lend money to local bodies or its subsidiaries to support local public services and stimulate local economic growth. Historically the Council has only done this in very limited circumstances where a significant service outcome is expected. Although at the time of writing there are no direct subsidiaries, Council agreed in September 2019 to a loan/equity of **£4.139m** as a Partner Council in the Materials Recycling Facility to be located in Coventry. In light of the public service objective, the Council is willing to take more risk than with treasury investments. However, it still plans for such investments to generate a profit after all costs to offset risk.

C2.2 There is no intention to increase the use of loans to local bodies and they are expected to be infrequent. The Council could lend to a potential subsidiary should it recommend the creation of a housing company, but this has not been subject to Council approval so the Council report that approves the setting up of any subsidiary would also amend the Investment Strategy limit.

C2.4. The main risk when making service loans is that the borrower will be unable to repay the principal lent and/or the interest due. In order to limit this risk and ensure that total exposure to service loans remains proportionate to the size of the Council, upper limits on the outstanding exposure will be set at £20m.

C2.5 Accounting standards require the Council to set aside loss allowance for loans, reflecting the likelihood of non-payment. The figures for loans in the Council’s statement of accounts from 2018/19 onwards will be shown net of this loss allowance. However, the Council makes every reasonable effort to collect the full sum lent and has appropriate credit control arrangements in place to recover overdue repayments.

C2.6 **Risk assessment**: The Council will assess the risk of loss before entering into service loans by assessing the counterparty’s resilience, the service users’ needs that the loan is designed to help meet and how these will evolve over time. During the life of the loan any change in original assumptions will be monitored. The Council will use external advisors if felt appropriate by the Head of Corporate Resources and Chief Financial Officer. All loans will be subject to contract agreed by Head of Legal and Democratic Services. All loans must be approved by full Council and will be monitored by the Head of Corporate Resources and Chief Financial Officer.

Service Investments: Shares

The Council has a minimal committed shareholding of £0.100m as part of its proposed investment in the Materials Recycling Facility noted at C2.1. If the Council creates a local housing company it may mean that the Council would need to invest as the shareholder of its subsidiary. As details are not known on the limit on investment in this type of share at present, our limit will be set at £0.100m and any change to the limit would be addressed in the report to the Council in setting up any subsidiary.

a. Security: One of the risks of investing in shares is that they potentially fall in value meaning that the initial outlay may not be recovered. To limit this risk upper limits on the sum invested in local subsidiaries will be set at the lowest practical level if and when exposure is allowed.

b. Risk assessment: The Council would assess the risk of loss before entering into and whilst holding shares by going through an extensive process of risk analysis. The risk analysis will include an assessment of the market that the subsidiarity will be active in including the nature and level of competition, how the market/customer needs will evolve over time, the barriers to entry and exit and any ongoing investment requirements. The Council will use external advisors as thought appropriate by Head of Corporate Resources and Chief Financial Officer.

c. Liquidity: Although this type of investment is fundamentally illiquid, to limit this the Council, when it sets a limit in this area, will initially set out the maximum periods for which funds may prudently be committed and how the Council will ensure it stays within its stated investment limits.

d. Non-specified Investments: Shares are the only investment type that the Council has identified that meets the definition of a non-specified investment in the government guidance. The limits above on share investments are therefore also the Council's required upper limits on non-specified investments. The Council has not adopted any procedures for determining further categories of non-specified investment since none are likely to meet the definition.

C3 Commercial Investments: Property

C3.1 The Council owns a small portfolio of Investment Property which are predominantly 'legacy' properties. Investment properties are defined as those that are used solely to earn rentals and/or for capital appreciation.

C3.2 The movement in the fair value of the investment properties over 2018/19 is as follows:

	£'000
Balance at 1st April 2018	723
Net gains/(losses) from fair value adjustments	0
Balance at 31st March 2019	723

Table C1 Movement in Fair Value of Investment Property 2018/19

C3.3 Investment properties are measured initially at cost and subsequently at fair value, based on the amount at which the asset could be exchanged between knowledgeable parties at arm's length. Properties are not depreciated but are revalued annually 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.

C3.4 Rentals received in relation to investment properties 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 Adjustments Account and (for any sale proceeds greater than £10,000) the Capital Receipts Reserve.

C4 Liquidity and Security

Fair Value Hierarchy

All the Council's investment properties have been value assessed as Level 2 on the fair value hierarchy for valuation purposes. This means that market conditions are such that similar properties are actively purchased and sold and the level of observable inputs are significant.

a. Security: In accordance with government guidance, the Council considers a property investment to be secure if its accounting valuation is at or higher than its purchase cost including taxes and transaction costs.

The commercial properties are revalued each year-end by external valuers so the Council will each year consider whether the underlying assets provide security i.e. are not below their purchase cost. Should this be the case the Head of Corporate Property will consider whether his current course of action in holding the assets is appropriate and bring any alternative actions to Council in an update to the Investment Strategy for that year.

b. Risk assessment: The Council assesses the risk of loss before entering into and whilst holding property investments by:

i. assessing the relevant market sector including the level of competition, the barriers to entry and exit and future market prospects;

ii. using advisors if thought appropriate by the Head of Corporate Resources and Chief Financial Officer;

iii. consulting Council's Asset Management Working Group

iv. taking a final comprehensive report on all new investments to Cabinet

v. continually monitoring risk in the whole portfolio and any specific assets

c. Liquidity: Clearly property is relatively difficult to sell and convert to cash at short notice and can take a considerable period to sell in certain market conditions. To ensure that the invested funds can be accessed when they are needed the Property Manager ensures that at least £5m of commercial property could be sold as a going concern within a six-month period.

C5 Loan Commitments and Financial Guarantees

C5.1 Although not strictly counted as investments, since no money has exchanged hands yet, loan commitments and financial guarantees carry similar risks to the Council and are included here for completeness. The Council does not provide such commitments and guarantees, and this strategy does not include them for 2020/21. As noted above, if the Council creates a potential subsidiary which may, or may not, require commitments or guarantees dependent on its legal structure. the required limits will be set as a part of the Council report on the setting up of a subsidiary.

C6 Investment Indicators

C6.1 The Council has set the following quantitative indicators to allow elected Members and the public to assess its total risk exposure as a result of its investment decisions.

C6.2 **Total risk exposure**: The first indicator shows the total exposure to potential investment losses.

Total investment exposure £m	2018/19 Actual	2019/20 Forecast	2020/21 Forecast
Treasury management investments	69.053	61.380	40.840
Service investments: Loans	-	-	4.039
Service investments: Shares	-	-	0.100
Commercial Investments: Property	0.723	0.750	0.780
TOTAL INVESTMENTS	**69.776**	**62.130**	**41.620**
Commitments to lend	-	-	-
Guarantees issued on loans	-	-	-
TOTAL EXPOSURE	**69.776**	**62.130**	**45.759**

C6.3 **How investments are funded**: Government guidance is that these indicators should include how investments are funded. The Council does not currently hold **any** investment assets with particular liabilities (i.e. associated borrowing). All the Council's investments are funded by usable reserves and income received in advance of expenditure.

C6.4 **Rate of return received**: This indicator shows the investment income received less the associated costs, including the cost of borrowing where appropriate, as a proportion of the sum initially invested. Note that due to the complex local government accounting framework, not all recorded gains and losses affect the revenue account in the year they are incurred.

	2018/19 Actual	2019/20 Forecast	2020/21 Forecast
Treasury management investments	0.9%	1.2%	1.9%
Service investments: Loans	0	0	6%
Service investments: Shares	0	0	0
Commercial investments: Property	4%	4%	4%

C6.5 The MHCLG guidance lists other indicators including:

- Commercial income to net service expenditure ratio;
- Benchmarking of returns – ratio of property income yield to IPD property yield index averaged over 5-year period;
- Average vacancy level; and
- Operating overheads of property section attributable to commercial property as a proportion of net property income

These indicators will be published in future reports at the point when the Council invests in significant service investments (loans and shares) or commercial property acquisition.

Agenda No 6

AGENDA MANAGEMENT SHEET

Report Title:	Requirements of the CIPFA Financial Management Code
Name of Committee:	Audit and Ethics Committee
Date of Meeting:	28 January 2020
Report Director:	Head of Corporate Resources and CFO
Portfolio:	Corporate Resources
Ward Relevance:	All
Prior Consultation:	None
Contact Officer:	Jon Illingworth, Financial Services Manager and Deputy Chief Finance Officer, 01788 533410 or jon.illingworth@rugby.gov.uk
Public or Private:	Public
Report Subject to Call-In:	No
Report En-Bloc:	No
Forward Plan:	No
Corporate Priorities: **(CR) Corporate Resources** **(CH) Communities and Homes** **(EPR) Environment and Public Realm** **(GI) Growth and Investment**	This report relates to the following priority(ies): ☒ To provide excellent, value for money services and sustainable growth ☒ Achieve financial self-sufficiency by 2020 ☐ Enable our residents to live healthy, independent lives ☒ Optimise income and identify new revenue opportunities (CR) ☒ Prioritise use of resources to meet changing customer needs and demands (CR) ☒ Ensure that the council works efficiently and effectively (CR) ☐ Ensure residents have a home that works for them and is affordable (CH) ☐ Deliver digitally-enabled services that residents can access (CH) ☐ Understand our communities and enable people to take an active part in them (CH) ☐ Enhance our local, open spaces to make them places where people want to be (EPR)

☐ Continue to improve the efficiency of our waste and recycling services (EPR)
☐ Protect the public (EPR)
☐ Promote sustainable growth and economic prosperity (GI)
☐ Promote and grow Rugby's visitor economy with our partners (GI)
☐ Encourage healthy and active lifestyles to improve wellbeing within the borough (GI)
☐ This report does not specifically relate to any Council priorities but

Statutory/Policy Background: CIPFA Financial Management Code – released October 2019 with implementation 1 April 2020

Summary: The purpose of the report is to inform the Committee on the new CIPFA guidance that the Authority will need to adopt from the 2020/21 financial year.

Financial Implications: There are no financial implications for this report.

Risk Management Implications: There are no risk management implications for this report.

Environmental Implications: There are no environmental implications for this report.

Legal Implications: There are no legal implications for this report.

Equality and Diversity: There are no equality and diversity implications for this report.

Options: Not applicable

Recommendation:

1) To note the requirements of the CIPFA financial management code and the timescales for the Authority to become compliant.
2) To agree to a receive further report which outlines current compliance and proposed actions to become fully compliant.

Reasons for Recommendation: The Code will be adopted by all CIPFA member organisations. Although the requirements of the code have been published, the practical implementation of the detail will be established with the publication of the guidance notes

Agenda No 6

Audit and Ethics Committee - 28 January 2019

Requirments of the CIPFA Financial Management Code

Public Report of the Head of Corporate Resources and CFO

Recommendation
1) To note the requirements of the CIPFA financial management code and the timescales for the Authority to become compliant. 2) To agree to a receive further report which outlines current compliance and proposed actions to become fully compliant.

1. Introduction

1.1. In October 2019 CIPFA launched the Financial Management (FM) Code which has six underlining principles:

Organisational **leadership** – demonstrating a clear strategic direction based on a vision in which financial management is embedded into organisational culture.

Accountability – based on medium-term financial planning that drives the annual budget process supported by effective risk management, quality supporting data and whole life costs.

Financial management is undertaken with **transparency** at its core using consistent, meaningful and understandable data, reported frequently with evidence of periodic officer action and elected member decision making.

Adherence to professional **standards** is promoted by the leadership team and is evidenced.

Sources of **assurance** are recognised as an effective tool mainstreamed into financial management, including political scrutiny and the results of external audit, internal audit and inspection.

The long-term **sustainability** of local services is at the heart of all financial management processes and is evidenced by prudent use of public resources.

1.2. Within these principles there are 17 standards for Local Authorities to follow; *Appendix 1 is a summary of the principles and the standards.*

1.3. The principles have been designed to focus on an approach that will assist in determining whether, in applying standards of financial management, a local authority is financially sustainable.

2. Structure of the FM Code

2.1. Although it may be expressed differently across the different jurisdictions of the UK, the FM Code is also further supported by statutory requirement for all local authorities to have sound financial management.

2.2. Section 151 of the Local Government Act 1972 requires that every local authority in England and Wales should "... make arrangements for the proper administration of their financial affairs and shall secure that one of their officers has responsibility for the administration of those affairs."

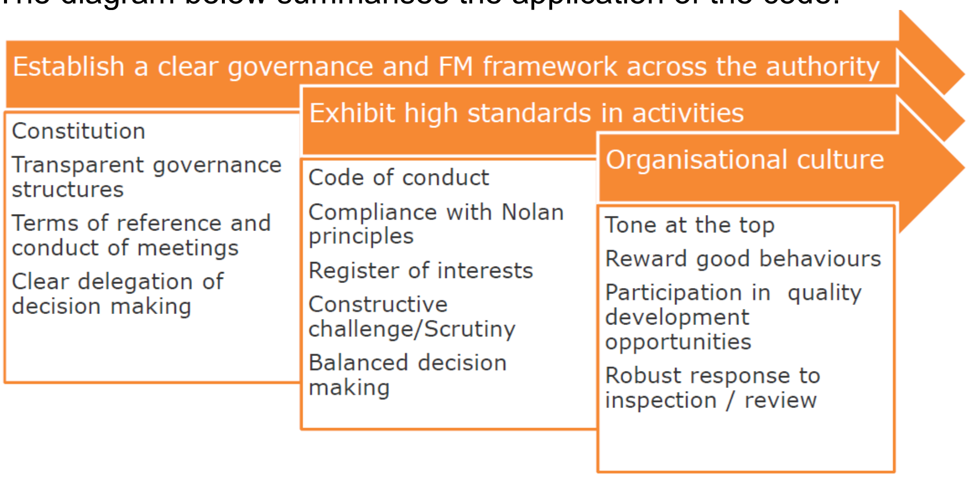
2.3. CIPFA's judgement is that compliance with the FM Code will assist local authorities to demonstrate that they are meeting these important legislative requirements.

2.4. In addition to the requirements of primary legislation and associated CIPFA Codes, an authority's prudent and proper financial management is informed by a framework of professional codes of practice and guidance, including:

- the CIPFA *Statements of Professional Practice (SOPP) (including ethics)*
- the CIPFA *Statement of the Role of the Chief Financial Officer*
- the CIPFA *Statement on the Role of the Chief Financial Officer in Local Government*
- the CIFFA *Statement on the Role of the Chief Finance Officer of the Police and Crime Commissioner and the Chief Finance Officer of the Chief Constable*

2.5. CIPFA considers the application of the FM Code to be a professional responsibility of all its members, regardless of their role in the financial management process. More specifically, the FM Code clarifies CIPFA's understanding of how CFOs should satisfy their statutory responsibility for good financial administration. The responsibilities of the Chief Finance Officer (CFO) are both statutory and professional. Notwithstanding these specific expectations of CIPFA members, the primary purpose of the FM Code is to establish how the CFO should demonstrate that they are meeting their statutory responsibility for sound financial administration.

2.6. The diagram below summarises the application of the code:

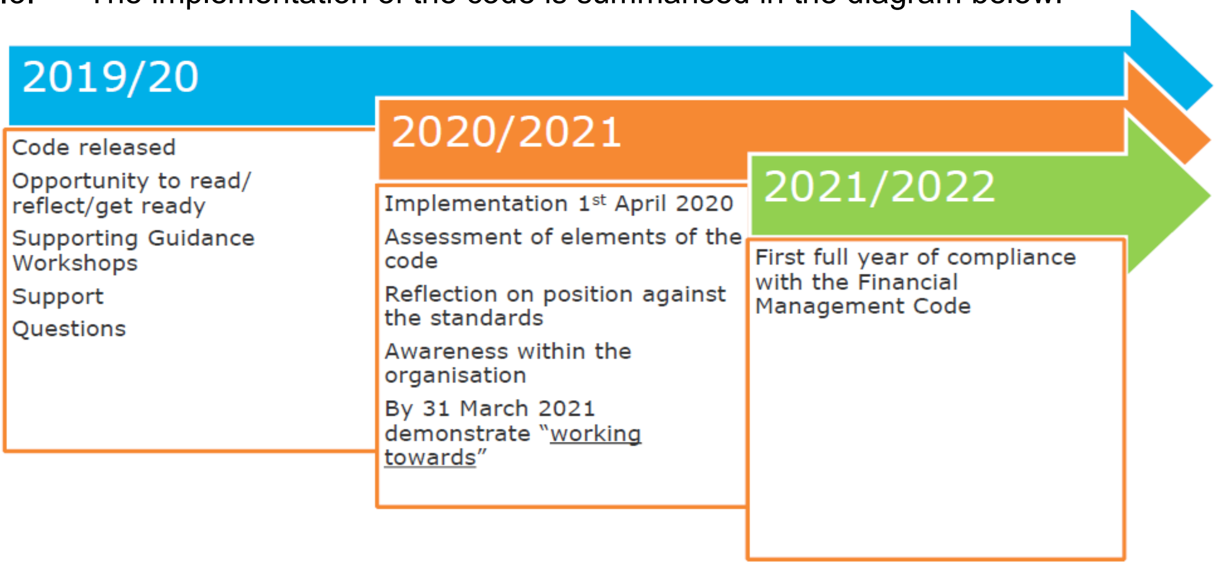


3. Application Date

3.1. Local authorities are required to apply the requirements of the FM Code with effect from 1 April 2020. This means that the 2020/21 budget process provides an opportunity for assessment of elements of the FM Code before April 2020 and to provide a platform for good financial management to be demonstrable throughout 2020/21. Local authorities will need to ensure that their governance and financial management style are fit in advance for this purpose. CIPFA has also considered the ambition within this code, the timescale and of course the wider resource challenges facing local authorities. Consequently, CIPFA considers that the implementation date of April 2020 should indicate the commencement of a shadow year and that by 31 March 2021, local authorities should be able to demonstrate that they are working towards full implementation of the code. The first full year of compliance with the FM Code will therefore be 2021/22.

3.2. It is the duty of each local authority to adhere to the principles of financial management. To enable authorities to test their conformity with the CIPFA Principles of Good Financial Management, the FM Code translates these principles into financial management standards. These financial management standards will have different practical applications according to the different circumstances of each authority.

3.3. The implementation of the code is summarised in the diagram below:



4. Financial resilience assessment and financial resilience index

4.1. The FM code standard F outlines that the authority should carry out a credible and transparent financial resilience assessment.

4.2. The key principles of this are:

- The extent to which the authority has embraced the four 'pillars' of financial sustainability outlined in the Code;
- The key financial risks facing the authority, by drawing on potential future scenarios including 'best' and 'worst' case scenarios;

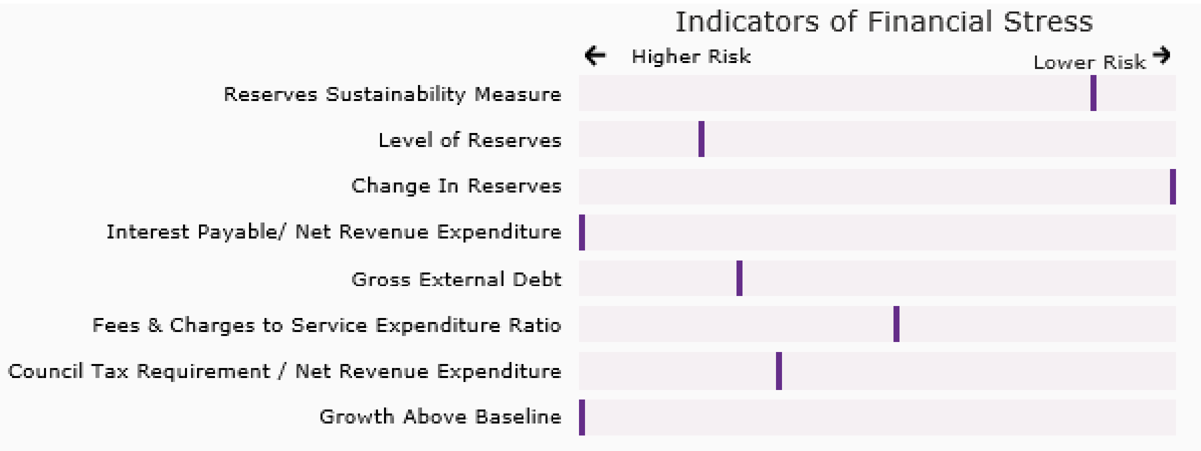
- The use of independent, objective measures to assess the risks to the authority's financial resilience and sustainability;
- The authority's understanding of the risks associated with all resources used for service delivery, including its workforce, its physical assets, its strategic business partners (including 'group' entities such as leisure trusts), its information technology infrastructure, etc;
- The robustness of the plans that the authority has put in place to address these risks; and
- The capacity and capability of the authority, its leadership team and its officers to manage the authority's finances in a sustainable manner.

4.3. With an awareness that risks will vary, it is expected that consideration be given to tools such as the Financial Resilience Index that may help organisations identify these pressure points. Without such stress testing an authority cannot be regarded as financially sustainable and will be deemed to have failed that test.

4.4. Launched in December 2019, CIPFA's Financial Resilience Index https://www.cipfa.org/services/financial-resilience-index/financial-resilience is a comparative analytical tool that may be used by chief financial officers to support good financial management, providing a common understanding within a council of their financial position.

4.5. Based on the financial statements for 2018/19, the index shows a council's position on a range of measures associated with financial risk. The selection of indicators has been informed by the extensive financial resilience work undertaken by CIPFA over the past four years, public consultation and technical stakeholder engagement.

4.6. Below is a summary of the indicators as reported within the index for Rugby Borough Council.



4.7. When compared to a pre-defined *neighbours list, the index has categorised the Authority as at the higher risk of financial stress in relation to interest payable/Net revenue expenditure and growth above baseline.

*created by CIPFA this is a model that generates sets of statistical nearest neighbours. The default model uses 20 factors including demographic variables, deprivation, employment and population density.

4.8. This assessment is not unexpected and officers have presented similar assessments to Members through:

- Capital Strategy Incorporating the Investment and Treasury Management Strategy. This strategy includes analysis of the % of the programme which is funded through borrowing;
- Medium Term Financial Strategy 2018-23 – which included a commitment to use a proportion of the Council's NHB allocations be withdrawn from the base budget by the 2020, with the monies ring-fenced for revenue contributions to capital expenditure to reduce the reliance on borrowing to finance the General Fund capital programme; and
- the annual budget setting process.

4.9. **Interest Payable/Net Revenue Expenditure –** Although capital expenditure is not charged directly to the revenue budget, interest payable on loans and MRP are charged to revenue, offset by any investment income receivable. The net annual charge is known as financing costs. The table below compares these costs to the net revenue stream i.e. the amount funded from Council Tax, business rates, rents and general government grants.

%	2018/19 Actual	2019/20 Estimate	2020/21 Estimate	2021/22 Estimate	2022/23 Estimate
General Fund	13	14	12	15	13
HRA	24	21	22	25	28

4.10. In the context of the General Fund, c45% of MRP/Interest charges relate to borrowing for the following 3 large schemes approved by Council in recent years:

- Queens Diamond Jubilee Leisure Centre;
- Rainsbrook Cemetery and Crematorium; and
- World Rugby Hall of Fame

4.11. In the context of the Housing Revenue Account, all current financing costs relate to the borrowing undertaken at the point of self-financing in 2012. As part of the settlement the Council undertook borrowing of £72m replacing the previous annual negative subsidy payment of £4m which was forecast to rise to £8m annually over the course of the 30-year HRA planning period.

4.12. **Growth Above (Business Rates) Baseline –** As reported in the Medium-Term Financial Plan and Medium-Term Financial Strategy, as a pro-growth authority, the proposed business rates reset will have a significant impact income generated through business rates. As the plans for reform of the system have been known for a number of years plans have been put in place to mitigate against this as far as practically possible. As part of the 2018-23 Medium Term Financial Strategy, any additional business rates growth above the sustainable baseline level have been transferred to the Business Rates Equalisation Reserve to help mitigate the anticipated cliff edge from the business rates reset and the fair funding review. This reserve is forecast to have a balance of £4.138m at 31 March 2020, which includes an additional £2.422m being contributed in 2019/20 as a result of the baseline reset being deferred until 2021/22.

4.13. **Other Indicators –** The remainder of the indicators are categorised at a lower level of financial stress but areas such as reserves are linked to the growth above baseline and Interest Payable/Net Revenue Expenditure. The MTFS sets out the policy to mitigate against the volatility of the business rates reset by allocating any business rates growth above the baseline value to the business rates equalisation reserve. Beyond the reset it is proposed to gradually reduce and taper the amount of business rates growth included in the base budget, with the long-term aim of only including an amount equivalent to the 'funding baseline' in the base budget. Growth retained above the funding baseline is utilised to make revenue contributions to finance capital or one-off expenditure, to reduce the extent of borrowing for the General Fund capital programme.

5. Next Steps

5.1 Detailed guidance notes for implementing the code will be published in April 2020. These will set out practices that Local Authorities can adopt to ensure compliance with the FM Code. These practices are not prescribed by the code but offered as a starting point to raise our approach to financial management to the minimum standard set out in the code This will enable officers to carry out a detailed assessment of the Authority's current level of compliance.

5.2 Following previous external audits of the financial statements it is expected that nothing significant will be identified, however there may be a requirement to review and update existing working practices. Following the compliance review a further paper will be presented to the committee with will outline compliance and proposed actions to become fully compliant by 31 March 2021.

Name of Meeting: Audit and Ethics Committee

Date of Meeting: 28 January 2020

Subject Matter: Requirements of the CIPFA Financial Management Code

Originating Department: Corporate Resources

DO ANY BACKGROUND PAPERS APPLY ☐ **YES** ☒ **NO**

LIST OF BACKGROUND PAPERS

Doc No	Title of Document and Hyperlink

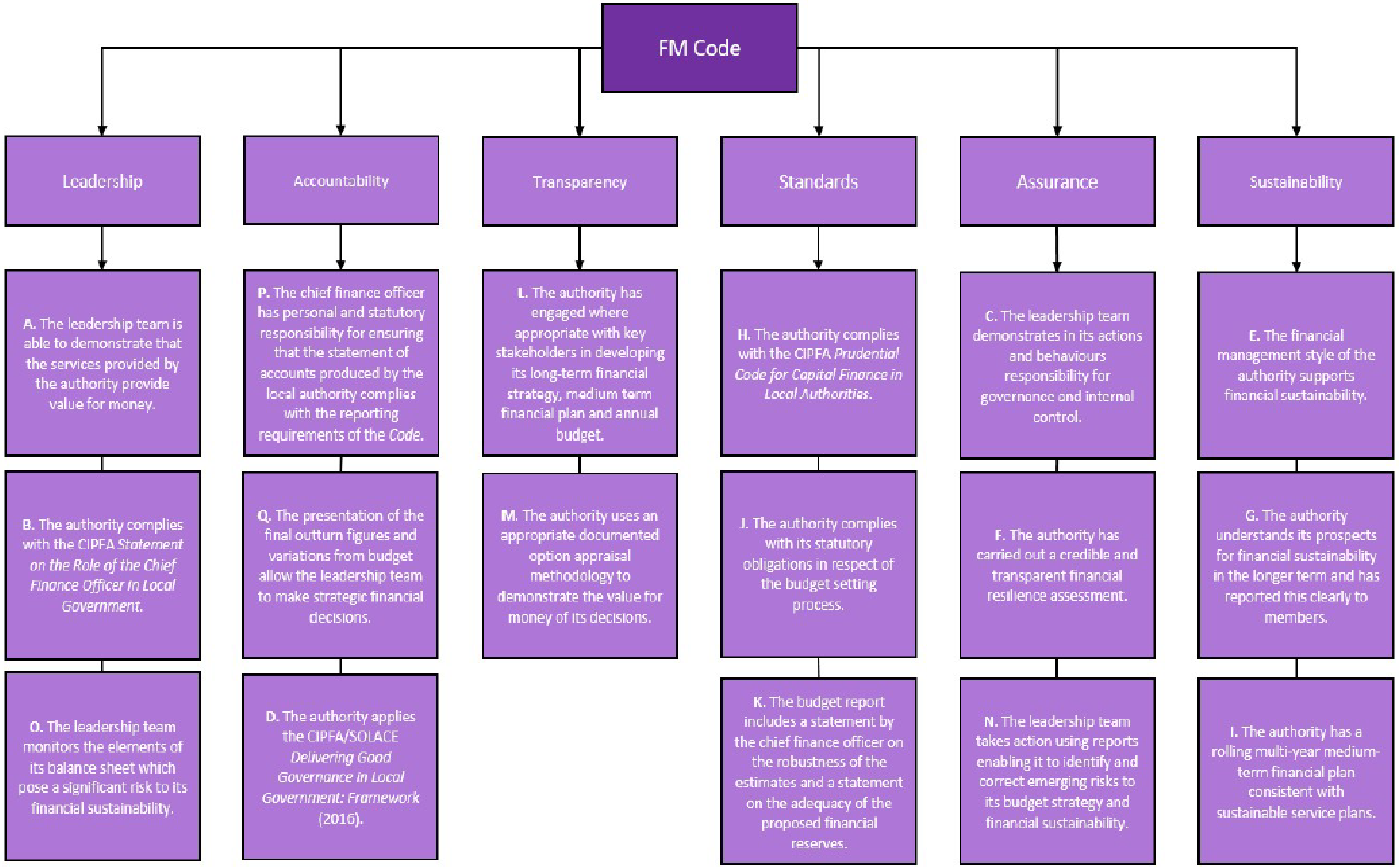
The background papers relating to reports on planning applications and which are open to public inspection under Section 100D of the Local Government Act 1972, consist of the planning applications, referred to in the reports, and all written responses to consultations made by the Local Planning Authority, in connection with those applications.

☐ Exempt information is contained in the following documents:

Doc No	Relevant Paragraph of Schedule 12A

Appendix 1

Financial Management Code – Summary of principles and standards



Agenda No 8

AGENDA MANAGEMENT SHEET

Report Title:	2019/20 Internal Audit Plan - Progress Update
Name of Committee:	Audit and Ethics Committee
Date of Meeting:	28 January 2020
Report Director:	Head of Corporate Resources and CFO
Portfolio:	Corporate Resources
Ward Relevance:	None
Prior Consultation:	Head of Corporate Resources and Chief Finance Officer
Contact Officer:	Chris Green, Corporate Assurance and Improvement Manager, 01788 533451 or chris.green@rugby.gov.uk
Public or Private:	Public
Report Subject to Call-In:	No
Report En-Bloc:	No
Forward Plan:	No
Corporate Priorities: **(CR) Corporate Resources** **(CH) Communities and Homes** **(EPR) Environment and Public Realm** **(GI) Growth and Investment**	This report relates to the following priority(ies): ☒ To provide excellent, value for money services and sustainable growth ☐ Achieve financial self-sufficiency by 2020 ☐ Enable our residents to live healthy, independent lives ☐ Optimise income and identify new revenue opportunities (CR) ☐ Prioritise use of resources to meet changing customer needs and demands (CR) ☒ Ensure that the council works efficiently and effectively (CR) ☐ Ensure residents have a home that works for them and is affordable (CH) ☐ Deliver digitally-enabled services that residents can access (CH) ☐ Understand our communities and enable people to take an active part in them (CH) ☐ Enhance our local, open spaces to make them places where people want to be (EPR)

	☐ Continue to improve the efficiency of our waste and recycling services (EPR) ☐ Protect the public (EPR) ☐ Promote sustainable growth and economic prosperity (GI) ☐ Promote and grow Rugby's visitor economy with our partners (GI) ☐ Encourage healthy and active lifestyles to improve wellbeing within the borough (GI)
Statutory/Policy Background:	Public Sector Internal Audit Standards (PSIAS)
Summary:	The report sets out progress against delivery of the Internal Audit Plan for 2019/20.
Financial Implications:	No direct implications
Risk Management Implications:	No direct implications
Environmental Implications:	No direct implications
Legal Implications:	No direct implications
Equality and Diversity:	No direct implications
Options:	None
Recommendation:	1. That the report be considered and noted. 2. That the proposed amendments to the internal audit plan be approved.
Reasons for Recommendation:	To comply with the requirements of the terms of reference of the Audit and Ethics Committee, and to discharge the Committee's responsibilities under the Constitution.

Agenda No 8

Audit and Ethics Committee - 28 January 2020

2019/20 Internal Audit Plan - Progress Update

Public Report of the Head of Corporate Resources and CFO

Recommendations
1. The report be considered and noted. 2. The proposed amendments to the internal audit plan be approved.

1. Introduction

1.1 The purpose of this report is to set out progress against the Internal Audit Plan for 2019/20.

The Council has a legal duty to maintain an adequate and effective Internal Audit service. The primary role of Internal Audit is to provide independent assurance that the Council has put in place appropriately designed internal controls to ensure that:

- The Council's assets and interests are safeguarded;
- Reliable records are maintained;
- Council policies, procedures and directives are adhered to; and
- Services are delivered in an efficient, effective and economic manner.

This work is normally referred to as Section 151 work.

2. Summary of Audit Work

2.1 The Internal Audit plan for 2019/20 was approved by the Audit and Ethics Committee on 26 March 2019. Progress against delivery of that plan is set out at Appendix A.

2.2 Appendix A also sets out the progress against the recommendations made by Internal Audit and details the latest position in relation to agreed actions which are overdue.

3. Revisions to the 2019/20 Audit Plan

3.1 The Committee's role as gatekeeper requires it to approve any significant changes to the internal audit plan, in accordance with the Public Sector Internal Audit Standards. It is also good practice to continually review the audit plan in light of emerging issues, to ensure that the work of internal audit adds maximum value by proactively responding to and aligning its work with the most significant risks facing the organisation.

3.2 There are four proposed amendments to the internal audit plan. Long term sickness absence has had an impact on resources for 2019/20. The Corporate Assurance and Improvement Manager has undertaken a review of the level of resource available for the remainder of the financial year, and has held discussions with senior managers to agree:

- which assignments remain a priority for the current financial year,
- any assignments which would no longer add significant value, and
- any assignments which can reasonably be deferred to the next financial year.

3.3 The proposed amendments to the internal audit plan are as follows:

Assignment	Objectives	Proposed Change	Rationale
Community Safety Partnership	Assurance that the partnership is delivering its action plans and expected outcomes. Assurance that statutory requirements under the Crime and Disorder Act are being fulfilled.	Defer to Q1 of 2020/21 (reduction of 12 days in the audit plan)	Based upon discussion with the Head of Environment and Public Realm the assurance work is not time critical in the short term.
Licensing	Assurance that efficient and effective controls are in place complying with all legislative requirements.	Defer to 2020/21 once the new system has been fully implemented. (reduction of 15 days in the audit plan)	Implementation of the new system is behind schedule and internal audit assurance work would not add maximum value at the present time.
Planning, Development and Enforcement	Assurance that planning administration, management and enforcement processes are consistently, efficiently and effectively applied.	Defer to Q1 of 2020/21 (reduction of 15 days in the audit plan)	The Head of Growth and Investment has requested a full system thinking review be conducted alongside the audit. This work can be more readily accommodated early in 2020/21.
RAGM Visitors Centre and Town Centre Improvement Fund RAGM Visitors Centre and	Scope had not been determined.	Cancel (reduction of 15 days in the audit plan)	Assurance work had already been carried out on the Visitors Centre in January 2018. This work resulted in Substantial Assurance and

Assignment	Objectives	Proposed Change	Rationale
Town Centre Improvement Fund (continued)			covered income management including Hall of Fame ticketing and merchandise sales, arrangements for securing value for money, and stock control. The Town Centre Improvement Fund is now ringfenced and management have stated that controls have been enhanced.

3.4 The proposed amendments to the internal audit plan are lower than the loss of resources due to long term sickness absence. This reflects the improved resilience of the service. Work is able to be shared and reallocated amongst members of the team, who have worked well to manage the impact and maintain the service.

3.5 In the opinion of the Corporate Assurance and Improvement Manager the amendments do not inhibit the provision of a broadly based internal audit opinion on the Council's control, risk management and governance arrangements for 2019/20. The requirements of the Public Sector Internal Audit Standards will therefore be met. The revised internal audit plan will contain 18 assurance assignments, compared with 16 in 2018/19 and 12 in 2017/18.

Name of Meeting: Audit and Ethics Committee

Date of Meeting: 28 January 2020

Subject Matter: 2019/20 Internal Audit Plan - Progress Update

Originating Department: Corporate Resources

DO ANY BACKGROUND PAPERS APPLY ☒ **YES** ☐ **NO**

LIST OF BACKGROUND PAPERS

Doc No	Title of Document and Hyperlink
1	Audit and Ethics Committee 22 October 2019 Agenda Item 7 – 2019/20 Internal Audit Plan – Progress Update https://www.rugby.gov.uk/meetings/meeting/990/audit_and_ethics_committee
2	Audit and Ethics Committee 30 July 2019 Agenda Item 5 – 2019/20 Internal Audit Plan – Progress Update https://www.rugby.gov.uk/meetings/meeting/989/audit_and_ethics_committee
3	Audit and Ethics Committee 26 March 2019 Agenda Item 10 – 2019/20 Internal Audit Plan https://www.rugby.gov.uk/meetings/meeting/896/audit_and_ethics_committee

The background papers relating to reports on planning applications and which are open to public inspection under Section 100D of the Local Government Act 1972, consist of the planning applications, referred to in the reports, and all written responses to consultations made by the Local Planning Authority, in connection with those applications.

☐ Exempt information is contained in the following documents:

Doc No	Relevant Paragraph of Schedule 12A

Appendix A

INTERNAL AUDIT PROGRESS UPDATE JANUARY 2020

Date**: 28 January 2020**

Introduction

1.1 The Public Sector Internal Audit Standards (the Standards) require the Audit and Ethics Committee to scrutinise the performance of Internal Audit and to satisfy itself that it is receiving appropriate assurance that the controls put in place by management address the identified risks to the Council. This report aims to provide the Committee with details on progress made in delivering planned work, the key findings of audit assignments completed since the last Committee meeting, updates on the implementation of actions arising from audit reports and an overview of the performance of the team.

Performance

2.1 Will the Internal Audit Plan be delivered?

The expected position by the date of the Committee meeting is as follows:

- 9 assignments have been completed;
- 1 assignment is at the draft report stage;
- 1 assignment is at the fieldwork completion stage;
- 10 assignments are in progress; and
- 3 assignments have not yet been started.

Sufficient resources are in place to deliver the amended internal audit plan on time.

Progress on individual assignments is shown at pages 7 to 9 of this report.

2.2 Based upon recent Internal Audit work, are there any emerging issues that impact upon the Internal Audit opinion of the Council's Control Framework?

At this stage there are no emerging issues arising from the work of Internal Audit which significantly impact upon the Internal Audit opinion of the Council's Control Framework. However, internal audit work has highlighted that the Council is not fully complying with the requirements of the Local Government Transparency Code and this will be referred to in the Annual Governance Statement for 2019/20.

2.3 Are clients progressing audit recommendations with appropriate urgency?

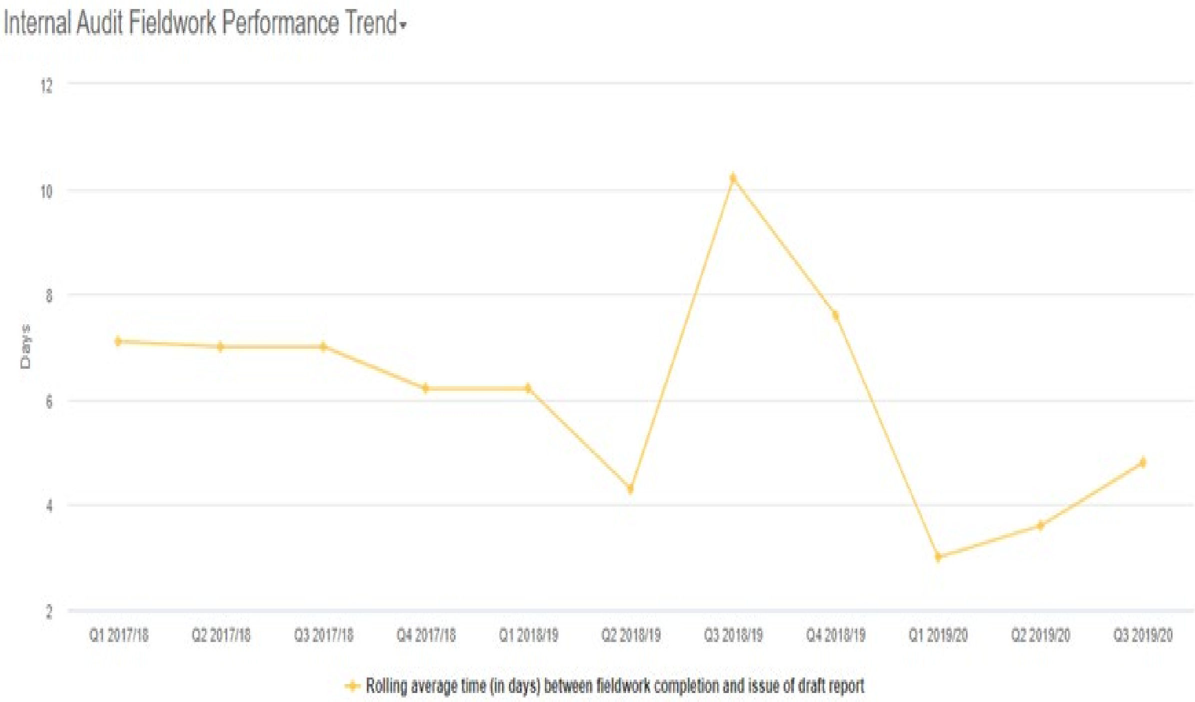
At the date of reporting, a combined **80.5% of management actions have been implemented by the agreed implementation date, with a further 7.1% implemented late, giving an overall implementation rate of 87.6%.** A summary analysis of progress on implementation of audit recommendations is shown at pages 10 to 11. **At the time of reporting there are 12 agreed management actions for which implementation is overdue, 1 of which are regarded as High risk and 8 as Medium risk.** The details of the actions related to High or Medium risks, along with a summary of the latest position, are set out at pages 12 to 13 of this report. Implementation of the actions will continue to be monitored by the Corporate Assurance and Improvement Team and reported to each Committee meeting.

2.4 Internal Audit Performance Indicators

The effectiveness with which Internal Audit discharges its section 151 responsibilities is being measured by the following indicators, as agreed by the Audit and Ethics Committee:

Theme	**Title of Performance Indicator**	**Current Performance**
Delivery	Average end to end time for audits (number of days)	Q3 Result: 114.6 days Q2 Result: 132.8 days Average - Terms of Reference to draft report issue: 65.6 days (unchanged from previous quarter) The team is working to bring this down and has completed an analysis of the full audit process using the council's Engage Software. This identified that the end to end time could be reduced by up to 20 days by streamlining the audit process. A new approach is being adopted for clearing audit reports with management.
Adding Value	Customer Satisfaction – Average Rating	Reported as an annual measure.
Timeliness	Timeliness of Reporting – Average time taken to issue draft reports following fieldwork completion	4.8 days Slight increase, however the results continue to compare favourably with previous years.
Effectiveness	Implementation of Agreed Actions – Percentage implemented on time	80.5% - at the time of reporting there are 12 recommendations which are past their agreed implementation date, 1 of which are regarded as High risk and 8 as Medium risk. Refer to pages 12 to 13 for detail.

2.5 Internal Audit Performance Trend Graphs



Limitations and Responsibilities

Limitations inherent to the Internal Auditor's work

Internal Audit is undertaking a programme of work agreed by the council's senior managers and approved by the Audit and Ethics Committee subject to the limitations outlined below.

Opinion

Each audit assignment undertaken addresses the control objectives agreed with the relevant responsible managers. There might be weaknesses in the system of internal control that Internal Audit are not aware of because they did not form part of the programme of work were excluded from the scope of individual internal audit assignments or were not brought to the attention of Internal Audit. As a consequence, the Audit and Ethics Committee should be aware that the Audit Opinion for each assignment might have differed if the scope of individual assignments was extended or other relevant matters were brought to Internal Audit's attention.

Internal Control

Internal control systems identified during audit assignments, no matter how well designed and operated, are affected by inherent limitations. These include the possibility of poor judgement in decision making, human error, control processes being deliberately circumvented by employees and others, management overriding controls, and unforeseeable circumstances.

Future Periods

The assessment of each audit area is relevant to the time at which the audit was completed. In other words, it is a snapshot of the control environment at that time. This evaluation of effectiveness may not be relevant to future periods due to the risk that:

- The design of controls may become inadequate because of changes in operating environment, law, regulatory requirements or other factors; or
- The degree of compliance with policies and procedures may deteriorate.

Responsibilities of Management and Internal Auditors

It is management's responsibility to develop and maintain sound systems of risk management, internal control and governance, and for the prevention or detection of irregularities and fraud. Internal audit work should not be seen as a substitute for management's responsibilities for the design and operation of these systems.

Internal Audit endeavours to plan its work so that there is a reasonable expectation that significant control weaknesses will be detected. If weaknesses are detected additional work is undertaken to identify any consequent fraud or irregularities. However, Internal Audit procedures alone, even when carried out with due professional care, do not guarantee that fraud will be detected, and its work should not be relied upon to disclose all fraud or other irregularities that might exist.

Progressing the Annual Internal Audit Plan

KEY
Current status of assignments is shown by ✓

Assignment	Budget (days)	Not Started	Planning	Field Work Underway	Field Work Complete	Draft Report	Final Report	Assurance Rating	Comments
Financial Risks									
Creditors	20						✓	Substantial	
Completeness of Income (Sundry Debtors)	15			✓					
Housing Rent Arrears	10					✓			
Cash and Bank	20			✓					
Counter Fraud									
Fraud Awareness	8			✓				Not Applicable	In progress. Two sessions delivered in July 2019 and four in January 2020. Further sessions are being scheduled for February and March 2020.
ICT									
IT Security	8						✓	Substantial	
IT Business Continuity	8			✓					Being delivered by TIAA.
CCTV	8			✓					

Assignment	Budget (days)	Not Started	Planning	Field Work Underway	Field Work Complete	Draft Report	Final Report	Assurance Rating	Comments
Corporate Risks									
Workforce Planning and Development - consultancy	12						✓	Not applicable	
Residential Property – Asset Maintenance Review - advisory	8						✓	Not applicable	
Absence Management	12						✓	Substantial	
Freedom of Information	8						✓	Substantial	
Complaints, Compliments and Suggestions	10						✓	Limited	See separate report to the Committee
Risk Management Effectiveness	80			✓					
Performance Management Effectiveness	80				✓				
Digitalisation	12			✓					
Ethical Risks									
Local Government Transparency Code	10						✓	Limited	See separate report to the Committee

Assignment	Budget (days)	Not Started	Planning	Field Work Underway	Field Work Complete	Draft Report	Final Report	Assurance Rating	Comments
Values and Behaviours Follow Up	8			✓					
Operational Risks									
Follow up work	12			✓					
Housing Management System	10		✓						Scheduled for February 2020.
Customer Service Centre Demand Management	15			✓					
Refuse and Recycling	20	✓							Scheduled for February & March 2020.
HR Capability and Disciplinary	12	✓							Scheduled for February & March 2020.
Additional Support									
Annual Governance Statement	12						✓	Substantial	Statement endorsed by SMT and Audit and Ethics Committee.
National Fraud Initiative	8							Not applicable	Ongoing co-ordination of the Council's NFI work.
Corporate Investigation Work	40	✓						Not applicable	No corporate investigations in progress at present.

Summary: Implementation of Audit Recommendations

Year	Audit	Not yet due	Overdue	Within time	Extended time	Out of time	Total Recs
2017/18	Business Continuity and Emergency Planning	0	1	0	0	0	**1**
2017/18	Corporate Credit Cards	1	0	0	0	0	**1**
2017/18	Council Tax and NDR	2	4	0	0	0	**6**
2017/18	Fleet Management	1	0	3	5	0	**9**
2017/18	Financial System Key Controls	0	2	1	0	0	**3**
2017/18	Housing Rent Arrears	0	1	0	0	2	**3**
2017/18	Payment Card Industry Data Security Standards	0	0	0	2	0	**2**
2017/18	Partnership Governance	0	0	1	0	0	**1**
2017/18	Property Repairs Stock Control	1	0	0	2	0	**3**
2017/18	PTC Interface	0	0	2	0	0	**2**
2017/18	Risk Management	2	1	1	1	0	**5**
2017/18	Values and Behaviours	2	0	4	0	0	**6**
2018/19	Absence Management	6	0	2	0	0	**8**
2018/19	Benefits	0	0	0	0	1	**1**
2018/19	Car Parking Enforcement	0	0	1	0	0	**1**
2018/19	Creditors	4	0	2	0	1	**7**
2018/19	Data Protection Governance	6	0	3	0	0	**9**
2018/19	Elections	0	2	0	0	0	**2**
2018/19	Fraud Risk Review	6	0	3	3	0	**12**
2018/19	Grants to Community Groups	0	0	13	0	0	**13**
2018/19	Green Waste Optimisation	0	0	2	0	0	**2**
2018/19	Health and Safety Follow Up	2	11**	0	0	0	**13**
2018/19	Independent Living	3	2	7	0	1	**13**
2018/19	Insurance	1	0	0	0	0	**1**
2018/19	ICT Backup	1	0	3	0	0	**4**

2018/19	Patch Management	2	0	4	0	0	**6**
2018/19	Property Repairs	0	1	6	2	2	**11**
2018/19	Treasury Management	0	2	2	0	2	**6**
2018/19	Tenant Recharges	0	1	5	0	1	**7**
2019/20	Freedom of Information	2	0	6	0	0	**8**
2019/20	Local Government Transparency Code	12	2	4	0	0	**18**
2019/20	Complaints, Compliments, Suggestions	4	0	4	0	0	**8**
2019/20	IT Security	3	0	0	0	0	**3**
	Totals	61	30	79	15	10	195
Amended Totals (see notes below)		**79**	**12**	**79**	**15**	**10**	**195**

Notes:

Of the 30 overdue actions, 18 were due on 31/12/2019. These have been discounted for the purposes of calculating the performance statistics given that this report was produced in the first week of the new calendar year and the actions were only overdue by a few days.

Extended time: This is where the Corporate Assurance and Improvement Manager had agreed an extension to the original timescale.

Out of time: This is where the action was implemented later than the agreed timescale.

** 10 of the overdue actions from the Health & Safety audit were actually due on 31/12/2019, so at the time of writing the report were only overdue by a few days.

Details of Overdue Medium and High Risk Audit Recommendations

Audit	Code & Title	Due Date	Latest Note	Risk Rating
Business Continuity & Emergency Planning 17/18	Draft and cascade an updated bomb threat procedure	31-Aug-2019	A draft Bomb threat procedure was presented to SRMG in November. It was agreed that further development work is required on the final procedure, but that the Health & Safety Manager would formulate an interim procedure for agreement by the SMT.	Medium Risk Recommendation
Council Tax & NDR Fraud 17/18	Consider introducing a £70 penalty for fraudulent claims for discounts, reductions and exemptions.	30-Sep-2019	Update from Revenues Manager: Another module would need to be purchased for the OpenRevenues system, at cost. This module is used by Warwick District Council and a discussion is to be held to understand their experiences of using the module, and whether it would be cost effective to implement.	Medium Risk Recommendation
Financial System Key Controls 17/18	Implement DASH as a uniform means of logging sundry debtor requests. Investigate interfacing this with OPENRevenues. Provide feedback to departments as and when invoice requests have been processed.	30-Sep-2019	The Revenues Manager has raised an enhancement request with Civica for automation in the sundry debt system. Timing of implementation would be depending on the system developmental work. An ideal solution would be to introduce an online form with the necessary fields which could then be automatically uploaded to Open Revenues and an invoice automatically generated. This would make the process more efficient and effective.	Medium Risk Recommendation
Housing Rent Arrears 17/18	The sampling of officer's cases for appropriateness of actions should be documented and the results (both positive and developmental) discussed at one to ones.	30-Sep-2019	This action remains outstanding. Responsible Officer: Revenues Manager	Medium Risk Recommendation

Audit	Code & Title	Due Date	Latest Note	Risk Rating
Health & Safety follow up 18/19	Update the driver handbook.	30-Sep-2019	Guidance documentation has now been sourced. The Health & Safety Manager stated that key stakeholders have not been available until this month and a consultation meeting has been arranged for the end of January.	High Risk Recommendation
Local Government Transparency Code 19/20	Amend the Organisation Chart to include the missing mandatory detail.	30-Nov-2019	The Communications, Consultation and Information team are liaising with Financial Services to confirm the data which needs to be published. Data was sent to the Communications team, but it was incomplete and in the incorrect format, it has been sent back to HR for the required changes to be made.	Medium Risk Recommendation
Treasury Management 18/19	The 'Treasury Management Practices 5 - Organisation, clarity and segregation of responsibilities' should be updated to clarify which individual roles are able to arrange, authorise and subsequently 'confirm' both Investments and Loans.	30-Nov-2019	Update from the Finance Services Manager: This exercise is currently being completed by the interim Principal Accountant.	Medium Risk Recommendation
Treasury Management 18/19	Ensure that the monthly investment reconciliation is re-instated and completed on a monthly basis.	31-Jul-2019	Update from the Finance Services Manager: The whole process is currently being redesigned by the interim Principal Accountant in combination with the required updates to transition to a software based treasury management system.	Medium Risk Recommendation
Tenant Recharges 18/19	A report detailing the collection rate of recharge sundry debts should be produced quarterly and forwarded to the Resources Head of Service, Property Manager and Property Repairs Manager.	31-Jul-2019	The Council is considering purchasing an additional module for the OpenRevenues system which would produce a spreadsheet of all data, which can be used to populate a report in the Power BI (business intelligence) system. In the meantime officers are exploring whether the data could be exported directly from OpenRevenues to Power BI.	Medium Risk Recommendation

Agenda No 9

AGENDA MANAGEMENT SHEET

Report Title:	Development of Internal Audit Plan for 2020/21
Name of Committee:	Audit and Ethics Committee
Date of Meeting:	28 January 2020
Report Director:	Head of Corporate Resources and CFO
Portfolio:	Corporate Resources
Ward Relevance:	None
Prior Consultation:	Head of Corporate Resources and CFO
Contact Officer:	Chris Green, Corporate Assurance and Improvement Manager, 01788 533451 or chris.green@rugby.gov.uk
Public or Private:	Public
Report Subject to Call-In:	No
Report En-Bloc:	No
Forward Plan:	No
Corporate Priorities: **(CR) Corporate Resources** **(CH) Communities and Homes** **(EPR) Environment and Public Realm** **(GI) Growth and Investment**	This report relates to the following priority(ies): ☒ To provide excellent, value for money services and sustainable growth ☐ Achieve financial self-sufficiency by 2020 ☐ Enable our residents to live healthy, independent lives ☐ Optimise income and identify new revenue opportunities (CR) ☐ Prioritise use of resources to meet changing customer needs and demands (CR) ☒ Ensure that the council works efficiently and effectively (CR) ☐ Ensure residents have a home that works for them and is affordable (CH) ☐ Deliver digitally-enabled services that residents can access (CH) ☐ Understand our communities and enable people to take an active part in them (CH) ☐ Enhance our local, open spaces to make them places where people want to be (EPR) ☐ Continue to improve the efficiency of our waste and recycling services (EPR)

	☐ Protect the public (EPR) ☐ Promote sustainable growth and economic prosperity (GI) ☐ Promote and grow Rugby's visitor economy with our partners (GI) ☐ Encourage healthy and active lifestyles to improve wellbeing within the borough (GI) ☐ This report does not specifically relate to any Council priorities but
Statutory/Policy Background:	Public Sector Internal Audit Standards
Summary:	The report sets out the proposed arrangements for developing the internal audit plan for 2020/21.
Financial Implications:	There are no financial implications arising directly from this report.
Risk Management Implications:	If the internal audit plan does not cover the key risks to the Council the quality of the assurances it provides about the control framework would be compromised.
Environmental Implications:	There are no environmental implications arising from this report.
Legal Implications:	There are no legal implications arising from this report.
Equality and Diversity:	There are no equality and diversity implications arising from this report.
Options:	None
Recommendations:	1. The process for developing the internal audit plan for 2020/21 is approved. 2. Members consider areas in which they require assurances from Internal Audit during 2020/21.
Reasons for Recommendation:	Discharges the committee's responsibilities under the Constitution.

Agenda No 9

Audit and Ethics Committee - 28 January 2020

Development of Internal Audit Plan for 2020/21

Public Report of the Head of Corporate Resources and CFO

Recommendations:
1. The process for developing the internal audit plan for 2020/21 is approved. 2. Members consider areas in which they require assurances from Internal Audit during 2020/21.

1. Introduction

1.1 The Internal Audit Plan is designed to support the provision of an annual Internal Audit Opinion. The basis for forming this opinion is as follows:

- An assessment of the design and operation of the underpinning Governance, Assurance and Risk Frameworks and supporting processes; and
- An assessment of the range of individual opinions arising from the risk based assignments, which will be reported throughout the year.

1.2 The Internal Audit Plan covers the two key component roles of Internal Audit:

- The provision of an independent and objective opinion to the Head of Corporate Resources/ Chief Finance Officer and the Audit and Ethics Committee on the degree to which risk management, control and governance support the achievement of Council objectives; and
- The provision of an independent and objective consultancy service specifically to help line management improve the organisation's risk management, control and governance arrangements.

2. Report Details

Public Sector Internal Audit Standards

2.1 In setting the Internal Audit Plan, the Public Sector Internal Audit Standards (the Standards) require that:

- The Internal Audit Plan should be developed taking into account the organisation's risk management framework and based upon a risk assessment process undertaken with senior management and the Audit and Ethics Committee;
- The Internal Audit Plan should be reviewed and approved by an effective and engaged Audit Committee to confirm that the plan addresses their assurance requirements for the year ahead;
- The "Chief Audit Executive" should consider accepting proposed consulting engagements based on the engagement's potential to improve

management of risks, add value and improve the organisation's operations. Accepted engagements must be included in the plan.

Proposed Approach to Developing the Internal Audit Plan

2.2 In order to ensure the Internal Audit Plan for 2020/21 addresses the Council's key strategic and operational risks and adds value to the organisation, it is proposed that the Corporate Assurance and Improvement Manager will identify and prioritise areas for coverage by reviewing sources such as:

- Strategic and Operational Risk Registers
- Corporate Strategy
- Financial Statements
- Service Action Plans
- Corporate Projects

2.3 Any other sources of assurance for each of the Council's key risks will be considered, which may reduce the added value of an Internal Audit review. Options for aligning work with other assurance providers will also be evaluated.

2.4 Coverage of Internal Audit reviews over the last four years will be reviewed together with the assurance opinions provided following each review, to identify any assurance gaps or areas where follow up work would be of value.

2.5 The Audit Universe (the long list of potential areas for audit review across the Council) will be reviewed and updated. Areas which have not been subject to Internal Audit review during the last four years, and for which the level of risk is considered to be medium or higher, will be considered for inclusion in the audit plan.

2.6 Members are encouraged to provide input to development of the internal audit plan by highlighting areas which they consider to be medium or high risk. This input may be provided at the Committee meeting; alternatively members are welcome to contact the Corporate Assurance and Improvement Manager before the end of February 2020.

2.7 Whilst there is no change to the audit planning methodology, it is proposed that an audit plan be developed covering the six month period April to September 2020, rather than for the full financial year. This is designed to ensure that the work of internal audit is prioritised on the areas of highest need throughout the year, so as to add greater value. It will also facilitate increased stakeholder engagement and consultation because there will be a second formal audit planning exercise conducted during August/September 2020. The new arrangements would also enable the Corporate Assurance and Improvement Manager to present an indicative opinion on the Council's control, governance and risk management arrangements half way through the year. The proposed changes reflect developments in the sector, with more organisations moving away from traditional three to five year internal audit strategies and annual plans and adopting a more agile approach. The change of approach will be seen as a trial and the benefits will be reviewed after the first year.

2.8 There is potentially an increased risk that the audit plan as a whole does not cover all the areas required by the Public Sector Internal Audit Standards; this will be managed by the Corporate Assurance and Improvement Manager who will ensure that appropriate coverage is maintained. The audit plan covering the period April to September 2020 will be presented to the SMT and Committee in a way which shows the required areas of coverage in accordance with the standards. Stakeholder meetings in February 2020 will undoubtably highlight more areas for audit than can be covered in the first six months and this will enable some audits to be provisionally scheduled for the period October 2020 to March 2021. When the audit plan for October 2020 to March 2021 is presented, this will demonstrate that the coverage requirements have been met.

2.9 The change in approach creates additional risks for the Corporate Assurance and Improvement team, which will be under more pressure to complete the first six month audit plan by the end of September 2020 and the second plan by the end of March 2021. There are wellbeing risks which will be managed by the Corporate Assurance and Improvement Manager. However, the additional half year deadline will help to spread workload pressures through the year, instead of there being more concentrated pressure during the final three months of the year. Furthermore, it is proposed, subject to the Committee's agreement, to commence detailed scoping of assignments prior to formal approval of the audit plan on 24 March 2020. This will enable the team to commence the audit fieldwork as early as possible in April.

2.10 Stakeholder meetings with each member of the Senior Management Team (SMT) will take place during February 2020. The Audit Universe will form a basis for the stakeholder discussions; in addition there will be a discussion of key risks and emerging risks for the months ahead, and any areas where Internal Audit support would be beneficial either in an assurance or consultancy role.

2.11 Following the stakeholder meetings, the planned audit coverage for the six month period covering April to September 2020 will be refined and prioritised.

2.12 The proposed six month Internal Audit Plan will then be presented to SMT for approval in March 2020, and members will be asked to approve the Plan at the next Audit and Ethics Committee meeting on 24 March 2020.

2.13 Delivery of the internal audit service is currently supported by an appointed third-party contractor, TIAA Ltd. TIAA delivers the Council's internal IT audits under a framework agreement managed by Warwickshire County Council. There is also a call off option for non-IT internal audit work, which helps to provide resilience to the Council's in-house service.

Name of Meeting: Audit and Ethics Committee

Date of Meeting: 28 January 2020

Subject Matter: Development of Internal Audit Plan for 2020/21

Originating Department: Corporate Resources

DO ANY BACKGROUND PAPERS APPLY ☐ **YES** ☒ **NO**

LIST OF BACKGROUND PAPERS

Doc No	Title of Document and Hyperlink

The background papers relating to reports on planning applications and which are open to public inspection under Section 100D of the Local Government Act 1972, consist of the planning applications, referred to in the reports, and all written responses to consultations made by the Local Planning Authority, in connection with those applications.

☐ Exempt information is contained in the following documents:

Doc No	Relevant Paragraph of Schedule 12A