14 October 2019

AUDIT AND ETHICS COMMITTEE – 22 OCTOBER 2019

A meeting of the Audit and Ethics Committee will be held at 6pm on Tuesday 22 October 2019 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 30 July 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. Annual Audit Letter 2018/19

5. Treasury Management Annual Report 2018/19

6. Treasury Management Strategy 2018/19 - 2020/21

7. 2019/20 Internal Audit Plan – Progress Update

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

2. 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:	Annual Audit Letter 2018/19
Name of Committee:	Audit and Ethics Committee
Date of Meeting:	22 October 2019
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:	National Audit Office (NAO)'s Code of Audit Practice (the Code) and Auditor Guidance Note (AGN) 07 –'Auditor Reporting'.
Summary:	The purpose of the annual audit letter is to communicate the key issues arising from the work of the external auditor to Members and external stakeholders, including members of the public.
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:	To note the Annual Audit Letter 2018/19 as attached Appendix.
Reasons for Recommendation:	Under the statutory Code of Audit Practice, the external auditors are required to issue a report to those charged with governance the conclusions from their audit work.

Agenda No 4

Audit and Ethics Committee - 22 October 2019

Annual Audit Letter 2018/19

Public Report of the Head of Corporate Resources and CFO

Recommendation
To note the Annual Audit Letter 2018/19 as attached Appendix.

1. Introduction

Each year the council's external auditors produce an Annual Audit Letter which summarises the key findings arising from their annual assessment of the Council. This Letter is intended to provide a commentary on the results of the work to the council and its external stakeholders, and to highlight any issues that they wish to draw to the attention of the public.

2. Annual Audit Letter

The Annual Audit Letter is presented at Appendix for the Committee's consideration. Much of the commentary contained within the Letter summaries the detail findings of audit that were presented to the Committee within the Audit Findings Report for 2018/19, at its meeting on 30 July 2019.

The Letter also confirms that the fees for the 2018/19 statutory audit are currently set at £46,825 which includes £4,500 of variation due to the issues in relation to;

- Assessing the impact of the McCloud ruling
- Pensions – IAS 19
- PPE Valuation – work of experts

The revised fee for the year is subject to approval by Public Sector Appointments Ltd (PSAA) but it should be noted that £46,825 would still represent a 15% statutory audit fee reduction on the prior year.

Name of Meeting: Audit and Ethics Committee

Date of Meeting: 22 October 2019

Subject Matter: Annual Audit Letter 2018/19

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 26 March 2019 Agenda Item 6 Draft External Audit Plan 2018/19 https://www.rugby.gov.uk/meetings/meeting/896/audit_and_ethics_committee
2	Audit and Ethics Committee 30 July 2019 Agenda Item 4 Statement of Accounts 2018/19 https://www.rugby.gov.uk/meetings/meeting/989/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

Grant Thornton

The Annual Audit Letter For Rugby Borough Council

Year ended 31 March 2019

20 August 2019

Contents

Your key Grant Thornton team members are:

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Executive Summary

Purpose

Our Annual Audit Letter (Letter) summarises the key findings arising from the work that we have carried out at Rugby Borough Council (the Council) for the year ended 31 March 2019.

This Letter is intended to provide a commentary on the results of our work to the Council and external stakeholders, and to highlight issues that we wish to draw to the attention of the public. In preparing this Letter, we have followed the National Audit Office (NAO)'s Code of Audit Practice and Auditor Guidance Note (AGN) 07 – 'Auditor Reporting'. We reported the detailed findings from our audit work to the Council's Audit and Ethics Committee as those charged with governance in our Audit Findings Report on 30 July 2019.

Respective responsibilities

We have carried out our audit in accordance with the NAO's Code of Audit Practice, which reflects the requirements of the Local Audit and Accountability Act 2014 (the Act). Our key responsibilities are to:

- give an opinion on the Council's financial statements (section two)
- assess the Council's arrangements for securing economy, efficiency and effectiveness in its use of resources (the value for money conclusion) (section three).

In our audit of the Council's financial statements, we comply with International Standards on Auditing (UK) (ISAs) and other guidance issued by the NAO.

Our work

Materiality	We determined materiality for the audit of the Council's financial statements to be £1,000,000, which is 1.77**%** of the Council's gross operating expenditure.
Financial Statements opinion	We gave an unqualified opinion on the Council's financial statements on 31 July 2019.
Whole of Government Accounts (WGA)	We completed work on the Council's consolidation return following guidance issued by the NAO.
Use of statutory powers	We did not identify any matters which required us to exercise our additional statutory powers.
Value for Money arrangements	We were satisfied that the Council put in place proper arrangements to ensure economy, efficiency and effectiveness in its use of resources. We reflected this in our audit report to the Council on 31 July 2019.
Certification of Grants	We completed work on the Council's 2017-18 Housing Benefit subsidy claim on behalf of the Department for Work and Pensions. We also carried out work to certify the Council's 2017-18 Pooling of Housing Capital Receipts return as an audit related non-audit service. There were no matters to report in respect of the Council's pooled capital receipts return but we did note one amendment and some minor exceptions in respect of the Council's subsidy claim (page 8). Our work on the 2018-19 subsidy claim is not yet complete and will be finalised by 30 November 2019. We have not yet started work on the 2018-19 pooled capital receipts return which has a 31 January 2020 deadline.
Certificate	We certified that we have completed the audit of the financial statements of Rugby Borough Council in accordance with the requirements of the Code of Audit Practice on 31 July 2019.

Working with the Council

- An efficient audit – we delivered an efficient audit with you in July, delivering the financial statements before the deadline, releasing your finance team for other work.
- Understanding your operational health – through the value for money conclusion we provided you with assurance on your operational effectiveness.
- Sharing our insight – we provided regular Committee updates covering best practice. We also shared our thought leadership reports.

We would like to record our appreciation for the assistance and co-operation provided to us during our audit by the Council's staff.

Audit of the Financial Statements

Our audit approach

Materiality

In our audit of the Council’s financial statements, we use the concept of materiality to determine the nature, timing and extent of our work, and in evaluating the results of our work. We define materiality as the size of the misstatement in the financial statements that would lead a reasonably knowledgeable person to change or influence their economic decisions.

.We determined materiality for the audit of the Council’s financial statements to be £1,000,000, which is 1.77**%** of the Council’s gross operating expenditure. This benchmark is considered the most appropriate because we consider users of the financial statements to be most interested in how it has expended its revenue and other funding.

We also set a lower level of specific materiality for senior officer remuneration disclosures of £25,000 as we believe these disclosures are of specific interest to the reader of the accounts.

We set a lower threshold of £50,000, above which we reported errors to the Audit and Ethics Committee in our Audit Findings Report.

The scope of our audit

Our audit involves obtaining sufficient evidence about the amounts and disclosures in the financial statements to give reasonable assurance that they are free from material misstatement, whether caused by fraud or error. This includes assessing whether:

- the accounting policies are appropriate, have been consistently applied and adequately disclosed;
- the significant accounting estimates made by management are reasonable; and
- the overall presentation of the financial statements gives a true and fair view.

We also read the remainder of the financial statements and the narrative report, annual governance statement and published alongside the financial statements to check it is consistent with our understanding of the Council and with the financial statements included in the Annual Report on which we gave our opinion.

We carry out our audit in accordance with ISAs (UK) and the NAO Code of Audit Practice. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Our audit approach was based on a thorough understanding of the Council’s business and is risk based.

We identified key risks and set out overleaf the work we performed in response to these risks and the results of this work.

Audit of the Financial Statements

Significant Audit Risks

These are the risks which had the greatest impact on our overall strategy and where we focused more of our work.

Risks identified in our audit plan	How we responded to the risk	Findings and conclusions
The revenue cycle includes fraudulent transactions Under ISA (UK) 240 – *the Auditor's Responsibility to Consider Fraud in an Audit of Financial Statements* - there is a rebuttable presumed risk that revenue may be misstated due to the improper recognition of revenue. This presumption can be rebutted if the auditor concludes that there is no risk of material misstatement due to fraud relating to revenue recognition.	Having considered the risk factors set out in ISA240 and the nature of the revenue streams at the Council we determined that the risk of fraud arising from revenue recognition could be rebutted, because: • there is little incentive to manipulate revenue recognition • opportunities to manipulate revenue recognition are very limited • the culture and ethical frameworks of local authorities, including Rugby Borough Council, mean that all forms of fraud are seen as unacceptable.	We have not altered our assessment as reported in the audit plan and, whilst not a significant risk, as part of our audit work we did undertake work on material revenue items. Our work did not identify any matters that would indicate our rebuttal was incorrect. We therefore have no issues to report in this regard
Management override of controls Under ISA (UK) 240 there is a non-rebuttable presumed risk that the risk of management over-ride of controls is present in all entities. The Authority faces external scrutiny of its spending and this could potentially place management under undue pressure in terms of how they report performance. We therefore identified management override of control, in particular journals, management estimates and transactions outside the course of business as a significant risk, which was one of the most significant assessed risks of material misstatement.	As part of our audit work we: • evaluated the design effectiveness of management controls over journals • analysed the journals listing and determine the criteria for selecting high risk unusual journals • tested unusual journals recorded during the year and after the draft accounts stage for appropriateness and corroboration • gained an understanding of the accounting estimates and critical judgements applied made by management and consider their reasonableness with regard to corroborative evidence • evaluated the rationale for any changes in accounting policies, estimates or significant unusual transactions.	Our audit work at the Council has not identified any issues in respect of management override of controls.

Audit of the Financial Statements

Significant Audit Risks - continued

<table>
<tr><th>Risks identified in our audit plan</th><th>How we responded to the risk</th><th>Findings and conclusions</th></tr>
<tr><td>Valuation of land and buildings (Periodic revaluation with desktop valuation in intervening years)

The Council revalues its land and buildings on a rolling five year basis. In the intervening years, such as 2018/19, to ensure the carrying value in the Authority financial statements is not materially different from the current value or the fair value (for surplus assets) at the financial statements date, the Authority carries out a desktop revaluation/requests a desktop valuation from its valuation expert to ensure that there is no material difference.

This valuation represents a significant estimate by management in the financial statements due to the size of the numbers involved (£234m) and the sensitivity of this estimate to changes in key assumptions.

We therefore identified valuation of land and buildings as a significant risk, which was one of the most significant assessed risks of material misstatement, and a key audit matter.</td><td>As part of our audit work we have:
evaluated management's processes and assumptions for the calculation of the estimate, the instructions issued to valuation experts and the scope of their work
evaluated the competence, capabilities and objectivity of the valuation expert
written to the valuer to confirm the basis on which the valuation was carried out to ensure that the requirements of the Code are met
challenged the information and assumptions used by the valuer to assess completeness and consistency with our understanding
tested, on a sample basis, revaluations made during the year to see if they had been input correctly into the Council's asset register, and
evaluated and challenged the assumptions made by management for those assets not revalued during the year and how management have satisfied themselves that these are not materially different to current value.</td><td>The Council owns 3,786 dwellings and is required to revalue these properties in accordance with DCLG's Stock Valuation for Resource Accounting guidance. The guidance requires the use of beacon methodology, in which a detailed valuation of representative property types is then applied to similar properties.

The Council's last full valuation of council dwellings was as at 1 April 2016, since this date the Council has carried out a desktop review using house price indexation for the West Midlands to assess any general market changes in value. This has been reviewed by the Council's external valuer. The year end valuation of Council Housing was £188.7m, a net increase of £302k from 2017/18 (£188.4m).

Whilst the use of indices is not strictly in line with the Code (LAAP Bulletin 104 2015/16), it has been through engagement with the external valuer. We have reviewed the analysis performed and consider that the approach that has been taken to arrive at this estimate is reasonable and we are satisfied there is no indication of material misstatement.

Other land and buildings comprises specialised assets such as the Queen's Diamond Jubilee Leisure Centre, Benn Hall and the John Barford Car Park , which are required to be valued at depreciated replacement cost (DRC) at year end. The remainder of other land and buildings are not specialised in nature and are required to be valued at existing use in value (EUV) at year end..

The Council has engaged its own external valuer to complete the valuation of properties as at 31 March 2019 on a four yearly cyclical basis. 16% of total assets (by value) were revalued during 2018/19. The year end valuation other land and buildings valued by the valuer has resulted in a net decrease of £583k to £31.679m.

Due to their nature i.e. infrastructure and community the remaining assets of £5.140m are not required to be revalued.

We have no other points to report in relation to the valuation of Property, Plant and Equipment.</td></tr>
</table>

Audit of the Financial Statements

Significant Audit Risks- continued

Risks identified in our audit plan	How we responded to the risk	Findings and conclusions
Valuation of pension fund net liability The Council's pension fund net liability, as reflected in its balance sheet as the net defined benefit liability, represents a significant estimate in the financial statements. The pension fund net liability is considered a significant estimate due to the size of the numbers involved (£50.7m million in the Council's balance sheet) and the sensitivity of the estimate to changes in key assumptions. We therefore identified valuation of the Council's pension fund net liability as a significant risk.	As part of our audit work we have: • documented our understanding of the processes and controls put in place by management to ensure that the Council's pension fund net liability is not materially misstated and evaluated the design of the associated controls; • evaluated the instructions issued by management to their management expert (an actuary) for this estimate and the scope of the actuary's work; • assessed the competence, capabilities and objectivity of the actuary who carried out the Council's pension fund valuation; • assessed the accuracy and completeness of the information provided by the Council to the actuary to estimate the liability; • checked the consistency of the pension fund asset and liability and disclosures in the notes to the core financial statements with the actuarial report from the actuary; • undertaken procedures to confirm the reasonableness of the actuarial assumptions made by reviewing the report of the consulting actuary (as auditor's expert) and performing any additional procedures suggested within the report.; and, • obtained assurances from the auditor of Warwickshire Pension Fund as to the controls surrounding the validity and accuracy of membership data; contributions data and benefits data sent to the actuary by the pension fund and the fund assets valuation in the pension fund financial statements.	Our audit identified one issue in relation to accounting for the impact of the McCloud Court of Appeal judgement in respect of age discrimination and Guaranteed Minimum Pension (GMP) equalisation. The Council requested an estimate from its actuary of the potential impact of both upon the Council. The actuary has estimated that the combined impact of the McCloud judgement (£650k) and Guaranteed Minimum Pension (GMP) indexation (£211k), amounts to £861k. The Council has increased their pensions disclosures following receipt of the revised report. The Council has not adjusted their primary statements, taking the view that the combined impact compared to the net pension liability of £50.7m is not material to the financial statements and will be considered for future years' actuarial valuations and that additional disclosure is appropriate. We reviewed the analysis performed by the actuary, and considered that the approach that has been taken to arrive at this estimate is reasonable. Although we are of the view that there is sufficient evidence to indicate that a liability is probable, we have satisfied ourselves that there is not a risk of material misstatement as a result of this issue. We also acknowledge the significant uncertainties relating to the estimation of the impact on the Council's liability. We are satisfied this has no impact upon our audit opinion but as we consider this to be an unadjusted audit difference we obtained the Audit & Ethics Committee agreement to management's decision and specific reference in the Letter of Representation.

Audit of the Financial Statements

Audit opinion

We gave an unqualified opinion on the Council's financial statements on 31 July 2019.

Preparation of the financial statements

The Council presented us with draft financial statements in accordance with the national deadline, and provided a good set of working papers to support them. The finance team responded promptly and efficiently to our queries during the course of the audit.

Issues arising from the audit of the financial statements

We reported the key issues from our audit to the Council's Audit and Ethics Committee on 30 July 2019.

Annual Governance Statement and Narrative Report

We are required to review the Council's Annual Governance Statement and Narrative Report. It published them on its website in the Statement of Accounts in line with the national deadlines.

Both documents were prepared in line with the CIPFA Code and relevant supporting guidance. We confirmed that both documents were consistent with the financial statements prepared by the Council and with our knowledge of the Council.

Whole of Government Accounts (WGA)

We carried out work on the Council's Data Collection Tool in line with instructions provided by the NAO . We issued an assurance statement which confirmed the Council was below the audit threshold for undertaking detailed testing.

Other statutory powers

We also have additional powers and duties under the Act, including powers to issue a public interest report, make written recommendations, apply to the Court for a declaration that an item of account is contrary to law, and to give electors the opportunity to raise questions about the Council's accounts and to raise objections received in relation to the accounts.

Certificate of closure of the audit

We certified that we have completed the audit of the financial statements of Rugby Borough Council in accordance with the requirements of the Code of Audit Practice on 31 July 2019.

Certification of Grants

Since our last Annual Audit Letter we have certified the Council's 2017-18 Housing Benefit Subsidy claim and the 2017-18 Pooling of housing Capital receipts return.

We also carry our work to certify the Council's 2018-19 Housing Benefit Subsidy claim on behalf of the Department for Work and pensions (DWP). Our work on this claim is not yet complete and will be finalised by 30th November 2019. We will report the results of this work to the Audit and Ethics Committee in our Annual Certification Letter.

2017-18 Housing Benefit subsidy claim

We certified the Council's Housing Benefit Subsidy Claim for the financial year 2017-18 relating to subsidy claimed of £16.012m. We reported the detailed findings from our audit work to the Council's Audit and Ethics Committee, as those charged with governance, in our Certification Letter dated 24 January 2019. Those which we particularly wish to highlight for your attention are that there:

- was one amendment of £1,709 (increase in subsidy) made in respect of errors found within the Non HRA rent rebate testing
- were three errors from extended testing that we carried out on this year's subsidy return which recurred from 2016/17, and
- five new errors were identified as a result of the testing undertaken.

We reported our findings to the DWP in our Qualification Letter dated 29 November 2018.

Certification of 2017-18 pooled housing capital receipts grant

As noted in Appendix A we provided non-audit services in respect of certifying the Council's Pooling of Housing Capital Receipts return. There were no matters we were required to report to the Ministry of Housing, Communities and Local Government in our agreed upon procedures report dated 30 January 2019.

Value for Money conclusion

Background

We carried out our review in accordance with the NAO Code of Audit Practice, following the guidance issued by the NAO in November 2017 which specified the criterion for auditors to evaluate:

- *In all significant respects, the audited body takes properly informed decisions and deploys resources to achieve planned and sustainable outcomes for taxpayers and local people.*

Key findings

Our first step in carrying out our work was to perform a risk assessment and identify the risks where we concentrated our work. The risks we identified and the work we performed are set out below.

As part of our Audit Findings report agreed with the Council in July 2019, we agreed recommendations to address our findings.

Risks identified in our audit plan	How we responded to the risk	Findings
Financial sustainability Our audit plan was drafted before the Council set its budget in February. We therefore noted that the Council was in the process of finalising the budget for 2019/20 and the Medium Term Financial Plan (MTFP for 2019 to 2023) and that as at 3rd December 2018 a proposed deficit for 2019/2020 of £333k was presented to Cabinet. Further savings were needed to be identified in order to deliver a balanced budget in the medium term . In particular the high level of uncertainty around retained Business Rates and the potential reset of the system presents a considerable risk to the council from 2020/2021 onwards Under a partial reset there is a cumulative deficit of approximately £1m over the 4 year MTFP which increases to £1.4m under a full reset scenario. Whilst recognising that the Council did set a balanced budget for 2019/20 the medium to long term financial sustainability risk remained.	To address this risk we planned to discuss key strategic challenges and the Council's proposed response, including review of reports to members on: a) the outturn position for 2018/19 and the budget plans up to 2022/2023 b) the Council's progress in updating its medium term financial strategy and progress against savings plans.	**Outturn position 2018/19** In 2018/19 the Council had total Portfolio expenditure of £13.6m against a revised budget, of £15.5m, resulting in an underspend of £1.9m. £125k of this favourable variance is being carried forward to 2019/20 with £1.175m being transferred to reserves . This leaves a total of £584k net expenditure variance for 2018/19 compared to budget. The HRA year-end position shows a favourable variance of £268k against the 2018/19 revised budget of £1.5m. Officers have requested that £125k be carried-forward to 2019/20, leaving a favourable variance of £143k. **Budget plans up to 2022/23** The Council is showing a balanced budget for 2019/20 however beyond this there are additional budget variances which need to be considered. The MTFP has been presented in two 'scenarios' i.e. the assumptions that the Council will either see the impact of s partial or full reset. Under a partial reset there is a cumulative deficit of approximately £700k across the 4 year MTFP, this increases to £1.1m under full reset. It is noted in the MTFP that due to the current challenging financial environment further savings still need to be identified in order to achieve a balanced budget across the medium term. In particular, the high level of uncertainty around Business Rates represents a considerable risk from 2020/2021. The Council will be refreshing the MTFP in October 2019 and throughout the budgeting period. **Savings plans** The approved budget for 2018/19 included savings and income proposals totalling £1.8m. These have been successfully achieved during the year. Income and savings progress is monitored through monthly variance analysis. Progress against savings and income plans are not monitored separately. **General Fund** In 2018/19 the Council has focussed on completing a risk assessment of the reserve levels held within corporate reserves which are used to respond to and manage financial risks. The risk assessment shows that there is potentially a funding gap in corporate reserves such that if all the risks present in the environment crystallised, particularly the funding risks, then the reserves would be depleted by 2022/23. This underlies the need to continue to focus on savings plans and supporting reserves but also creates the opportunity that, if the funding outcomes in 2020/21 are better than currently forecast, the Council will have greater flexibility to use them for other purposes.

Overall Value for Money conclusion

We are satisfied that in all significant respects the Council put in place proper arrangements to secure economy, efficiency and effectiveness in its use of resources for the year ending 31 March 2019.

A. Reports issued and fees

We confirm below our final reports issued and fees charged for the audit.

Reports issued

Report	Date issued
Audit Plan	26 March 2019
Audit Findings Report	30 July 2019
Annual Audit Letter	August 2019

Fees

	Planned £	Actual fees £	2017/18 fees £
Statutory audit	42,325	46,825	54,968
Non-audit services	11,500	TBC	11,649
Total fees	**£53,825**	**TBC**	**£66,617**

Fees for non-audit services

Service	Fees £
Audit related services	
- Housing benefit (Subsidy) Assurance Process	9,000
- Certification of pooled Housing capital receipts return	2,500
Non-Audit related services	0

Non- audit services

- For the purposes of our audit we have made enquiries of all Grant Thornton UK LLP teams providing services to the Council. The table above summarises all non-audit services which were identified.
- We have considered whether non-audit services might be perceived as a threat to our independence as the Council's auditor and have ensured that appropriate safeguards are put in place.

The above non-audit services are consistent with the Council's policy on the allotment of non-audit work to your auditor.

Audit fee variation

As outlined in our audit plan, the 2018-19 scale fee published by PSAA of £42,325 assumes that the scope of the audit does not significantly change. There are a number of areas where the scope of the audit has changed, which has led to additional work. These are set out in the following table.

Area	Reason	Fee Variation proposed £
Assessing the impact of the McCloud ruling	The Government's transitional arrangements for pensions were ruled discriminatory by the Court of Appeal last December. The Supreme Court refused the Government's application for permission to appeal this ruling. As part of our audit we have reviewed the revised actuarial assessment of the impact on the financial statements along with any audit reporting requirements.	
Pensions – IAS 19	The Financial Reporting Council has highlighted that the quality of work by audit firms in respect of IAS 19 needs to improve across local government audits. Accordingly, we have increased the level of scope and coverage in respect of IAS 19 this year to reflect this.	**£4,500**
PPE Valuation – work of experts	As above, the Financial Reporting Council has highlighted that auditors need to improve the quality of work on PPE valuations across the sector. We have increased the volume and scope of our audit work to reflect this.	

The revised fee for the year is subject to approval by Public Sector Appointments Ltd (PSAA) but it should be noted that £46,825 would still represent a 15% statutory audit fee reduction on the prior year.

Agenda No 5

AGENDA MANAGEMENT SHEET

Report Title:	Treasury Management Annual Report 2018/19
Name of Committee:	Audit and Ethics Committee
Date of Meeting:	22 October 2019
Report Director:	Head of Corporate Resources and CFO
Portfolio:	Corporate Resources
Ward Relevance:	All
Prior Consultation:	N/A
Contact Officer:	Mannie Keltey, 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.
Summary:	The report sets out the Treasury Management activities for 2018/19.
Financial Implications:	The report ensures that the Council is aware of the final Treasury Management position for 2018/19.
Risk Management Implications:	There are no environmental 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:	None
Recommendation:	1)The Treasury Management report for 2018/19 be considered; and 2)The actual treasury management indicators be noted.
Reasons for Recommendation:	To comply with the code of practice.

Agenda No 5

Audit and Ethics Committee - 22 October 2019

Treasury Management Annual Report 2018/19

Public Report of the Head of Corporate Resources and CFO

Recommendation

1)The Treasury Management report for 2018/19 be considered; and

2)The actual treasury management indicators be noted.

Background

At the meeting of Cabinet held on 24 June 2019 the Treasury Management Annual Report 2018/19 was approved.

Attached as Appendix is a copy of the report.

Name of Meeting: Audit and Ethics Committee

Date of Meeting: 22 October 2019

Subject Matter: Treasury Management Annual Report 2018/19

Originating Department: Corporate Resources

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

LIST OF BACKGROUND PAPERS

Doc No	**Title of Document and Hyperlink**
1	Cabinet 24 June 2019 Agenda Item 12 Treasury Management Strategy 2018/19 - 2020/21 https://www.rugby.gov.uk/meetings/meeting/974/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**

Agenda No

AGENDA MANAGEMENT SHEET

Report Title:	Treasury Management 2018/19 - Annual Report
Name of Committee:	Cabinet
Date of Meeting:	24 June 2019
Report Director:	Head of Corporate Resources and CFO
Portfolio:	Corporate Resources
Ward Relevance:	ALL
Prior Consultation:	Treasury Management Strategy 2018/19 - 2020/21 Cabinet February 2018
Contact Officer:	Mannie Ketley, Head of Corporate Resources and Chief Financial Officer Tel: (01788) 533420
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 should be considered by Cabinet to comply with the Code of Practice.

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 2018/19.
Financial Implications:	The report ensures that Cabinet is aware of the final Treasury Management position for 2018/19.
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:	As this report complies with the Treasury Management Code of Practice, which was approved by Council, no other options have been considered.
Recommendation:	1) The Treasury Management report for 2018/19 be considered; and 2) The actual treasury management indicators (Appendix A) be noted; and 3) The amended counterparties list for 2019/20 (Appendix B) be approved.
Reasons for Recommendation:	To comply with the Code of Practice

Agenda No

Cabinet - 24 June 2019

Treasury Management 2018/19 - Annual Report

Public Report of the Head of Corporate Resources and CFO

Recommendation

1) The Treasury Management report for 2018/19 be considered;
2) the actual treasury management indicators (Appendix A) be noted; and
3) the amended counterparties list for 2019/20 (Appendix B) be approved.

1.1 INTRODUCTION

The annual Treasury Management Report is a requirement of the Council's reporting procedures; and a cornerstone of the CIPFA Code of Practice on Treasury Management in the Public Services. This report covers the treasury activities for the financial year 2018/19.

Part of the Council's treasury activity is to address any borrowing need, either through borrowing from external bodies, or utilising temporary cash resources available within the Council. The wider treasury activities also include managing the Council's cash flows, its existing borrowing activities, and investment of surplus funds. These activities are structured to manage risk foremost, and then to optimise performance.

1.2 ECONOMIC REVIEW

After weak economic growth of only 0.2% in quarter one of 2018, growth picked up to 0.4% in quarter 2 and to a particularly strong 0.7% in quarter 3, before cooling off to 0.2% in the final quarter. Given all the uncertainties over Brexit, this weak growth in the final quarter was as to be expected. However, some recovery in the rate of growth is expected going forward. The annual growth in Q4 came in at 1.4% y/y confirming that the UK was the third fastest growing country in the G7 in quarter 4.

The Monetary Policy Committee raised Bank Rate from 0.5% to 0.75% in August 2018. We are unlikely to see any further action from the MPC until the uncertainties over Brexit clear. If there were a disorderly exit, it is likely that Bank Rate would be cut to support growth. Nevertheless, the MPC has been having increasing concerns over the trend in wage inflation which peaked at a new post financial crisis high of 3.5%, (excluding bonuses), in the three months to December before falling only marginally to 3.4% in the three months to January. British employers ramped up their hiring at the fastest pace in more than three years in the three months to January as the country's labour market defied the broader weakness in the overall economy as Brexit approached. The number of people in work surged by 222,000, helping to push down the unemployment rate to 3.9 percent, its lowest rate since 1975. Correspondingly, the total level of vacancies has risen to new highs.

As for CPI inflation itself, this has been on a falling trend since peaking at 3.1% in November 2017, reaching a new low of 1.8% in January 2019 before rising marginally to 1.9% in February. The most recent forecast for inflation over both the two and three year time horizons remained marginally above the MPC's target of 2%.

The rise in wage inflation and fall in CPI inflation is good news for consumers as their spending power is improving in this scenario. Given 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.

1.3 THE COUNCIL'S CAPITAL EXPENDITURE AND FINANCING 2018/19

This forms one of the required prudential indicators, and shows total capital expenditure for the year and how this was financed.

	2018/19 Actual £'000	**2018/19 Estimate £'000**
Total capital expenditure	9,700	4,906
Resourced by:		
Capital receipts	1,231	506
Capital grants and other contributions	1,770	589
Capital reserves	1,346	1,114
Revenue	4,551	835
Unfinanced capital expenditure	**802**	**1,862**

Full details of capital expenditure and explanations of variances from budget can be found within the Financial and Performance Monitoring Outturn Report also included on this agenda. The significant rise in capital expenditure between estimate and outturn relates to the initial costs (decant, design, survey) relating to Biart Place and an increase in housing acquisitions.

The Council undertakes capital expenditure on long term assets. These activities may either be:

- Financed immediately through the application of capital or revenue resources (capital receipts, capital grants, revenue contributions etc.), which has no resultant impact on the Council's borrowing need (although this does result in a loss of interest on resources which would otherwise be invested) or;
- If insufficient financing is available, or a decision is taken not to apply resources, the capital expenditure will give rise to a borrowing need (unfinanced capital expenditure, therefore resulting in an increase in interest costs and eventual loan repayment)

1.4 THE COUNCIL'S OVERALL BORROWING NEED

The Council's underlying need to borrow is called the **Capital Financing Requirement** (CFR). This figure is a gauge for the Council's debt position and represents 2018/19 and historic net capital expenditure which has not yet been charged to revenue. The process for charging this capital expenditure to revenue is a statutory requirement and is called the **Minimum Revenue Provision** (MRP)*. The Council has the option to charge more than the statutory MRP each year through Voluntary Revenue Provision (VRP). The Council's CFR for the year is shown below and represents a key prudential indicator. The total CFR can also be reduced by the application of additional capital resources (such as unapplied capital receipts.)

*In effect this is the amount required to be set aside for the eventual loan repayment.

Capital Financing Requirement	31 March 2019 Actual £'000	31 March 2019 Original Indicator £'000
Opening balance 1st April 2018	84,733	83,056
Plus: unfinanced capital expenditure	802	1,862
Less: MRP/Repayment of Loan	(1,705)	(7,825)
Closing balance 31st March 2019	**83,830**	**77,093**

This table demonstrates that the Council's long-term borrowing need has increased from that predicted at the beginning of 2018/19. This is predominantly related to:

- Decision by Council (Dec 2018) to replace the voluntary repayment provision (VRP) from the Housing Revenue Account (HRA) in 2018/19 with a revenue contribution to capital investment balances in advance of forecast works relating to high rise blocks in Rugby.

Current and future estimated MRP and interest costs (updated from the most recent General Fund and HRA Medium Term Financial Plans) are detailed in the table below:

	2019/20 £'000	2020/21 £'000	2021/22 £'000
MRP/VRP (Debt repayments)	1,602	1,864	1,557
Net Cost of Borrowing (Interest repayments)	1,678	2,016	2,479
Revenue Contributions to Capital Outlay	112	285	838
Total Revenue Implications	**3,392**	**4,165**	**4,874**

The table shows a rising charge to revenue of direct capital expenditure based on current schemes and forecast programme costs. These values may change as a consequence of the rescheduling of HRA debt subject to refined estimates of works relating to high rise blocks in Rugby.

As explained in the 2018-22 Medium Term Financial Strategy, the Council agreed to taper its reliance on New Homes Bonus income within the core income budget, in order to achieve financial self-sufficiency.

Any additional allocations over and above the reported figures have been transferred and ringfenced for revenue contributions to capital outlay (RCCO) to reduce the reliance on borrowing to finance the General Fund capital programme.

The implication of the adoption of this policy, is that the Council will finance a greater proportion of its capital programme using revenue resources with an equivalent reduction in the proportion of the programme being financed by borrowing.

This has the effect of allowing the Council to eliminate the need to borrow to finance its core capital programme by 2022/23. Furthermore, the Council would also be able to make Voluntary Revenue Payments (VRP) from 2022/23 onwards, effectively meaning the Council will be making additional payments over and above its scheduled debt repayment. By continuing to make these overpayments the Council would eliminate the underlying debt for the General Fund by 2032, compared to an existing 2052 timeframe.

1.5 TREASURY POSITION AT 31st MARCH 2019

The table below shows a snapshot of the Council's position as at 31st March 2019 (not for the whole of 2018/19) compared with the previous year. This situation will of course change daily as investments are adjusted to meet cash flow requirements. The results for the year as a whole are shown below in 1.7.

	31/03/2019		**31/03/2018**	
	£'000	**Average Rate (%)**	**£'000**	**Average Rate (%)**
Borrowings:				
PWLB	35,821	2.8	43,421	2.6
Money Market	13,688	3.7	13,688	3.7
Local Authorities	44,000	1.3	42,000	1.0
Total Debt Outstanding	**93,509**	**2.2**	**99,109**	**2.1**
Investments:				
In house	69,629	1.4	65,860	1.2
Total Investments Outstanding	**69,629**		**65,860**	**1.2**

(PWLB = Public Works Loan Board)

1.6 BORROWING IN THE YEAR:

The movement in outstanding debt was £5.600m (including temporary borrowing) as shown below:

	£'000
Debt outstanding at 1st April 2018	99,109
Borrowing in year	41,000
Less: Repayments in year (Inc. temporary borrowing)	46,600
Debt Outstanding at 31st March 2019	**93,509**

1.7 INVESTMENTS IN THE YEAR

1.7.1 Internally Managed Investments

The net movement in the year was an increase of £3.769m as shown below:

	£'000
Opening Balance at 1st April 2018	65,860
Investments in year	216,059
Less: Repayments in year	212,290
Closing balance at 31st March 2019	**69,629**

Note that investments made, and subsequent repayments received, result from daily short-term activities.

1.7.2 Investment Performance for 2018/19

The returns achieved through the investment strategy undertaken by the Council are shown below:

	Average Investment £m	Rate of Return (Net of Fees) %	Benchmark Return (3 Month LIBID Rate) %	Original Estimate %
Internally managed	83.483	1.14	0.67	0.35

1.8 Counterparty List

Appendix B contains the revised investment counterparty list for 2019/20. The list has been amended to facilitate the use of unrated corporate bonds and other products to a maximum of 5 years duration with a maximum £5m limit per transaction/counterparty. **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.

Accounting treatment of investments: The accounting treatment may differ from the underlying cash transactions arising from investment decisions made by the Council. To ensure that the Council is protected from any adverse revenue impact, which may arise from these differences, we will review the accounting implications of new transactions in conjunction with advisors, before they are undertaken.

APPENDIX A

TREASURY MANAGEMENT INDICATORS 2018/19

1. 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 0.24% chance of default within 1 year and a 1.21% chance of default within 3 years.

	Target	Actual
Historic risk of default	0.25% (max)	0.04%

2. 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 maturity structure of fixed rate borrowing was:

	Upper Limit	Lower Limit	Actual
Under 12 months[1,2]	50	0%	21
12 months and within 24 months	50	0%	36
24 months and within five years	60	0%	22
Five years and within 10 years	60	0%	14
10 years to 20 years	75	0%	1
20 years to 30 years	75	0%	1
30 years to 40 years	75	0%	1
40 years +	75	0%	4

[1]Includes temporary borrowing for cash flow purposes.

[2]The Council's repayment profile for HRA self-financing debt includes significant sums in forthcoming years meaning that the proportion of borrowing falling due within 1 year will increase in relation to the overall debt portfolio. The Upper Limit on this indicator was re-set to 50% in 2018/19 and future years to accommodate this situation and allow scope for increased use of temporary borrowing from other local authorities at below PWLB rates.

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

3. 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:

	2018/19	2019/20	2020/21
Limit on principal invested beyond year end	£20m	£20m	£20m
Actual principal invested beyond year end	£15m	£7m	£2m

Appendix B

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	Corporate	Registered Providers
AAA	£5m 5 years	£10m 20 years	£10m 50 years	£5m 10 years	£5m 20 years
AA+	£5m 5 years	£10m 10 years	£10m 25 years	£5m 7 years	£5m 10 years
AA	£5m 4 years	£10m 5 years	£10m 15 years	£5m 5 years	£5m 10 years
AA-	£5m 3 years	£10m 4 years	£10m 10 years	£5m 5 years	£5m 10 years
A+	£5m 2 years	£10m 3 years	£10m 5 years	£5m 5 years	£5m 5 years
A	£5m 13 months	£10m 2 years	£10m 5 years	£5m 5 years	£5m 5 years
A-	£5m 6 months	£10m 13 months	£10m 5years	£5m 5 years	£5m 5 years
None	£3m 6 months	n/a	n/a	£5m 5 years	£5m 3 year
UK Govt	Central government: £unlimited 50 years UK Local Authority: £10m 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.

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>

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.

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.

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 and £12m in total apply for unrated societies

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 £6m 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.

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.

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.

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.

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.

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.

Name of Meeting: Cabinet

Date of Meeting: 24 June 2019

Subject Matter: Treasury Management Outturn Report 2018/19

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 6

AGENDA MANAGEMENT SHEET

Report Title:	Treasury Management Strategy 2018/19 - 2020/21
Name of Committee:	Audit and Ethics Committee
Date of Meeting:	22 October 2019
Report Director:	Head of Corporate Resources and CFO
Portfolio:	Corporate Resources
Ward Relevance:	All
Prior Consultation:	N/A
Contact Officer:	Mannie Keltey, 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.
Summary:	The report sets out the Treasury Management Strategy 2018/19 – 2020/21.
Financial Implications:	The report ensures that the Council is aware of the latest Treasury Management Strategy.
Risk Management Implications:	There are no environmental 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:	None
Recommendation:	The Treasury Management Strategy 2018/19 – 2020/21 is considered.
Reasons for Recommendation:	To comply with the code of practice.

Agenda No 6

Audit and Ethics Committee - 22 October 2019

Treasury Management Strategy 2018/19 - 2020/21

Public Report of the Head of Corporate Resources and CFO

Recommendation
The Treasury Management Strategy 2018/19 - 2020/21 is considered.

Background

At the meeting of Cabinet held on 4 February 2019 the Treasury Management Strategy 2018/19 - 2020/21 was approved.

Attached as Appendix is a copy of the report.

Name of Meeting: Audit and Ethics Committee

Date of Meeting: 22 October 2019

Subject Matter: Treasury Management Strategy 2018/19 - 2020/21

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 incorporating Treasury Management Strategy 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

Agenda No

AGENDA MANAGEMENT SHEET

Report Title:	Capital Strategy 2019/20 incorporating Investment and Treasury Management Strategy
Name of Committee:	Cabinet
Date of Meeting:	4 February 2019
Report Director:	Head of Corporate Resources and CFO
Portfolio:	Corporate Resources
Ward Relevance:	ALL
Prior Consultation:	Treasury Management Strategy 2018/19 – 2020/21 Cabinet 5 February 2018
Contact Officer:	Mannie Ketley – Head of Corporate Resources and Chief Financial Officer, Tel: (01788) 533416
Public or Private:	Public
Report Subject to Call-In:	Yes
Report En-Bloc:	No
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)
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☐ 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 Capital Finance and Treasury Management in Local Authorities.

Summary: This report is a new report for 2019/20, required by changes in CIPFA and the Ministry of Housing, Communities and Local Government (MHCLG) guidance. It combines an overview of how capital expenditure, capital financing, treasury and other investment activity contribute to the provision of local public services along with an overview of 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 RECOMMENDED TO COUNCIL THAT -

(1) the Capital Strategy for 2019/20 as an overarching strategy for the Council be approved;

(2) the Treasury Management Strategy for 2019/20 including associated limits and specific indicators (section 4 and Appendix B) be approved:

(3) the Investment Strategy for 2019/20 and associated limits and specific indicators (section 5 and Appendix C) be approved; and

(4) the Minimum Revenue Provision (MRP) policy be approved.

Reasons for Recommendation: To comply with the Codes of Practice

Agenda No

Cabinet - 4 February 2019

Capital Strategy 2019/20 incorporating Investment and Treasury Management Strategy

Public Report of the Head of Corporate Resources and CFO

IT BE RECOMMENDED TO COUNCIL THAT -

1. the Capital Strategy for 2019/20 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 2019/20 – 2021/22 be approved;
3. the Investment Strategy for 2019/20 including associated limits and specific indicators (section 5 and Appendix C) be approved; and
4. the Minimum Revenue Provision (MRP) policy be approved.

Background Information

1 Introduction

The purpose of this report

1.1 This is a new report responding to a revised set of Codes and guidance 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.

1.2 The Treasury Management Strategy at section 4 is the usual report that 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 is a new requirement for 2019/20 and covers investments held for service purposes or for commercial profit which were not included in the Treasury Management Strategy.

1.3 The changes to guidance are designed to bring together areas which CIPFA and 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 although here we follow the Council's existing Constitution that the Cabinet recommends the Treasury Management Strategy be approved by the full Council.

2 Background

Economic background

2.1 The Council's strategies must take account of expectations for the economy and specifically the finance sector. The Council receives advice on this from its advisors Link Asset Services, Treasury Solutions. Appendix A is a commentary by them on the current economic background, the outlook for creditworthiness and interest rates.

2.2 The forecast for the Bank Rate is that it rises gradually in the medium term but stays at levels that are below the historical average. For the purpose of the interest budget, new investments are estimated to achieve an average return of c.1% during 2019/20.

2.3 The treasury management environment remains difficult with yields and quality counterparties still reduced in the aftermath of the financial crisis of 2008 and with no return to pre-crisis rates in sight. Governments and regulators have put in place measures prompted by the crisis that restrict any government bail-out of individual financial institutions. This means an institution in difficulty may have to use its own resources and its deposits to continue to operate, exposing any depositor's capital to risk.

Statutory background

2.4 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.

2.5 The regulatory background has been complicated by the revision by both CIPFA and MHCLG codes and guidance. 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

2.6 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.

2.7 The existing Treasury Management Strategy 2018/19 and Prudential indicators were approved by the Council on 27th February 2018 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 then presented to Cabinet in January and to Council in February each year.

3.3 The current projected capital programme and financing is shown below. It includes current estimates for capital bids for 2019/20 and beyond. It will be revised if necessary as the 2019/20 budget process develops and the final figures incorporated into the Budget in February 2019 will constitute one of the prudential indicators required by the CPIFA.

Capital expenditure £m	2017/18 Actual	2018/19 Estimate	2019/20 Estimate	2020/21 Estimate	2021/22 Estimate
Non-HRA	**1.914**	**3.113**	**17.541**	**2.120**	**2.073**
HRA*	**6.884**	**13.062**	**4.142***	**3.530***	**3.530***
Total	**8.798**	**16.175**	**21.683**	**5.650**	**5.603**

** The council is currently undertaking options appraisal on the redevelopment / refurbishment 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. The council has approached central government to provide financial assistance in the redevelopment/refurbishment of the sites. In the event that only partial or no support is forthcoming there will be a corresponding impact on the net financing need for the year.*

3.4 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	2017/18 Actual	2018/19 Estimate	2019/20 Estimate	2020/21 Estimate	2021/22 Estimate
Capital receipts	1.535	1.935	4.505	0.505	0.505
Capital grants	0.770	0.586	0.586	0.586	0.586
Capital reserves	4.692	1.606	1.933	1.755	1.755
Revenue	1.961	10.792	1.549	1.835	2.645
Net financing need for the year	**0.160**	**1.256**	**13.110**	**0.969**	**0.112**

The Council's borrowing need (the Capital Financing Requirement)

3.5 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.

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

3.7 The Council is asked to approve the CFR projections below:

£m	2017/18 Actual	2018/19 Estimate	2019/20 Estimate	2020/21 Estimate	2021/22 Estimate
Capital Financing Requirement					
CFR – non-housing	23.101	22.653	34.161	33.266	31.821
CFR – housing	61.632	61.632	61.632	61.632	61.632
Total CFR	**84.733**	**84,285**	**95.793**	**94.898**	**93.453**
Movement in CFR	**-1.897**	**-0.448**	**11.508**	**-0.895**	**-1.445**

Movement in CFR represented by					
Net financing need for the year (above)	-0.160	1.256	13.110	0.969	0.112
Less MRP/VRP and other financing movements	1.737	1.704	1.602	1.864	1.557
Movement in CFR	**-1.897**	**-0.448**	**11.508**	**-0.895**	**-1.445**

Minimum revenue provision (MRP) policy statement

3.8 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).

3.9 MHCLG regulations have been issued which require the full 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.

The Council is recommended to approve the following MRP Statement for financial year 2019/20:

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)

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

3.11 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 (although there are transitional arrangements in place).

4 Treasury Management

4.1 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.

4.2 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.

4.3 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.

4.4 **Borrowing strategy**: 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.

Against this background and the risks within the economic forecast, caution will be adopted with the 2019/20 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.

4.5 Projected levels of the Council’s total outstanding debt (which comprises borrowing and leases) are shown below, compared with the Capital Financing Requirement. Statutory guidance is that debt should remain below the Capital Financing Requirement, except in the short-term. As can be seen from the table the Council expects to comply with this in the medium term.

£m	2019/20 Estimate	2020/21 Estimate	2021/22 Estimate
Debt at 1 April	91.522	91.856	93.580
Expected change in Debt	-0.334	1.724	-8.498
Actual gross debt at 31 March	**91.856**	**93.580**	**85.082**
The Capital Financing Requirement	**95.793**	**94.898**	**93.453**

4.6 The table above demonstrates that the Council will be relying 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.

4.7 **Affordable borrowing limit**: 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. In most cases, this would be a similar figure to the CFR. However, in the event that 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.

Further details on borrowing are in Appendix B.

Operational boundary £m	2018/19 Estimate	2019/20 Estimate	2020/21 Estimate	2021/22 Estimate
Debt	115.000	145.000	145.000	145.000
Total	115.000	145.000	145.000	145.000

Authorised limit £m	2018/19 Estimate	2019/20 Estimate	2020/21 Estimate	2021/22 Estimate
Debt	125.000	155.000	155.000	155.000
Total	125.000	155.000	155.000	155.000

4.6 **Investment strategy**: Treasury investments arise from receiving cash before it is paid out again. Investments made for service reasons or for pure financial gain are not generally considered to be part of treasury management and will be dealt with in the Investment Strategy in section 5 and Appendix C.

4.7 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.

4.8 Further detail on treasury investments are in Appendix C including limits and indicators which the Council is asked to consider.

4.9 **Governance**: 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.

5 Investment Strategy (loans, shares and property)

5.1 This section is the disclosure newly required by CIPFA and MHCLG guidance. 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.

Investments for Service Purposes

5.2 The Council has the ability to makes 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 subsidiaries. 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.

5.3 **Governance**: 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 new limit of £20m on the total exposure to loans for service purposes and no exposure permitted for shares being held.

Commercial Activities

5.4 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.

5.5 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.

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 £6m of general reserves available to balance the revenue budget in the short term while the Property Manager reviews the performance of the portfolio.

5.6 **Governance**: 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

5.7 The Council has set aside £4.437m to cover risks of Business Rates Appeals. The Council may also 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.

5.8 **Governance**: 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 2017/18 statement of accounts.

Revenue Budget Implications

5.9 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; this is compared to the net revenue stream i.e. the amount funded from Council Tax, business rates and general government grants.

%	2017/18 Actual	2018/19 Estimate	2019/20 Estimate	2020/21 Estimate	2021/22 Estimate
General Fund	13	14	12	15	13
HRA	24	21	22	25	28

The estimates of financing costs include current commitments and the proposals in the 2019/20 General Fund and HRA budget reports.

<u>General Fund</u>

The Medium Term Financial Strategy adopted by Council in April, included the following policies in relation to New Homes Bonus:

"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"

This policy was adopted in order to achieve one of the Council's overarching corporate priorities: financial self-sufficiency. The organisation will need to taper its reliance on New Homes Bonus within its core income budget.

The implication of the adoption of this policy, is that the Council will finance a greater proportion of its capital programme using revenue resources with an equivalent reduction in the proportion of the programme being financed by borrowing.

Excluding the Housing Acquisitions Fund, this has the effect of allowing the Council to eliminate the need to borrow to finance its capital programme by 2022/23. Furthermore, the Council would also be able to make Voluntary Revenue Payments (VRP) from 2022/23 onwards, effectively meaning the Council will be making additional payments over and above its scheduled debt repayment. By continuing to make these overpayments the Council would eliminate the underlying debt for the General Fund by 2032, compared to an existing 2052 timeframe.

<u>HRA</u>

The ratio of financing costs within the HRA has fallen from estimates presented in the 2018/19 strategy as a consequence of diverting repayments of debt to revenue contribution to capital expenditure to commence works at Biart Place / Rounds Gardens subject to central government support.

5.10 **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.

Knowledge and Skills

5.11 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.

5.12 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 2019/20 is £0.59m (2018/19 £0.56m), which is equivalent to an average investment portfolio of £38m at an interest rate of 1.6%. The budget for debt interest paid in 2019/20 is £2.196m (2018/19 £2.054m).

Appendix A Economic background and interest rate forecast

Economic background

The UK's progress negotiating its exit from the European Union, together with its future trading arrangements, will continue to be a major influence on the Authority's treasury management strategy for 2019/20.

The flow of generally positive economic statistics after the quarter ended 30 June meant that it came as no surprise that the MPC came to a decision on 2 August to make the first increase in Bank Rate above 0.5% since the financial crash, from 0.5% to 0.75%. However, the MPC emphasised again, that future Bank Rate increases would be gradual and would rise to a much lower equilibrium rate, (where monetary policy is neither expansionary of contractionary), than before the crash; indeed they gave a figure for this of around 2.5% in ten years' time but they declined to give a medium term forecast. It is unlikely that the MPC will increase Bank Rate in February 2019, ahead of the deadline in March for Brexit. Similarly, the MPC is more likely to wait until August 2019, than May 2019, before the next increase, to be followed by further increases of 0.25% in May and November 2020 to reach 1.5%. However, the cautious pace of even these limited increases is dependent on a reasonably orderly Brexit.

The overall longer run future trend is for gilt yields, and consequently PWLB rates, to rise, albeit gently. However, over about the last 25 years, we have been through a period of falling bond yields as inflation subsided to, and then stabilised at, much lower levels than before, and supported by central banks implementing substantial quantitative easing purchases of government and other debt after the financial crash of 2008. Quantitative easing, conversely, also caused a rise in equity values as investors searched for higher returns and purchased riskier assets. In 2016, we saw the start of a reversal of this trend with a sharp rise in bond yields after the US Presidential election in November 2016, with yields then rising further as a result of the big increase in the US government deficit aimed at stimulating even stronger economic growth. That policy change also created concerns around a significant rise in inflationary pressures in an economy which was already running at remarkably low levels of unemployment. Unsurprisingly, the Fed has continued on its series of robust responses to combat its perception of rising inflationary pressures by repeatedly increasing the Fed rate to reach 2.00 – 2.25% in September 2018. It has also continued its policy of not fully reinvesting proceeds from bonds that it holds as a result of quantitative easing, when they mature. We have, therefore, seen US 10 year bond Treasury yields rise above 3.2% during October 2018 and also seen investors causing a sharp fall in equity prices as they sold out of holding riskier assets.

Rising bond yields in the US have also caused some upward pressure on bond yields in the UK and other developed economies. However, the degree of that upward pressure has been dampened by how strong or weak the prospects for economic growth and rising inflation are in each country, and on the degree of progress towards the reversal of monetary policy away from quantitative easing and other credit stimulus measures.

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

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

Credit outlook

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.

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.

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

Appendix B Treasury Management Strategy

Present position and forecast

1 On 31 December 2018 the Council held £106.120m of borrowing and £93.496m of investments at market value; broken down as follows:

	Principal £'000
Call Accounts	5,391
Money Market Funds	10,000
Other Local Authorities	35,880
Pooled Funds	6,000
Bonds and Certificates of Deposit	36,225
Total Investments	**93,496**
PWLB	43,421
Other Long-Term Borrowing	38,700
Short Term Borrowing	23,999
Total Borrowing	**106,120**
Net Investments	**-12,624**

2 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	**2017/18 Actual**	**2018/19 Estimate**	**2019/20 Estimate**	**2020/21 Estimate**	**2021/22 Estimate**
Fund balances / reserves	31.736	26.691	16.622	17.618	18.302
Capital receipts	8.802	8.802	6.031	4.031	3.931
Other	0.989	0.989	0.989	0.989	0.989
Total core funds	**41.527**	**36.482**	**23.642**	**22.638**	**23.222**
Working capital*	**0.854**	**-3.661**	**-1.725**	**-0.520**	**-1.924**
(Under)/over borrowing**	14.389	4.859	-3.037	-1.318	-8.498
Expected investments	**56.770**	**37.680**	**18.880**	**20.800**	**12.800**

3 Borrowing Strategy

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.

Against this background and the risks within the economic forecast, caution will be adopted with the 2018/19 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.

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

4 **Sources of borrowing**: 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.

5 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.

6 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.

7 **Municipal Bonds Agency**: UK Municipal Bonds Agency plc was established in 2014 by the Local Government Association as an alternative to the PWLB. It plans to issue bonds on the capital markets and lend the proceeds to local authorities. This will be a more complicated source of finance than the PWLB for two reasons: borrowing authorities are required to provide bond investors with a joint and several guarantee to refund their investment in the event that the agency is unable to for

any reason; and there will be a lead time of several months between committing to borrow and knowing the interest rate payable. Any decision to borrow from the Agency will therefore be the subject of a separate report to full Council.

8 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.

Investment Strategy

9 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 £50m and £90m 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.

10 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.

11 **Negative interest rates**: If the UK enters into a recession in 2019/20, 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.

12 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 2019/20. This is especially the case for the estimated £10m - £20m 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.

13 **Business models**: Under the new IFRS 9 standard, 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.

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	Corporate	Registered Providers
AAA	£5m 5 years	£10m 20 years	£10m 50 years	£5m 10 years	£5m 20 years
AA+	£5m 5 years	£10m 10 years	£10m 25 years	£5m 7 years	£5m 10 years
AA	£5m 4 years	£10m 5 years	£10m 15 years	£5m 5 years	£5m 10 years
AA-	£5m 3 years	£10m 4 years	£10m 10 years	£5m 4 years	£5m 10 years
A+	£5m 2 years	£10m 3 years	£10m 5 years	£5m 3 years	£5m 5 years
A	£5m 13 months	£10m 2 years	£10m 5 years	£5m 2 years	£5m 5 years
A-	£5m 6 months	£10m 13 months	£10m 5years	£5m 1 year	£5m 5 years
None	£3m 6 months	n/a	n/a	£1m 1 year	£3m 1 year
UK Govt	Central government: £unlimited 50 years UK Local Authority: £10m 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. However, investment decisions are never made solely based on credit ratings, and all other relevant factors including external advice will be taken into account.

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 and £12m in total 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 £6m 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.

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. 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.

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 and Communities Agency 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.

25 **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. These are not classed as investments, but still subject to the risk of a bank bail-in and balances will therefore be kept below £5.0m. 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-.

26 **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 £20m has been set total long term (over a year) investments.

27 **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

28 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.

29 **Other Information on the Security of Investments**: 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.

30 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.

31 **Investment limits**: The Council's revenue reserves available to cover investment losses are forecast to be in the region of £8m on 31 March 2019. In order that no more than 2/3 of available reserves will be put at risk in the case of a single default, the maximum that will be lent to any one organisation (other than the UK Government) will be £5m. 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.

Cash flow management

32 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 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.

Treasury Management Indicators

33 **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)

34 **Interest rate exposures**: this indicator is set to control the Council's exposure to interest rate risk. New CIPFA guidance has led to a change in this indicator which is now an upper limit on the one-year revenue impact of a 1% rise or fall in interest rates. The impact of a change in interest rates is calculated on the assumption that maturing loans and investments will be replaced at current rates.

	Limit
Upper Limit on one-year revenue impact of a 1% rise in interest rates	
Upper Limit on one-year revenue impact of a 1% fall in interest rates	

Maturity structure of borrowing

35 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%

Principal sums invested for periods longer than a year

36 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	£20m	£20m	£20m

Other Treasury Management issues

37 The CIPFA Code requires the Council to include the following in its treasury management strategy.

38 **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).

39 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.

40 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.

41 **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.

Appendix C Investment Strategy

1. This Investment Strategy is a new report for 2019/20, meeting 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.

Service Investments: Loans

2. 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. At present the Council has no such loans.

3. 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.

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.

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.

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

7. The Council does not currently invest in any shares and has no agreed plans to do so. 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 the limit on investment in this type of share will be set at zero and any change to the limit would be addressed in the report to the Council in setting up any subsidiary.

8. **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.

9. **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.

10. **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.

11. **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.

Commercial Investments: Property

12. 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.

The movement in the fair value of the investment properties over 2017/18 is as follows:

	£'000
Balance at 1st April 2017	695
Net gains/(losses) from fair value adjustments	28
Balance at 31st March 2018	723

13 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 & Expenditure Statement. The same treatment is applied to gains and losses on disposal.

14 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.

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.

15. **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.

16. 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.

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

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

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

c. consulting Council's Asset Management Working Group

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

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

18. **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.

Loan Commitments and Financial Guarantees

19. 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 2019/20. 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.

Proportionality

20. The Council is likely to become more dependent on profit generating investment activity to achieve a balanced revenue budget over time. The table below shows the current extent to which the expenditure planned to meet the service delivery objectives is dependent on achieving the expected net profit from investments over the lifecycle of the Medium Term Financial Strategy. Should it fail to achieve the expected net profit, the Council has general reserves to cover the immediate shortfall in income and Head of Corporate Property would review the

cause of any shortfall and identify any actions needed to ensure the income shortfall is remedied.

Proportionality of Investments £m	2017/18 Actual	2018/19 Forecast	2019/20 Budget	2020/21 Budget	2021/22 Budget
Gross service expenditure	36.324	32.353	33.802	32,202	33,138
Investment income	792	895	623	602	629
Proportion	2%	3%	2%	2%	2%

23. **Capacity, skills and culture**

Elected Members and statutory officers: The Council recognises that those elected Members and statutory officers involved in the investments decision making process must have appropriate capacity, skills and information to enable them to:

o take informed decisions as to whether to enter into a specific investment;

o to assess individual assessments in the context of the strategic objectives and risk profile of the Council; and

o to enable them to understand how new decisions have changed the overall risk exposure of the Council.

The Council will ensure that the relevant officers and the Members of Audit and Ethics Committee and Asset Management Working Group have appropriate skills, providing training and advisor support where there is a skills gap.

24. **Commercial deals**: The Council will ensure that the Audit and Ethics Committee, Asset Management Working Group, Cabinet, and officers negotiating commercial deals are aware of the core principles of the prudential framework and of the regulatory regime within which local authorities operate.

25. **Corporate governance**: Any investment decisions will be scrutinised by Senior Management Team, Asset Management Working Group, and Cabinet before final approval. The Overview and Scrutiny committee review all decisions made by the Cabinet. Although after the event the Committee can make any recommendations to the Council if it sees fit.

Investment Indicators

26. 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.

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

Total investment exposure £m	2017/18 Actual	2018/19 Forecast	2019/20 Forecast
Treasury management investments	52.385	37.680	18.880
Service investments: Loans	-	-	-
Service investments: Shares	-	-	-
Commercial Investments: Property	0.723	0.750	0.780
TOTAL INVESTMENTS	**53.108**	**38.430**	**19.660**
Commitments to lend	-	-	-
Guarantees issued on loans	-	-	-
TOTAL EXPOSURE	**53.108**	**38.430**	**19.660**

28. **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.

29. **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.

	2017/18 Actual	2018/19 Forecast	2019/20 Forecast
Treasury management investments	0.9%	1.1%	1.6%
Service investments: Loans	0	0	0
Service investments: Shares	0	0	0
Commercial investments: Property	4%	4%	4%

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.

Name of Meeting: Cabinet

Date of Meeting: 4 February 2019

Subject Matter: Capital Strategy incorporating Treasury Management Strategy 2019/20 – 2021/22

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 7

AGENDA MANAGEMENT SHEET

Report Title:	2019/20 Internal Audit Plan - Progress Update
Name of Committee:	Audit and Ethics Committee
Date of Meeting:	22 October 2019
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, Tel: 01788 533451
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 amendment 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 7

Audit and Ethics Committee - 22 October 2019

2019/20 Internal Audit Plan - Progress Update

Public Report of the Head of Corporate Resources and CFO

Recommendation
1. The report be considered and noted. 2. The proposed amendment 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 is one proposed amendment to the internal audit plan. The proposal is to change the nature of the Residential Properties Audit. The review was originally intended to provide assurance that the action plan from a recent external review has been implemented.

However, the external review was not commissioned as it was felt the internal statutory compliance review the Asset Maintenance Team Leader had completed was comprehensive and needed no further external input. The review included an action plan to address any identified areas of weakness and covered both our Housing and Corporate Properties. This action plan was stated as predominantly complete however some of the actions were ongoing.

To ensure that this review adds value it is proposed that an auditor should conduct a light touch third party review of the internal action plan and produce a report confirming the progress the team has made against the plan.

Name of Meeting: Audit and Ethics Committee

Date of Meeting: 22 October 2019

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 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

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 OCTOBER 2019

Date**: 22 October 2019**

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:

- 3 assignments have been completed;
- 4 assignments are at the draft report stage; and
- 9 assignments are in progress

The Corporate Assurance and Improvement Manager has been on long term sickness absence since July and therefore the delivery of the assignments allocated to him (with the exception of Workforce Planning) have been delayed until his return. Delivery of the full audit plan on time will be dependent on the length of this ongoing absence.

At planning stage the 8 days allocated to a Residential Property (Communal Areas) Audit was not felt to be the best use of resource as the Asset Maintenance Team Leader completed an internal statutory compliance review when he first started producing an action plan to address any shortfalls identified. It was felt that a third party review of the progress against this action plan would provide more appropriate use of Auditor time and that this light touch review would reduce the resource required to two days.

Progress on individual assignments is shown at pages 8 to 11 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.

2.3 Are clients progressing audit recommendations with appropriate urgency?

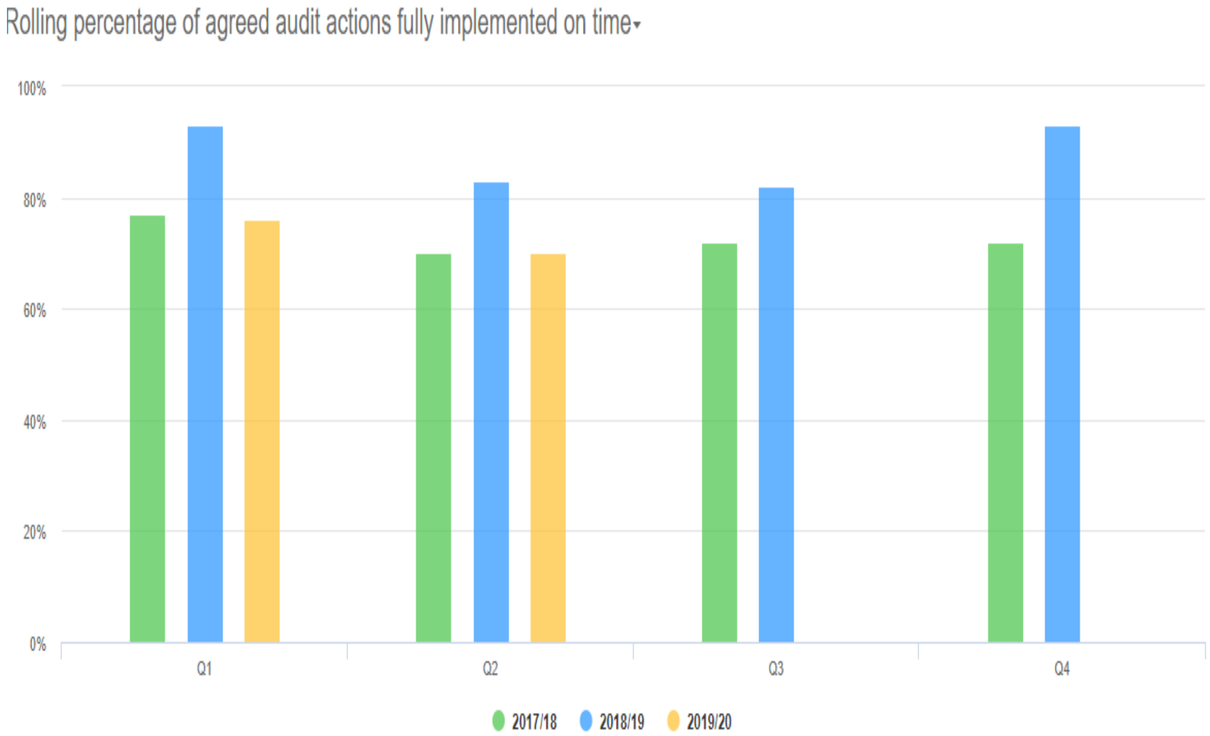
At the date of reporting, a combined **71% of management actions related to 2018/19 and prior have been implemented by the agreed implementation date, with a further 15% implemented late, giving an overall implementation rate of 86%.** A summary analysis of progress on implementation of audit recommendations is shown at pages 11 to 12. **At the time of reporting there are 9 agreed management actions for which implementation is overdue, 5 of which are regarded as High or 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 13 to 15 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.

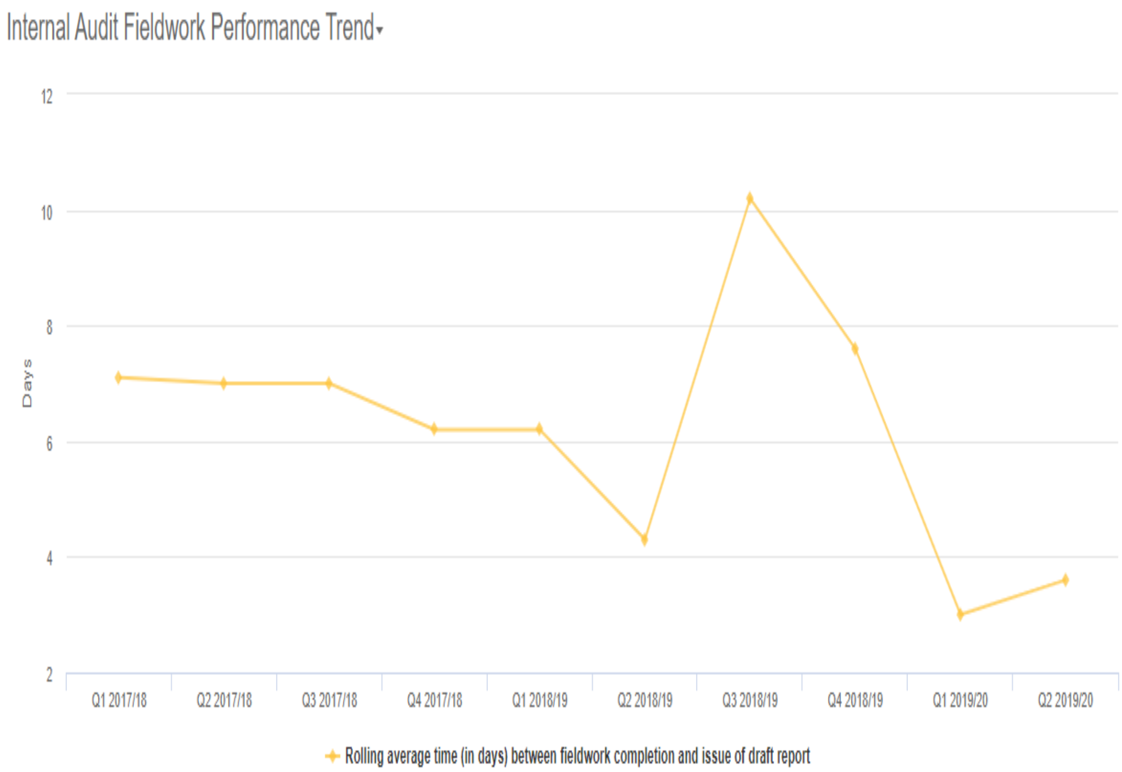
2.4 Internal Audit Performance Indicators

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)	Q2 Result: 177 days Average - Terms of Reference to draft report issue: 87 days Average – Draft report to final report issue: 90 days These results reflect the Absence Management report which was recently finalised following additional testing identified as being required at draft report stage and Auditor sickness absence. The team is working to bring this down, including completing an analysis of the full audit process using the council's Engage Software in order to identify where efficiencies in processes may be made.
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	3.6 days Slight increase from the figure of 3.0 days reported in July 2019 due to the sickness absence of a key manager for three of the assignments.
Effectiveness	Implementation of Agreed Actions – Percentage implemented on time	71% - at the time of reporting there are 9 recommendations which are past their agreed implementation date, 5 of which are regarded as Medium risk. There were no overdue High risk actions. Refer to pages 13 to 15 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					✓			
Completeness of Income (Sundry Debtors)	15			✓					
Housing Rent Arrears	10			✓					Scheduled for Q2 Two additional days may be required following a broadening of the scope of this audit.
Cash and Bank	20	✓							Scheduled for Q3
Counter Fraud									
Fraud Awareness	8			✓				Not Applicable	In progress. Two sessions delivered in July 2019. Further sessions will be re-booked upon return of the CAIM from long term absence.
ICT									
IT Security	8		✓						Scheduled for Q3. Being delivered by TIAA.
IT Business Continuity	8	✓							Scheduled for Q3. Being delivered by TIAA.
CCTV	8		✓						Scheduled for Q3

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	12			✓					Deferred from 2018/19 Scheduled for Q3
Residential Properties	2			✓					Proposal that the assignment is amended from a full 8 day Audit to a 2 day Progress Review due to a comprehensive internal review and action plan being identified at planning stage.
Absence Management	12						✓	Substantial	
Freedom of Information	8					✓			
Complaints, Compliments and Suggestions	10					✓			
Community Safety Partnership	12	✓							Scheduled for Q4
Risk Management Effectiveness	80		✓						Work scheduled to be completed between August 2019 and March 2020, reviewing the extent to which effective risk management is embedded across a range of departments.

Assignment	Budget (days)	Not Started	Planning	Field Work Underway	Field Work Complete	Draft Report	Final Report	Assurance Rating	Comments
Performance Management Effectiveness	80			✓					Work scheduled to be completed between August 2019 and March 2020, reviewing the extent to which effective performance management is embedded across a range of departments. This will also include testing of data to ensure it is accurate, timely and complete.
Digitalisation	12			✓					
Ethical Risks									
Local Government Transparency Code	10					✓			
Values and Behaviours Follow Up	8	✓							Scheduled for Q2
Operational Risks									
Follow up work	12			✓					
Housing Management System	10			✓					Scheduled for Q2 & Q3
Customer Service Centre Demand Management	15		✓						Scheduled for Q3

Assignment	Budget (days)	Not Started	Planning	Field Work Underway	Field Work Complete	Draft Report	Final Report	Assurance Rating	Comments
Licensing	15	✓							Scheduled for Q4
Refuse and Recycling	20	✓							Timing to be confirmed once a new manager is in post.
Planning Development and Enforcement	15	✓							Scheduled for Q3
RAGM – Visitor Centre and Town Centre Improvement Fund	15	✓							Scheduled for Q2 Delayed at request of Head of Service. Re-scheduled to Q3.
HR Capability and Disciplinary	12	✓							Scheduled for Q3
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 – 2018/19 and Prior

Audit	No. of Recs	Implemented on Time	Implemented Late	Not yet due	Overdue	Rejected Medium or High Risk Actions
Corporate Credit Cards	1	0	0	1	0	0
Business Continuity and Emergency Planning	1	0	0	0	1	0
Council Tax and NDR	6	0	0	6	0	0
Fleet Management	9	3	0	6	0	0
Financial System Key Controls	3	1	0	2	0	0
Housing Rent Arrears	3	0	1	1	1	0
Payment Card Industry Data Security Standards	2	0	2	0	0	0
Partnerships	1	1	0	0	0	0
Property Repairs Stock Control	3	0	2	1	0	0
PTC Interface	2	2	0	0	0	0
Risk Management	5	1	0	4	0	0
Values and Behaviours	6	1	0	2	3	0
Grants to Community Groups	13	13	0	0	0	0
Fraud Risk Review	14	5	0	9	0	0
Housing Repairs	11	6	3	2	0	0
ICT Backup	4	2	0	2	0	0
Independent Living	13	5	0	8	0	0

Summary: Implementation of Audit Recommendations – 2018/19 and Prior (continued)

Audit	No. of Recs	Implemented on Time	Implemented Late	Not yet due	Overdue	Rejected Medium or High Risk Actions
Treasury Management	6	0	1	3	2	0
ICT Patching	6	0	0	6	0	0
Health and Safety Follow Up	13	0	0	13	0	0
Elections	2	0	0	1	1	0
Data Protection Governance	9	0	0	9	0	0
Tenant Recharges	8	6	1	0	1	0
Car Parking Enforcement	1	0	0	1	0	0
Insurance	1	0	0	1	0	0
Green Waste Optimisation	2	0	0	2	0	0
Benefits	1	0	0	1	0	0
Due for Completion	**65**	**46 (71%)**	**10 (15%)**	**-**	**9 (14%)**	**0**
Totals	**146**	**46 (32%)**	**10 (7%)**	**81 (55%)**	**9 (6%)**	**0**

Details of Overdue Medium and High Risk Audit Recommendations

Audit	Agreed Action	Target Date	Risk Rating	Management Comments	Revised Timescale
Business Continuity and Emergency Planning	Draft and cascade an updated bomb threat procedure.	Original 31/05/2019 Revised 31/08/2019	Medium	Responsible Officer: Safety and Resilience Manager. The new Safety and Resilience Manager (SRM) confirmed that SMT have reviewed a new Bomb Threat procedure and are awaiting his feedback. He plans to do this by 31/10/2019 and will then present the final version at the next SRMG meeting on 28/11/2019.	28/11/2019 If the procedure is not approved at the SRMG meeting the SRM to attend the next A & E committee meeting to discuss.
Housing Rent Arrears	The Guidelines should be updated to reflect the introduction of Universal Credit and the best practices for dealing with tenants in receipt of this benefit.	Original 30/10/2018 Revised 31/07/2019	Medium	Responsible Officers: Housing Services Manager and Revenues Manager The Housing Services Team Leader confirmed that the document has been updated with regards to Universal Credit and was recirculated to the team on 11/10/2019.	Action now Complete

Audit	Agreed Action	Target Date	Risk Rating	Management Comments	Revised Timescale
Treasury Management	Ensure that all loan and investment forms are signed as confirmed in a timely manner and in accordance with the Treasury Management Practices (The transaction itself is authorised separately at the time of the trade through the banking system. This signature is a retrospective confirmation that the loan/investment was in line with the Treasury Management Strategy).	31/07/2019	Medium	Responsible Officer: Financial Services Manager Update received from FSM 02/10/2019: 'We are in the process of reviewing the options for an automated workflow solution. In addition to this the treasury management practices will be reviewed and updated to ensure feasibility of the approach. A review of activity is received from our treasury management partner (Link) and monthly treasury management meetings are scheduled with FSM and treasury team.' The FSM further stated that whilst the workflow system is being reviewed that he will sign the forms as an interim solution.	N/A
Treasury Management	Ensure that the monthly investment reconciliation is re-instated and completed on a monthly basis.	31/07/2019	Medium	Responsible Officer: Financial Services Manager Update received from FSM 02/10/2019: 'Reconciled as at 31st March, an updated reconciliation will be produced as part of quarter 2 monitoring' This will be completed w/ending 11/10/2019 and re-instated at a monthly frequency subsequently.	N/A

Audit	Agreed Action	Target Date	Risk Rating	Management Comments	Revised Timescale
Tenant Recharges	A report detailing the collection rate of recharge sundry debts should be produced quarterly and forwarded to the Resources Head of Service, Property Repairs Manager and Property Repairs Manager.	31/07/2019	Medium	Responsible Officer: Revenues Manager The Revenues Manager confirmed that producing detailed collection figures for each year's sundry debts would be an onerous task. However an overall report regarding invoice totals and collection amounts could be produced without excessive resource. The Corporate Resources team are to investigate the use of Power BI as a potential solution.	30/11/2019