STROUD DISTRICT COUNCIL
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Council Offices Ebley Mill Ebley Wharf Stroud Gloucestershire GL5 4UB

23 January 2015

AUDIT AND STANDARDS COMMITTEE

A meeting of the Audit and Standards Committee will be held on **Tuesday, 3 February 2015** in the Council Chamber, Ebley Mill, Ebley Wharf, Stroud at **7.00 pm.**

David Hagg
Chief Executive

A G E N D A

Please Note: This meeting will be filmed for live or subsequent broadcast via the Council's internet site (www.stroud.gov.uk). By entering the Council Chamber you are consenting to being filmed. The whole of the meeting will be filmed except where there are confidential or exempt items, which may need to be considered in the absence of the press and public.

1. **APOLOGIES**
   To receive apologies of absence.

2. **DECLARATIONS OF INTEREST**
   To receive declarations of interest.

3. **MINUTES**
   To confirm and sign as a correct record the Minutes of the meeting held on 25 November 2014.

4. **PUBLIC QUESTION TIME**
   The Chair of the Committee will answer questions from members of the public, submitted in accordance with the Council's procedures.

DEADLINE FOR RECEIPT OF QUESTIONS
Noon on Thursday, 29 January 2015

Questions must be submitted in writing to the Chief Executive, Democratic Services, Ebley Mill, Ebley Wharf, Stroud and sent by post, by fax (01453 754957), or by Email: democratic.services@stroud.gov.uk

5. WORK PROGRAMME 2014/15

To approve the Work Programme.

6. ANNUAL SUMMARY OF CERTIFICATION OF GRANT CLAIMS AND RETURNS 2013/14

To receive a summary of the above from KPMG, the Council's external auditor.

7. INTERNAL AUDIT PLAN MONITORING REPORT

To accept the above report and the assurances given on the adequacy of internal controls operating in the systems audited.

8. THIRD QUARTER TREASURY MANAGEMENT ACTIVITY 2014/15

To receive an update and approve the treasury management activity as at 31 December 2014.

9. TREASURY MANAGEMENT STRATEGY STATEMENT, ANNUAL INVESTMENT STRATEGY AND MINIMUM REVENUE PROVISION POLICY STATEMENT 2015/16

To recommend to Council the adoption and approval of recommendations contained within the report.

10. INTERNAL AUDIT AND RISK MANAGEMENT SHARED SERVICE

To recommend to Council the creation of a shared Internal Audit and Risk Management Service with Gloucester City and Gloucestershire County Councils.

11. PROTECTING THE PUBLIC PURSE, FRAUD BRIEFING 2014

To receive a presentation from KPMG on the above.

DATE OF NEXT MEETING

7 April 2015

The Committee Membership for 2014/2015 Civic Year is as follows:

Councillor Nigel Studdert-Kennedy (Chair)
Councillor Tom Williams (Vice Chair)
Councillor Dorcas Binns
Councillor Martin Baxendale
Councillor Karon Cross
Councillor Colin Fryer
Councillor Keith Pearson
Councillor Rhiannon Wigzell
Councillor Penny Wride

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AUDIT AND STANDARDS COMMITTEE

25 November 2014

7.00 pm – 8:25

Council Chamber, Ebley Mill, Stroud

Minutes

Membership:

Councillor Nigel Studdert-Kennedy (Chair)	A	Councillor Colin Fryer	P
Councillor Tom Williams (Vice Chair)	P	Councillor Keith Pearson	P
Councillor Dorcas Binns	P	Councillor Rhiannon Wigzell	P
Councillor Martin Baxendale	P	Councillor Penny Wride	P
Councillor Karon Cross	A		

A = Absent P = Present

Other Members in attendance
Councillor Nigel Cooper

Officers in attendance
Sandra Cowley, Strategic Head (Finance and Business) Services
Graham Bailey, Principal Accountant
Maxine Bell, Senior Accountancy Officer
Darren Gilbert, KPMG
Terry Rodway, Internal Audit Manager

AC.029 APOLOGIES

Apologies for absence were received from Councillors Nigel Studdert-Kennedy and Karon Cross.

In Councillor Nigel Studdert-Kennedy's absence Councillor Tom Williams took the Chair.

Penny Wride was welcomed to the Committee. The Chairman asked everyone to stand for a few moments to remember Paul Carter and his family.

AC.030 DECLARATIONS OF INTEREST

There were none.

AC.031 MINUTES

Performance Monitoring – Cllr Wigzell asked a question of how and when performance monitoring takes place and how it is recorded, as there seems to be a lack of consistency between committees.

Councillor Pearson offered to talk to the Legal Services Manager and Monitoring Officer in order for this issue to be put on the agenda of the Constitution working group.

RESOLVED **That the Minutes of the meeting of the Audit and Standards Committee held on 25 September 2014, are approved as a correct record and signed by the Chair.**

AC.032 PUBLIC QUESTION TIME

None received.

AC.033 AUDIT AND STANDARDS WORK PROGRAMME

Members agreed the following changes to the work programme.

Review of Effectiveness of the Audit Committee – 3 February 2015

Update on joint working with Gloucester City – Audit Service – 3 February 2015

AC.034 KPMG ANNUAL AUDIT LETTER 2013/14

Darren Gilbert, KPMG presented this report to Committee. The letter is produced each year at the end of the financial process. It summarised the outcomes outlined to Committee in September

RESOLVED **To note the report.**

AC.035 HALF YEAR TREASURY MANAGEMENT ACTIVITY REPORT 2014/15

The Principal Accountant presented this report to committee. The report is essential under the code of practice of Treasury Management.

Committee discussed various options regarding investments.

RESOLVED **The Audit and Standards Committee RECOMMENDS that the Council APPROVES the treasury management activity half year report for 2014/15, including the revisions to the 2014/15 strategy as set out in paragraphs 8 and 9.**

AC.036 INTERNAL AUDIT PLAN MONITORING REPORT

Audit Manager presented the report which updated Committee on the following completed audits against the 2014/15 plan.

- Members Expenses
- Development Control
- Treasury Management
- Community Grants
- Contract Audit – Servicing and Repairs to Domestic Heating Appliances Contract.

Concern was expressed over the areas of weakness identified in the Community Grants audit and the Contract Audit.

The audit of Community Grants had highlighted an issue regarding a duplicate payment. An invoice had been raised to recover this amount, although at the date of the meeting this invoice had not been paid.

There was concern that discussion regarding the issues identified in the Contract Audit was taking place by Committee once again, as this seemed to be a recurring issue.

In response to a Member question, the Audit Manager agreed to look back at the level of assurance provided for previous audits to identify the direction of travel and report back to Committee.

Members' expenses – Committee asked Democratic Services to do a guide for Members on how to claim expenses, to be put in Councillor's pigeon holes.

RESOLVED **to accept the report and the assurance given on the accuracy of internal controls operating in the systems audited.**

AC.037 RISK MANAGEMENT UPDATE

The Strategic Head (Finance and Business) Services presented this report. The information presented to Committee is a snapshot of the risk register at any particular point in time. Corporate Team review this information on a regular basis.

RESOLVED **Committee agrees that the Risk Register as set out in Appendix A to the report is representative of the key risks facing the Council.**

The meeting closed at 8.25

Chair

Audit & Standards Committee Work Programme 2014/15

15 July 2014
1. Term of Reference & Work Programme 2014/15 2. KPMG - Audit Fee Letter 2014/15 3. KPMG – Interim Audit Letter 4. Statement of Accounts 2013/14 5. The Annual Governance Statement 2013/14 6. Treasury Management Outturn 2013/14 7. Treasury Management Activity Q1 2014/15 8. Internal Audit Plan Monitoring Report Qtr 4 2013/14 9. Internal Audit Annual Report 2013/14 10. Review of Effectiveness of Internal Audit 2013/14

25 September 2014
1. Work Programme 2014/15 2. HRA Outturn Variances 2013/14 3. KPMG - Report to those charged with Governance – ISA 260 4. Statement of Accounts 2013/14 5. Internal Audit Plan Monitoring Report 2014/15 6. Internal Audit Charter 7. Annual Report on Fraud Activity 2013/14 8. Review of Procurement Processes

25 November 2014
1. KPMG – Annual Audit Letter 2013/14 2. Treasury Management Activity 2013/14 Half Year Review 3. Internal Audit Plan Monitoring Report 2014/15 4. Review of Effectiveness of the Audit Committee 5. Review of the Risk Register

3 February 2015
1. KPMG - Annual Summary of Certification of Grant Claims & Returns 2013/14 2. Protecting the Public Purse, Fraud Briefing - KPMG 3. Internal Audit Plan Monitoring Report 2014/15 4. Treasury Management Activity Q3 2014/15 5. Treasury Management Strategy Statement, Annual Investments Strategy and MRP Strategy 2015/16 6. Internal Audit & Risk Management Shared Service

7 April 2015
1. KPMG - Financial Statements 2014/15 Audit Plan 2. Internal Audit Plan Monitoring Report 2014/15 3. Annual Internal Audit Plan 2015/16 4. Procurement Review 5. Annual Review of Risk Management Strategy 7. Review of the Code of Conduct 6. Review of the Functioning of the Standards Panel 7. Review of the Effectiveness of the Audit Committee 8. Work Programme 2015/16

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Sandra Cowley
Head of Finance
Stroud District Council
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Our ref Dg/ma/450

21 January 2015

Dear Sandra

Certification of claims and returns - annual report 2013/14

The Audit Commission requires its external auditors to prepare an annual report on the claims and returns it certifies for each client. This letter is our annual report for the certification work we have undertaken for 2013/14.

In 2013/14 we carried out certification work on the following claims/returns:

Claim/return	**Certified value (£)**
BEN01 – Housing Benefit subsidy claim	£25,021,307
CFB06 – Pooling of Housing Capital Receipts	£1,660,968
Total	£26,682,275

Matters arising

Our certification work did not identify any issues or errors with the Pooling of Housing Capital Receipts return, which was certified unqualified.

The Housing Benefit subsidy claim was also certified unqualified, but our certification work on the claim identified a number of amendments which were required before we could certify the claim:

1. There was an expenditure missclassification in eight initial cases identified as part of our Non-HRA testing on cells 12 and 13;
2. Mis-typing of entry in Cell 225 was identified during our testing of Modified Schemes;
3. In Year Reconciliation Cell 77 did not agree to headline Cell 55 in the original claim;

4. An overpayment was identified in one initial rent allowance sample claim, which required further investigation. The issue was eventually able to be limited to an isolated population of 23 cases which had an increase in the Claim-related Rent (CRR) decision made by the Rent Officer. The errors were only found in such cases that had then also (in addition to the CRR increase) had a change in the actual rent on property. This isolated a total of six cases from within the 23 and resulted in a minor amendment to the claim of £70.

Consequently we have made a two recommendations to the Council to improve its claims completion process. These are provided in detail in the Action Plan in Appendix 1.

In our 2012/13 Certification Annual Report we raised two recommendations relating to the Housing Benefit subsidy claim; the first relating to the Civica reconciliation process not being performed fully, and the second relating to errors in the initial claim form provided for audit. We are satisfied that the Council has improved its arrangements regarding the Civica reconciliation process and has addressed this recommendation. The second recommendation has not been addressed and the two errors found in the 2012/13 claim were repeated this year (amendments 1 & 2 above). Full details are included in Appendix 2.

Certification work fees

The Audit Commission set an indicative fee for our certification work in 2013/14 of £14,000. Our actual fee was slightly higher than the indicative fee, and also higher than the fee for 2012/13 of £13,258 fee for these claims (excluding the National Non-Domestic Rates return which is no longer subject to certification).

The details are set out in the table below.

Claim	**2013/14 Indicative fee (£)**	**2013/14 Final fee (£)**	**2012/13 Final fee (£)**
BEN01 – Housing Benefit subsidy claim	11,652	12,024	11,958
CFB06 – Pooling of Housing Capital Receipts	2,348	2,348	1,300
LA01 – National Non-Domestic Rates	N/A	N/A	900
Total	**14,000**	**14,372**	**14,158**

The variation between the indicative and final fee for the Housing Benefit subsidy claim is due to the net effect of a fee rebate of £1,398 resulting the discontinuation of the Council Tax Benefit Scheme, and an additional fee of £1,770 resulting from additional work required to resolve the issues noted in the Matters Arising section above. Our final fees are subject to determination by the Audit Commission.

Yours sincerely

Darren Gilbert
Director

Appendix 1 – 2013/14 Certification of Claims and Returns Action Plan

Priority rating for recommendations		
❶ Issues that are fundamental and material to your overall arrangements for managing grants and returns or compliance with scheme requirements. We believe that these issues might mean that you do not meet a grant scheme requirement or reduce (mitigate) a risk.	❷ Issues that have an important effect on your arrangements for managing grants and returns or complying with scheme requirements, but do not need immediate action. You may still meet scheme requirements in full or in part or reduce (mitigate) a risk adequately but the weakness remains in the system.	❸ Issues that would, if corrected, improve your arrangements for managing grants and returns or compliance with scheme requirements in general, but are not vital to the overall system. These are generally issues of best practice that we feel would benefit you if you introduced them.

No.	Issue	Recommendation	Priority	Comment/Responsible officer/Due date
1	An overpayment was identified in one initial rent allowance sample claim, which required further investigation. The issue was eventually able to be limited to an isolated population of 23 cases which had an increase in the Claim-related Rent (CRR) decision made by the Rent Officer. The errors were only found in such cases that had then also (in addition to the CRR increase) had a change in the actual rent on property. This isolated a total of six cases from within the 23 and resulted in an amendment to the claim of £70. The Council has discussed the cause of the issue with Civica, its benefits software provider, as it appears to relate to a system error. Civica has been unable to recreate the issue so is not taking further action at the current time. <u>Implication</u> There is a risk that the same error could occur in future years if the issue is not resolved.	If a software fix to the issue is not possible, the Council should monitor all cases where the criteria that caused the issue in 2013/14 occur (i.e. an increase in CRR decision and also in actual rent) and review these for similar errors. This should be done on a periodic basis (preferably monthly) to identify any overpayments on a timely basis, rather than as part of the year-end form preparation procedures.	❷	Software issue identified has been reported to Civica. We will revisit with Civica again and check for the same issue during preparation of the 2014/15 claim. Simon Killen March 2015

No.	Issue	Recommendation	Priority	Comment/Responsible officer/Due date
2	As detailed in Appendix 2, there continue to be some errors present in the claim form presented for certification which could be avoided by the Council performing a review for prior year issues and in-year reconciliations within the form prior to submission. These relate to the following: The form required amendment for an error in rent rebates cells 12/13 (expenditure above/below the one bedroom self-contained LHA rate). This same error resulted in amendment to those cells in the previous two years. Cells 214 and 225 (which should always agree in the form) did not agree in the original form sent to DWP, so any variances should be investigated before the claim form is submitted. Similarly, the In Year Reconciliation Cell 77 did not agree to headline Cell 55 in the original form. Implication Additional work was required by the Council and KPMG in order to arrive at the amendments required and produce an amended signed form.	Perform a review of the claim form prior to submission for audit, paying particular regard to cells on the claim which are required to reconcile or agree to other cells, and also to the cell 12/13 issue.	❷	Agreed. More robust checking will be undertaken on the next claim Simon Killen March 2015

Appendix 2 – Follow up of 2012/13 Certification of Claims and Returns Recommendations

No.	Prior year recommendation	Priority	Current status
1	<u>Issue</u> The certification methodology requires us to check that the Council is fully reconciling Housing Benefit benefit granted to benefit paid using the software supplier's instructions. We found that initially the supplier reconciliation had not been performed and that although the Council carried out an alternative reconciliation, this did not perform the same function as the supplier method. Subsequently the Council performed the Civica reconciliation but was unable to fully reconcile the Rent Allowances line in the time available before the certification deadline. <u>Implication</u> There is a risk that if the reconciliation is not fully performed, the subsidy claimable included in the claim form may be inaccurate. <u>Recommendation</u> Perform the reconciliation in line with supplier instructions on a timely basis in order to eliminate all unreconciled differences.	❷	Our 2013-14 certification work confirmed that the Council is now performing the reconciliations fully in line with the supplier instructions.
2	<u>Issue</u> The form required amendment for an error in rent rebates cells 12/13 (expenditure above/below the one bedroom self-contained LHA rate). This was also amended last year. In addition. Cells 214 and 225 (which should always agree in the form) did not agree in the original form sent to DWP. <u>Implication</u> Additional work was required by the Council and KPMG in order to arrive at the amendments required and produce an amended form. <u>Recommendation</u> In future years, undertake a thorough review of the draft subsidy form prior to submission to ensure no repeat of the cell 13 classification errors seen in previous years.	❷	The errors highlighted were still present in the 2013/14 claim form presented for audit – see Appendix 1.

This report is addressed to the Authority and has been prepared for the sole use of the Authority. We take no responsibility to any member of staff acting in their individual capacities, or to third parties. The Audit Commission has issued a document entitled Statement of Responsibilities of Auditors and Audited Bodies. This summarises where the responsibilities of auditors begin and end and what is expected from the audited body. We draw your attention to this document.
External auditors do not act as a substitute for the audited body's own responsibility for putting in place proper arrangements to ensure that public business is conducted in accordance with the law and proper standards, and that public money is safeguarded and properly accounted for, and used economically, efficiently and effectively.

If you have any concerns or are dissatisfied with any part of KPMG's work, in the first instance you should contact Darren Gilbert, who is the engagement leader to the Authority (telephone 029 2046 8205, e-mail darren.gilbert@kpmg.co.uk) who will try to resolve your complaint. If you are dissatisfied with your response please contact Trevor Rees (telephone 0161 236 4000, e-mail trevor.rees@kpmg.co.uk) who is the national contact partner for all of KPMG's work with the Audit Commission. After this, if you are still dissatisfied with how your complaint has been handled you can access the Audit Commission's complaints procedure. Put your complaint in writing to the Complaints Unit Manager, Audit Commission, 3rd Floor, Fry Building, 2 Marsham Street, London, SW1P 4DF or by email to complaints@audit-commission.gsi.gov.uk. Their telephone number is 0303 444 8330.

STROUD DISTRICT COUNCIL

AUDIT & STANDARDS COMMITTEE

3 FEBRUARY 2015

AGENDA ITEM NO

7

Report Title	INTERNAL AUDIT PLAN MONITORING REPORT
Purpose of Report	To inform Members of the audits completed as part of the 2014/15 Internal Audit Plan.
Decision(s)	**The Committee RESOLVES to accept the report and the assurance given on the adequacy of internal controls operating in the systems audited.**
Consultation and Feedback	Internal Audit findings are discussed with service managers. Management responses to audit recommendations are included in each assignment report.
Financial Implications and Risk Assessment	There are no financial implications arising from this report. Sandra Cowley Strategic Head (Finance & Business Services) Tel: 01453 754136 Email: sandra.cowley@stroud.gov.uk It is important that planned audits are carried out so that assurance can be given about the adequacy of the Council's control environment. If too few audits are undertaken, this limits the extent of assurance that can be given.
Legal Implications	The Committee is being requested to "accept" the report and the assurances given for each audit on the basis of the information provided in the report. This may be viewed as either (I) a request to "note" the report as a whole and the assessment of the appropriate assurance levels, or (ii) a request to specifically approve the report and the particular assurance levels. If it is the latter, the Committee may wish to seek further information (e.g. regarding the recommendations which have been touched upon in the report). Karen Trickey, Legal Services Manager Tel: 01453 754369 Email:karen.trickey@stroud.gov.uk

Report Author	Terry Rodway, Internal Audit Manager Tel: 01453 754111 Email: terry.rodway@stroud.gov.uk
Options	Not applicable
Performance Management Follow Up	This is the third report relating to the 2014/15 Plan. The Committee will continue to receive monitoring reports on achievement against the 2014/15 Internal Audit Plan.
Background Papers/ Appendices	**Appendix A** – List of Audits completed as part of the Internal Audit Plan 2014/15: November 2014 to December 2014 **Appendix B** – Levels of Assurance

Background

1. At the Audit and Standards Committee meeting held on 25 March 2014 Members approved the Internal Audit Annual Plan 2014/15. In accordance with the requirements of the Public Sector Internal Audit Standards this report details the outcomes of Internal Audit work.

Progress

2. This is the third report on compliance against the 2014/15 Plan and includes details of the audits completed during the period November to December 2014. The performance information is based on the number of completed audits vs. the number of planned audits (i.e. an output measure). The indicator for the period April to December 2014 is 64% (16 out of 25 planned audits completed), against a target of 90% (22 out of 25 planned audits completed). However, these figures do not take into account two reports that were at draft report stage and two audits that were substantially complete as at 31 December 2014.

3. Details of the audits completed are given in **Appendix A**. The Audit Opinion reached on each audit has been provided, which should provide Members with a view on the adequacy of the controls operating within each area audited.

4. It has been agreed previously that Members would be notified of any agreed Rank 1 ‘High Priority’ and Rank 2 ‘Medium Priority’ audit recommendations that had not been fully implemented by the agreed date. None was identified for the period covered by this report.

Contract Audit

5. The Chief Executive requested Internal Audit, via the Strategic Head (Finance and Business Services) to undertake a review of renewable energy work. This was particularly in relation to the use of the Responsive Repairs and Void Reinstatement contract for this type of work and the verification of expenditure.

6. The main issues identified by Internal Audit from discussions with Officers responsible for the renewable energy work and a review of documents that were made available at the time of the audit are as follows:

- The award of the renewable energy work via the Responsive Repairs and Void Reinstatement Contract was not in accordance with the Council's Contract Procedure Rules;

- Tenant Services has determined that approximately £7.4m has been invoiced for renewable energy work completed up to 31 March 2014. The costs for materials and management fees recorded on the contractor's invoices could not be verified to appropriate documents as at the date of the audit, e.g. supplier invoices, etc, to agree and substantiate the charges made, and the type, and value of, costs allowable for the contract management fee;

- The Renewable Energy Project Manager advised that he had performed limited checks on the contractor's invoices prior to payment, based on his knowledge of the work completed; however, documentary evidence of these checks was not retained. The Renewable Energy Project Manager also advised that appropriate documents have now been requested from the contractor in order to perform a reconciliation of all costs and to verify the charges and, if any discrepancies are found, an adjustment will be undertaken to realign the final account. The Interim Head of Housing Contracts has advised that this reconciliation exercise was always going to be undertaken after the project had reached Practical Completion;

- The employment arrangements of agency staff who were employed as Clerk of Works/Surveyors, who undertook property surveys to establish their condition, including recommending work and valuing the completed work performed by the Contractor, were not independent of the Contractor.

Levels of Assurance

7. At the previous meeting of this Committee Members requested details of the levels of assurance that had been provided to date, including previous years, to establish whether there were any particular trends. Details have been provided in **Appendix B** to this report.

8. Some benchmarking data has been obtained from other District Councils within the Midlands region to provide a comparison with Stroud DC's results. See table below:

YEAR	% < Satisfactory		
	SDC	Benchmark Group (Average)	Benchmark Group (Range)
2011/12	27%	15%	0% - 27%
2012/13	23%	26%	0% - 34%
2013/14	25%	27%	0% - 33%

Conclusions

9. The role of Internal Audit is to examine, evaluate, and report on the adequacy of internal controls. The audit work that has been completed has either identified that controls are operating as intended, or, where weaknesses have been identified, made recommendations to improve the level of control.

APPENDIX A

List of Audits Completed

2014/15 Audit Plan - November 2014 to December 2014

Audit	Comments	Level of Assurance
Housing Tenancy Fraud	<u>Audit Objective</u> The objectives for this audit were to verify that the following controls were in place and operating effectively: 1. Policy and procedures were in place and up to date; 2. Potential cases of tenancy fraud are identified and investigated in accordance with agreed policy and procedures. <u>Audit Opinion</u> The assessment of the processes and controls relating to Housing Tenancy Fraud is that there is a **Satisfactory** level of assurance. The main area of weakness identified, for which two Rank 3 'Low Priority' recommendations have been made, relate to the records and supporting information of cases investigated.	Satisfactory
Brimscombe Port Management Agreement	<u>Audit Objective</u> The objectives for this audit were to verify that the following were in place and operating effectively. The management and operation of Brimscombe Port is in accordance with the Management Agreement, specifically in relation to accounting arrangements; insurance cover, and lettings. The scope of the audit covered the period 1 December 2013 to November 2014. <u>Audit Opinion</u> The assessment of the processes and controls over the transfer of responsibilities for the management and operation of Brimscombe Port and ongoing responsibilities is that there is a **Limited** level of assurance. The main areas of weakness identified, for which a	Limited

	number of Rank 2 'Medium Priority' recommendations have been made, are as follows: 1. The Memorandum of Agreement between the Council and the Stroud Valley Canal Company (SVCC) was not formally agreed until 10 months after the Council took over the operation and management of Brimscombe Port; 2. Stroud DC was not fully aware of the complete financial accounting position and arrangements for Brimscombe Port until some time after it took over the operation and management of it in December 2013; 3. Quarterly reports with accounts, including a list of outstanding debtors, has not been provided on a timely basis to the SVCC Board as per the Memorandum of Agreement; 4. There is no documentary evidence of regular bank, sales and purchase ledger control account reconciliations that have also been subject to management review and approval; 5. Outstanding debtors have not been pursued in accordance with Stroud DC's recovery procedures and the tenancy agreements, due to issues with the financial records and debtor disputes; 6. There was no documentary evidence to confirm that the grant conditions had been satisfied by SVCC prior to the payment of the 2013/14 £50k grant by the Council. As at the date of the audit, no grant had been paid for 2014/15. 7. The key risk of taking on the operation and management of Brimscombe Port, as noted in the 14 November 2013 and 27 March 2014 Strategy and Resources Committee reports, has not been included in the Corporate Risk Register (Excelsis) and therefore subject to formal management and monitoring.	

Car Parks	<u>Audit Objective</u> The objectives for this audit were to verify that the following were in place and operating effectively: 1. The Merrywalks multi storey car park is managed and operated in accordance with the management agreement; 2. An agreement/contract between Stroud DC and cash services operator exists, is complete and has been formally approved; 3. Car park takings are properly accounted for and subject to regular and timely reconciliation; 4. Season tickets are correctly managed, access limited to authorised staff, promptly issued and money received correctly accounted for; 5. Access to the car park machines cash boxes, tickets and for the setting of fees are limited to authorised staff and the keys stored in a secure location; 6. The Merrywalks car park process for the replenishment of float money is effective, secure and correctly accounted for. <u>Audit Opinion</u> The assessment of the operations and controls over car parks during the audit period is that there is an **Unsatisfactory** level of assurance. The main areas of weakness identified for which two Rank 1 'High' and a larger number of Rank 2 'Medium Priority' recommendations have been made are as follows: 1. The contract for the collection and banking of car park takings, which was let approximately 9 years ago, does not specify a termination date; 2. At the time of the audit there was no documented and agreed contingency plan to account for the risk that all car park machines on the same site were not operating as intended;	Unsatisfactory

	3. The Council took over responsibility for the management and operation of the Merrywalks MSCP on 2 December 2013. However, the Management Agreement between the Council and the landlord, at the time of the audit, had still not been formally agreed and approved; 4. There are a number of issues with the car park machine cash collection, banking and reconciliation processes and controls e.g. Balancing Tickets from the car park machines recording the total value of money taken have not always been provided by the Contractor, resulting in the Council being unable to confirm that all the money due has been received; and, the late receipt of the relevant documents from the Contractor has resulted in Stroud DC not always being able to carry out the required control checks in a timely manner. 5. Appropriate checks on the monthly invoices submitted by the Contractor for the cash collection and banking service have not been undertaken resulting in over payment for contractual services that have not been performed. In addition the charges made could not be verified to contract documentation; 6. The general ledger account postings include the total cash banked by the Contractor rather than the amount shown on the car park machine 'Balancing Tickets'. Therefore, any differences between takings and cash banked by the Contractor are not identified and monitored; 7. There are no checks performed to confirm that car park money collected via debit or credit card has been correctly and fully accounted for; 8. The monthly car park cash and notes general ledger reconciliations are not always performed promptly and are not subject to management review and approval. In addition a copy of the reconciliation is not provided to Community Safety management as budget holders; 9. There is no regular reconciliation of season ticket income between the car park back office systems and general ledger;	

	10. A regular review of staff systems access to the car park back office systems is not performed to confirm correct and that it remains appropriate to staff job responsibilities; 11. The ‘management’ logon passwords to one of the car park back office systems are known to operational staff; 12. Where Stroud DC staff are involved, there is a lack of separation of duties in respect of cash machine float money replenishment arrangements; 13. Not all payments due to the Landlord have been made from the commencement date of the Merrywalks MSCP Management Agreement.	

The report includes an ‘opinion’ on the adequacy of controls in the area that has been audited, classified in accordance with the following descriptions:

CONTROL LEVEL	**DESCRIPTION**
Good	Robust framework of controls – provides substantial assurance. A few minor recommendations (if any) i.e. Rank 3 (Low Priority).
Satisfactory	Sufficient framework of controls – provides satisfactory level of assurance – minimal risk. A few areas identified where changes would be beneficial. Recommendations mainly Rank 3 (Low Priority), but one of two in Rank 2 (Medium Priority).
Limited	Some lapses in framework of controls – provides limited assurance. A number of areas identified for improvement. Mainly Rank 2 (Medium Priority) recommendations, but one or two Rank 1 (High Priority) recommendations.
Unsatisfactory	Significant breakdown in framework of controls – provides unsatisfactory level of assurance. Unacceptable risks identified – fundamental changes required. A number of Rank 1 (High Priority) recommendations.

Internal Audit recommendations are graded as follows:

RANK		DESCRIPTION
1	High Priority	Necessary due to statutory obligation, legal requirement, Council policy or major risk of loss or damage to Council assets, information or reputation, or, compliance with External Audit identified key control.
2	Medium Priority	Could cause limited loss of assets or information or adverse publicity or embarrassment. Necessary for sound internal control and confidence in the system to exist.
3	Low Priority	Current procedure is not best practice and could lead to minor inefficiencies.

APPENDIX B

Level of Assurance

Assurance Level	2011/12		2012/13		2013/14		2014/15 (to Dec 2014)		Average
	No.	%	No.	%	No.	%	No.	%	%
Good	11	27	13	30	17	36	4	21	29
Satisfactory	19	46	20	47	18	39	9	47	45
Limited	11	27	10	23	10	21	4	21	23
Unsatisfactory	0	0	0	0	2	4	2	11	3
TOTAL	41	100	43	100	47	100	19	100	100
>= Satisfactory	30	73	33	77	35	75	13	68	73
<Satisfactory	11	27	10	23	12	25	6	32	27
TOTAL	41	100	43	100	47	100	19	100	100

STROUD DISTRICT COUNCIL

AUDIT AND STANDARDS COMMITTEE

3 February 2015

AGENDA ITEM NO

8

Report Title	**THIRD QUARTER TREASURY MANAGEMENT ACTIVITY REPORT 2014/15**
Purpose of Report	To provide an update on treasury management activity as at 31 December 2014.
Decision(s)	**The Audit and Standards Committee APPROVES the treasury management activity third quarter report for 2014/2015.**
Consultation and Feedback	Capita Asset Services Limited
Financial Implications & Risk Assessment	Total interest of £218,000 at the end of the third quarter means that the Council is likely to exceed the budgeted figure of £250,000. Good governance requires regular reporting as one of the means of addressing inherent risks associated with treasury management. Graham Bailey, Principal Accountant Tel: 01453 754133 E-mail: graham.bailey@stroud.gov.uk
Legal Implications	There are no significant legal implications arising from the decision recommended in this report. Alan Carr, Solicitor Email : alan.carr@stroud.gov.uk Tel: 01453 754357
Report Author	Maxine Bell, Senior Accounting Officer Tel: 01453 754134 E-mail: maxine.bell@stroud.gov.uk
Chair of Committee	Councillor Nigel Studdert-Kennedy Tel: 01453 821491 E-mail: cllr.nigel.studdert-kennedy@stroud.gov.uk
Options	None
Performance Management Follow Up	An outturn report showing the full year position for 2014/15 will be presented to the Audit and Standards Committee. This is a requirement of the revised CIPFA Code of Practice for Treasury Management.

Background Papers	Council Report 27 February 2014, Agenda Item 9(b), Treasury Management Strategy, Annual Investment Strategy and Minimum Revenue Provision Policy Statement 2014/15.
Appendices	A – Economic Update B – Prudential Indicators as at 31 December 2014 C – Explanation of prudential indicators

Background

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

2. This report is presented to the Audit and Standards Committee to provide an overview of the investment activity and performance for the first half of the financial year, and to report on prudential indicators and compliance with treasury limits. A mid year report is essential under the Code of Practice for Treasury Management (the Code).

Discussion

3. The Chartered Institute of Public Finance and Accountancy (CIPFA) issued the revised Code in November 2009, and it was adopted by this Council on 21 January 2010. This third quarter report has been prepared in compliance with CIPFA's Code of Practice, and covers the following:

   - An economic update – Appendix A
   - A review of the Treasury Management Strategy Statement (TMSS) and Investment Strategy
   - A review of the Council's investment portfolio for 2014/15
   - A review of the Council's borrowing strategy for 2014/15
   - A review of compliance with Treasury and Prudential Limits for 2014/15

Treasury Management Strategy Statement and Investment Strategy update

4. The TMSS for 2014/15 was approved by Council on 27 February 2014. The Council's Investment Strategy, which is incorporated in the TMSS, outlines the Council's investment priorities as follows:

   - Security of Capital
   - Liquidity
   - Yield

5. The Council will also aim to achieve the optimum return on investments commensurate with the proper levels of security and liquidity. As interest rates on the Council's call accounts have fallen sharply more timed-deposits are being made with highly credit rated financial institutions, using Capita's suggested creditworthiness approach, which includes a sovereign credit

rating and Credit Default Swap (CDS) overlay. The Council is prepared to invest for up to a year with UK Government supported banks.

6. A breakdown of the Council's investment portfolio as at 31 December, 30 September and 30 June 2014 is shown in Table 2 of this report. Investments and borrowing during the year have been in line with the Strategy, and there have been no deviations from the strategy.

7. Capita's latest economic analysis is set out in Appendix A. Current advice from Capita is to invest for no more than a year with UK banks, or up to a maximum of five years with government or local government provided they are sufficiently highly rated on Capita's weekly list.

Investment Portfolio 2014/15

8. In accordance with the Code, it is the Council's priority to ensure security and liquidity of investments, and once satisfied with security and liquidity, to obtain a good level of return. The investment portfolio yield is shown in the table below as at the end of each quarter.

TABLE 1: Average Interest Rate Compared With Benchmark Rates

Period	Investment Interest Earned	Average Investment	Average Interest Rate	Benchmark 7 day LIBID	Benchmark 3 month LIBID
01/04/14 - 30/06/14	£48,223	£22.08m	0.89%	0.34%	0.41%
01/04/14 - 30/09/14	£114,493	£26.26m	0.88%	0.34%	0.42%
01/04/14 - 01/12/14	£168,223	£26.88m	0.86%	0.35%	0.43%

9. An amount of Icelandic Krona equivalent to £667,000 is held in an Escrow account due to currency controls in Iceland earning 4.2%. This interest amount is excluded from the figures shown in the above table. Also the Local Area Mortgage Scheme investment of £1m at 3.8% with Lloyds is excluded. These amounts of interest are excluded because the investments are not as a result of Treasury Management decisions. When this interest is included interest earned is £218,000 at an average interest rate of 1.04%.

10. Table 2 below shows the investments and borrowing position at the end of December 2014.

11. The approved limits as set out in the Treasury Management Strategy report to Council 27 February 2014 within the Annual Investment Strategy were breached once during the first quarter of 2014/15, as previously reported. The breach was an investment total of £75,000 over the limit for the RBS Banking Group for one day due to a spreadsheet error. There were no breaches during the second and third quarter.

12. Funds were available for investment on a temporary basis. The level of funds available was mainly dependent on the timing of precept payments, receipt of grants and progress on the Capital Programme and canal project. The authority holds £6m core cash balances for investment purposes (i.e. funds that, potentially, could be invested for more than one year).

TABLE 2: Investments & Borrowing

	Jun 14 £'000	Sep 14 £'000	Dec 14 £'000
Federated Prime Rate	0	0	645
Ignis	0	0	87
Money Market Funds	**0**	**0**	**732**
Bank of Scotland	4,000	6,000	6,000
Lloyds	4,000	4,000	5,000
Lloyds Banking Group Total	**8,000**	**10,000**	**11,000**
NatWest	12,579	7,689	2
Royal Bank of Scotland	7	2,007	2007
RBS Banking Group Total	**12,586**	**9,696**	**2009**
Svenska Handlesbanken	**5,620**	**4,368**	**5,851**
Barclays Bank	**2**	**1,002**	**5,959**
Standard Chartered	**0**	**0**	**1,000**
Santander	**0**	**0**	**5,959**
TOTAL INVESTMENTS	**26,208**	**25,066**	**32,510**
Local Authority	2,000	2,000	2,000
PWLB	92,717	92,717	93,717
TOTAL BORROWING	**94,717**	**94,717**	**95,717**

External Borrowing

13. The Council's original Capital Financing Requirements (CFR) for 2014/15 is £101m. The CFR denotes the Council's underlying need to borrow for capital purposes. If the CFR is positive the Council may borrow from the PWLB or the market (External Borrowing) or from internal balances on a temporary basis (Internal Borrowing). The Council has borrowing of £95.717m as at 31 December 2014. HRA borrowing of £5.4m had been planned during the year together with up to £1.4m of General Fund borrowing, however circumstances have meant that expenditure will slip into 2015/16. However, following Capita's advice the Council has taken advantage of an opportunity to borrow £1m PWLB 50-year at a rate of 3.6%

in advance of need due to favourable fluctuations in long-term PWLB rates. There is an ongoing monitoring of rates on a daily basis to take further advantage of any sharp reductions in rates that may occur.

Compliance with Treasury and Prudential Limits

14. It is a statutory duty for the Council to determine and keep under review the “Affordable Borrowing Limits”. The Council’s approved Treasury and Prudential Indicators are outlined in the approved TMSS.

15. During the period to 31 December 2014 the Council has operated within the treasury limits and Prudential Indicators set out in the Council’s TMSS and in compliance with the Council's Treasury Management Practices. The Prudential and Treasury Indicators are shown in Appendix B.

Sector's economic background for the quarter ended 31 December 2014 and interest rate forecast

Economic Background

After strong UK GDP growth in 2013 at an annual rate 2.7%, and then in 2014 0.7% in Q1, 0.9% in Q2 2014 (annual rate 3.2% in Q2), Q3 has seen growth fall back to 0.7% in the quarter and to an annual rate of 2.6%. It therefore appears that growth has eased since the surge in the first half of 2014 leading to a downward revision of forecasts for 2015 and 2016, albeit that growth will still remain strong by UK standards. For this recovery to become more balanced and sustainable in the longer term, the recovery needs to move away from dependence on consumer expenditure and the housing market to exporting, and particularly of manufactured goods, both of which need to substantially improve on their recent lacklustre performance. This overall strong growth has resulted in unemployment falling much faster than expected. The MPC is now focusing on how quickly slack in the economy is being used up. It is also particularly concerned that the squeeze on the disposable incomes of consumers should be reversed by wage inflation rising back significantly above the level of inflation in order to ensure that the recovery will be sustainable. There also needs to be a major improvement in labour productivity, which has languished at dismal levels since 2008, to support increases in pay rates. Unemployment is expected to keep on its downward trend and this is likely to eventually feed through into a return to significant increases in wage growth at some point during the next three years. However, just how much those future increases in pay rates will counteract the depressive effect of increases in Bank Rate on consumer confidence, the rate of growth in consumer expenditure and the buoyancy of the housing market, are areas that will need to be kept under regular review.

Also encouraging has been the sharp fall in inflation (CPI), reaching 1.0% in November, the lowest rate since September 2002. Forward indications are that inflation is likely to remain around or under 1% for the best part of a year. The return to strong growth has helped lower forecasts for the increase in Government debt over the last year but monthly public sector deficit figures during 2014 have disappointed until November. The autumn statement, therefore, had to revise the speed with which the deficit is forecast to be eliminated.

The U.S. Federal Reserve ended its monthly asset purchases in October 2014. GDP growth rates (annualised) for Q2 and Q3 of 4.6% and 5.0% have been stunning and hold great promise for strong growth going forward. It is therefore confidently predicted that the first increase in the Fed. rate will occur by the middle of 2015.

The Eurozone is facing an increasing threat from deflation. In November the inflation rate fell to 0.3%. However, this is an average for all EZ countries and includes some countries with negative rates of inflation. Accordingly, the ECB did take some rather limited action in June and September to loosen monetary policy in order to promote growth and is currently expected to embark on quantitative easing early in 2015 to counter this threat of deflation and to stimulate growth.

Interest Rate Forecast

The Council's treasury advisor, Capita Asset Services, has provided the following forecast:

	Mar-15	Jun-15	Sep-15	Dec-15	Mar-16	Jun-16	Sep-16	Dec-16	Mar-17	Jun-17	Sep-17	Dec-17	Mar-18
Bank rate	0.50%	0.50%	0.50%	0.75%	0.75%	1.00%	1.00%	1.25%	1.25%	1.50%	1.75%	1.75%	2.00%
5yr PWLB rate	2.20%	2.20%	2.30%	2.50%	2.60%	2.80%	2.90%	3.00%	3.20%	3.30%	3.40%	3.50%	3.60%
10yr PWLB rate	2.80%	2.80%	3.00%	3.20%	3.30%	3.50%	3.60%	3.70%	3.80%	3.90%	4.00%	4.10%	4.20%
25yr PWLB rate	3.40%	3.50%	3.70%	3.80%	4.00%	4.20%	4.30%	4.40%	4.50%	4.60%	4.70%	4.70%	4.80%
50yr PWLB rate	3.40%	3.50%	3.70%	3.80%	4.00%	4.20%	4.30%	4.40%	4.50%	4.60%	4.70%	4.70%	4.80%

Capita Asset Services undertook a review of its interest rate forecasts on 5 January 2015 after a proliferation of fears in financial markets around the plunge in the price of oil had caused a flight from equities into bonds and from exposure to the debt and equities of emerging market oil producing countries to safe havens in western countries. These flows were compounded by further fears that Greece could be heading towards an exit from the Euro after the general election on January 25 and financial flows generated by the increasing likelihood that the ECB would soon be starting on full blown quantitative easing (QE) purchase of Eurozone government debt. In addition, there has been a sharp increase in confidence that the US will start increasing the Fed. rate by the middle of 2015 due to the stunning surge in GDP growth in quarters 2 and 3 of 2014. This indicated that the US is now headed towards making a full recovery from the financial crisis of 2008.

The result of the combination of the above factors is that we have seen bond yields plunging to phenomenally low levels, especially in long term yields. These falls are unsustainable in the longer term but just how quickly these falls will unwind is hard to predict. In addition, positive or negative developments on the world political scene could have a major impact in either keeping yields low or prompting them to recover back up again. We also have a UK general election coming up in May 2015; it is very hard to predict what its likely result will be and the consequent impact on the UK economy, and how financial markets will react to those developments.

This latest forecast includes a move in the timing of the first increase in Bank Rate from quarter 2 of 2015 to quarter 4 of 2015 as a result of the sharp fall in inflation due to the fall in the price of oil and the cooling of the rate of GDP growth in the UK, albeit, that growth will remain strong by UK standards, but not as strong as was previously forecast. The Governor of the Bank of England, Mark Carney, has repeatedly stated that increases in Bank Rate will be slow and gradual. The MPC is concerned about the impact of increases on many heavily indebted consumers, especially when average disposable income is only currently increasing marginally as a result of wage inflation now running slightly above the depressed rate of CPI inflation, though some consumers will not have seen that benefit come through for them. In addition, whatever party or coalition wins power in the next general election, will be faced with having to implement further major cuts in expenditure and / or increases in taxation in order to eradicate the annual public sector net borrowing deficit.

Prudential Indicators as at December 2014

Prudential Indicator	2014/15 Indicator £'000	Actual as at 31 December 2014 £'000
Capital Financing Requirement (CFR)	102,349	95,549
Gross Borrowing	100,207	95,717
Authorised Limit for external debt	110,000	95,717
Operational Boundary for external debt	106,000	95,717
Limit of fixed interest rates based on net debt	100%	100%
Limit of variable interest rates based on net debt	100%	0%
Principal sums invested > 364 days	6,000	0
Maturity structure of borrowing limits		
Under 12 months	100%	0%
12 months to 2 years	100%	0%
2 years to 5 years	100%	3%
5 years to 10 years	100%	0%
10 years and above	100%	97%

* Revised from £101,039

Explanation of prudential indicators

Central Government control of borrowing was ended and replaced with Prudential borrowing by the Local Government Act 2003. Prudential borrowing permitted local government organisations to borrow to fund capital spending plans provided they could demonstrate their affordability. Prudential indicators are the means to demonstrate affordability.

Gross borrowing – compares estimated gross borrowing in February 2014 strategy with actual gross borrowing as at 31 December 2014.

Capital financing requirement (CFR) – the capital financing requirement shows the underlying need of the Council to borrow for capital purposes as determined from the balance sheet. The overall positive revised CFR of £102,349m provides the Council with the opportunity to borrow if appropriate. £5.4m of HRA borrowings had been planned for 2014/15, however as at 31st December 2014 no further borrowing has been required due to slippage.

Authorised limit for external debt - this is the maximum limit for gross external indebtedness. This is the statutory limit determined under section 3(1) of the Local Government Act 2003. This limit is set to allow sufficient headroom for day to day operational management of cashflows. This limit has not been breached in the period 1 April 2014 to 31 December 2014.

Operational boundary for external debt – this is set as the more likely amount that may be required for day to day cashflow. This limit has not been breached in the period 1 April 2014 to 31 December 2014.

Upper limit for fixed and variable interest rate exposure – these limits allow the Council flexibility in its investment and borrowing options. Current investments are either fixed rate term investments or on call. Borrowing is at a fixed rate.

Upper limit for total principal sums invested for over 364 days – the amount it is considered can prudently be invested for a period in excess of a year. Current policy is to keep investments less than one year with Government supported banks and less than 3 months with any other banks with appropriate credit ratings, therefore there are no long term investments as at 31 December 2014, apart from the £1m invested for 5 years as part of the Local Area Mortgage Scheme. It is recommended the Council permits lending for up to 3 years with other Local Authorities with effect from the current 2014/15 TMSS.

STROUD DISTRICT COUNCIL

AGENDA ITEM NO

AUDIT AND STANDARDS COMMITTEE

3 February 2015

9

Report Title	**TREASURY MANAGEMENT STRATEGY, ANNUAL INVESTMENT STRATEGY AND MINIMUM REVENUE PROVISION POLICY STATEMENT 2015/16**
Purpose of Report	This report outlines the Council’s prudential indicators for 2015/16 – 2017/18 and sets out the treasury strategy for this period. It fulfils three key reports required by the Local Government Act 2003: • reporting prudential indicators required by the CIPFA Prudential Code for Capital Finance in Local Authorities; • a treasury management strategy in accordance with the CIPFA Code of Practice on Treasury Management; • an investment strategy in accordance with the DCLG investment guidance. It also fulfils the statutory duty to approve a minimum revenue policy statement for 2015/16.
Decision(s)	**The Audit and Standards Committee RECOMMEND that Council:** **1. adopt the prudential indicators and limits for 2015/16 to 2017/18;** **2. approve the treasury management strategy 2015/16, and the treasury prudential indicators;** **3. approve the investment strategy 2015/16, and the detailed criteria for specified and non-specified investments; and** **4. approve the Minimum Revenue Policy Statement 2015/16.**

Consultation and Feedback	Capita Asset Services (CAS) and KPMG
Financial Implications & Risk Assessment	This report sets out the expected activities of the Council's Treasury function for 2015/16 and recommends the investment instruments that are available to the council and the limits on these investments. The report also sets out the Council's borrowing strategy, limits and associated policies. The Council has £95.717m of borrowing and the Council's capital spending plans (excluding the budget proposals being considered by Council on 29 January 2015) increase the borrowing to £103.479m by 31 March 2018. It will be important to consider carefully, in conjunction with our Treasury Management advisers, the optimum timing and nature of any new borrowing to minimise the cost to the Council. The Council makes investments during the year as part of its management of treasury balances. The investment strategy sets out the Council's investment priorities and the criteria used to make those investments to ensure security of capital, liquidity and a return on investment. The Treasury Management Strategy is designed to protect the Council's finances through limiting exposure to risk. It is worth noting that the prudential indicators and capital financing requirement calculation shown in the report do not include the budget proposals being considered by Council on 29 January 2015. Should Council approve the budget, the prudential indicators and CFR calculation will be amended accordingly. David Stanley, Accountancy Manager Tel: 01453 754100 E-mail: david.stanley@stroud.gov.uk
Legal Implications	The legal implications pertinent to this matter are summarised in the report. Alan Carr, Solicitor Email : alan.carr@stroud.gov.uk Tel: 01453 754357

Report Author	Graham Bailey, Principal Accountant Tel: 01453 754133 E-mail: graham.bailey@stroud.gov.uk
Chair of Committee	Councillor Nigel Studdert-Kennedy Tel: 01453 821491 E-mail: cllr.nigel.studdert-kennedy@stroud.gov.uk
Options	Full Council is required to adopt the prudential indicators and approve the annual treasury management strategy. These are largely determined by the Council's revenue and capital budget decisions when setting the 2015/16 Council Tax and Housing rent levels.
Performance Management Follow Up	Quarterly, half-yearly and annual Treasury Management reports of actual compared with estimated prudential indicators for 2015/16. Any breaches of the Prudential Code will be reported to the Audit and Standards Committee. A breach of the Authorised Borrowing Limit would require immediate investigation and reporting to Council.
Background Papers	Treasury Management Policy Statement Treasury Management Practices - Main Principles Treasury Management Practices – Schedules The Prudential Code (2011) Treasury Management in the Public Services Guidance Notes for Local Authorities (2011) Treasury Management in the Public Services Code of Practice and Cross-Sectoral Guidance Notes (2011). Reports: ○ Capital Programme and Proposed Schemes, 8 January 2015 ○ General Fund Revenue Estimates – Revised 2014/15 and Original 2015/16, 8 January 2015 ○ The General Fund Revenue Budget 2015/16 and Medium Term Financial Plan 2014/15 – 2018/19, 8 January 2015 ○ Housing Revenue Account Revised Estimates 2014/15 and Original Estimates 2015/16, 8 January 2015
Appendices	A. Investments at 8 January 2015 B. Explanation of Prudential Indicators C. Economic Background D. Treasury Management Scheme of Delegation

Discussion

1. Under the Local Government Act 2003 (the Act) and supporting regulations the Council is required to “have regard to” the Chartered Institute of Public Finance and Accountancy (CIPFA) Prudential Code and the CIPFA Treasury Management Code of Practice to set Prudential and Treasury Indicators for the next three years to ensure that the Council’s capital investment plans are affordable, prudent and sustainable.

2. Council is required to approve an Annual Treasury Management Strategy Statement for borrowing, and an Investment Strategy which sets out the Council’s policies for managing its investments and for giving priority to security and liquidity of investments.

3. Also, there is a statutory duty to approve a Minimum Revenue Provision (MRP) Policy Statement for the year and this is set out in paragraphs 2.6 – 2.10 of this report.

4. CIPFA Code of Practice on Treasury Management (revised November 2011) as adopted by this Council on 21 January 2010 requires the Council to maintain a Treasury Management Manual, which is reviewed annually. This manual is a record of internal procedures and operational guidance, as such it does not need to be approved by Members. The manual incorporates the following documentation relating to Treasury management:

   - Treasury Management Policy Statement. This was approved by Members in 2002 and is reviewed annually.
   - Treasury Management Practices (TMP) – Main Principles. There are 12 practices which set out the manner in which this Council will seek to achieve its treasury management policies and objectives and how it will manage and control those activities. These were adopted in 2002. They are reviewed annually.
   - Treasury Management Practices – Schedules. These schedules set out the details of how the TMPs are put into effect by this Council. This document is revised annually to include the latest detailed procedural documents.
   - Counterparty Lending List and lending criteria. The list used by the Council is provided by Capita Asset Services (CAS), the Council’s treasury advisors. A new list is provided weekly, and there are daily updates by email of any changes to ratings.

5. Other CIPFA requirements are:

   - a Mid-year Review Report and an Annual Report covering activities during the previous year;
   - delegation by the Council of responsibilities for implementing and monitoring treasury management policies and practices and for the execution and administration of treasury management decisions. At this Council, delegation is to the Strategic Head (Finance & Business Services), the Council’s Section 151 officer;

- delegation by the Council of the role of scrutiny of treasury management reports and strategy to a specific named body. For this Council the delegated body is the Audit and Standards Committee.

Treasury Management Strategy Statement, Annual Investment Strategy and Minimum Revenue Provision Statement 2015/16

1. INTRODUCTION

1.1 The Act and supporting regulations require the Council to 'have regard to' the CIPFA Prudential Code and to set Prudential Indicators for the next three years to ensure that the Council's capital investment plans are affordable, prudent and sustainable.

1.2 The Act therefore requires the Council to set out its treasury strategy for borrowing and to prepare an Annual Investment Strategy (as required by Investment Guidance issued subsequent to the Act). This sets out the Council's policies for managing its investments and for giving priority to the security and liquidity of those investments.

1.3 2015/16 strategy for the following aspects of the treasury management function is based upon the treasury officers' views on interest rates, supplemented with market forecasts provided by the Council's treasury advisor, CAS. The strategy covers:

- limits in force to mitigate the Council's treasury risk;
- Prudential Indicators;
- current treasury position;
- borrowing requirement;
- prospects for interest rates;
- borrowing strategy;
- policy on borrowing in advance of need;
- investment strategy;
- creditworthiness policy;
- policy on use of external service providers;
- Minimum Revenue Provision (MRP) statement;
- treasury management scheme of delegation and section 151 role;
- miscellaneous treasury issues.

1.4 It is a statutory requirement under Section 33 of the Local Government Finance Act 1992, for the Council to produce a balanced budget. In particular, Section 32 requires a local authority to calculate its budget requirement for each financial year to include the revenue costs that flow from capital financing decisions. This means that increases in capital expenditure must be limited to a level whereby increases in charges to revenue from:

- increases in interest charges caused by increased borrowing to finance additional capital expenditure, and

- any increases in running costs from new capital projects are limited to a level which is affordable for the foreseeable future.

2. CAPITAL PRUDENTIAL INDICATORS FOR 2015/16 TO 2017/18

2.1 Capital expenditure plans are a key driver of treasury management activity. There are prudential indicators that focus on the Council's capital spending plans.

2.2 The first prudential indicator is a summary of the Council's capital expenditure plans, shown in Table 1.

Table 1: Capital Expenditure

Capital Expenditure	**2013/14 £000 Actual**	**2014/15 £000 Estimate**	**2015/16 £000 Estimate**	**2016/17 £000 Estimate**	**2017/18 £000 Estimate**
Community Services	918	989	1,802	215	215
Environment	1,445	900	1,626	750	11
Strategy & Resources	190	289	278	-	-
General Fund	2,553	2,178	3,706	965	226
HRA	16,094	13,650	20,687	12,996	9,578
Total	18,647	15,828	24,393	13,961	9,804

2.3 Any shortfall of resources to finance the capital programme results in a borrowing need as set out in Table 2 below.

Table 2: Capital Financing

Capital Expenditure	**2013/14 £000 Actual**	**2014/15 £000 Estimate**	**2015/16 £000 Estimate**	**2016/17 £000 Estimate**	**2017/18 £000 Estimate**
General Fund	2,553	2,178	3,706	965	226
HRA	16,094	13,650	20,687	12,996	9,578
Total	18,647	15,828	24,393	13,961	9,804
Financed by:					
Capital receipts	2,854	1,211	590	400	300
Capital grants	1,063	7,622	971	679	0
Capital reserves	2,392	1,897	2,286	965	215
Revenue	9,338	5,098	11,784	11,917	9,289
Net Borrowing Need for the year	3,000	-	8,762	-	-

2.4 The second prudential indicator is the Council's Capital Financing Requirement (CFR). The CFR is simply the total historic capital expenditure which has not yet been financed from either revenue or capital resources. It is the measure of the Council's underlying borrowing need. Any newly planned unfinanced capital expenditure will increase the CFR.

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

Table 3: The Council's borrowing need (Capital Financing Requirement)

Capital Financing Requirement	2013/14 £000 Actual	2014/15 £000 Estimate	2015/16 £000 Estimate	2016/17 £000 Estimate	2017/18 £000 Estimate
CFR - General Fund	7,569	7,569	8,569	8,569	8,569
CFR - HRA	87,980	87,980	95,742	95,742	95,742
Total CFR	95,549	95,549	104,311	104,311	104,311
Movement in CFR	-	-	8,762	-	-

Movement in CFR represented by					
Net financing need for the year	-	-	8,762	-	-
Less MRP / VRP and other financing movements	-	-	-	-	-
Movement in CFR	-	-	8,762	-	-

Minimum revenue provision (MRP) policy statement 2015/16

2.6 The Council's MRP policy statement for 2015/16 is in accordance with the main recommendations contained within the guidance issued by the Secretary of State under section 21(1A) of the Local Government Act 2003. MRP is only chargeable on General Fund outstanding capital liabilities.

2.7 An MRP charge is not currently required for the HRA. Following HRA reform the HRA will be required to charge depreciation on its assets. This will have a revenue effect. In order to address any possible adverse impact, regulations allow the Major Repairs Allowance as a proxy for depreciation until 31 March 2017.

2.8 The government is protecting the General Fund from any adverse MRP liability arising from HRA self-financing borrowing. Consequently, as there was no General Fund MRP liability for the General Fund prior to HRA Self-Financing, there will be no General Fund MRP liability for 2015/16. The Council's MRP liability for 2015/16 is therefore NIL.

2.9 When the Council's General Fund CFR (for MRP purposes) becomes positive, MRP will be charged under Option 3 of the DCLG guidance. Option 3 is an MRP charge over a time period reasonably commensurate with the estimated useful life of a new asset. The Council is funding £1m of expenditure on Dursley Pool fitness extension by borrowing. This means that under Option 3 MRP will be chargeable in the year following the completion of the asset. So MRP will commence in 2016/17 and will continue for a period of 25 years.

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

Table 4: Core Funds and Expected Investments

Year end resources	2013/14 £m Actual	2014/15 £m Estimate	2015/16 £m Estimate	2016/17 £m Estimate	2017/18 £m Estimate
Fund balances / reserves	17.808	22.434	17.612	15.101	15.871
Capital receipts	0.046	0.287	0.307	0.342	0.366
Provisions	0.590	0.590	0.590	0.590	0.590
Other	0.408	0.400	0.350	0.300	0.250
Total Core funds	**18.852**	**23.711**	**18.859**	**16.333**	**17.077**
Working capital	0.353	0.500	0.500	0.500	0.500
Under / over borrowing	-0.832	0.168	-0.832	-0.832	-0.832
Expected investments	**18.373**	**24.379**	**18.527**	**16.001**	**16.745**

Affordability of capital plans prudential indicators

2.11 Prudential indicators are required to assess the affordability of capital expenditure plans. These provide an estimate of the impact of capital investment plans on the Council's overall finances. The Council is asked to approve the indicators shown in tables 5, 6 and 7.

2.12 The indicator shown in table 5 shows the cost of capital expenditure plans against the net revenue stream.

Table 5: Ratio of financing costs to net revenue stream

	2013/14 Actual	2014/15 Estimate	2015/16 Estimate	2016/17 Estimate	2017/18 Estimate
Non-HRA	-2.81%	-2.33%	-2.45%	-1.53%	-1.52%
HRA	15.30%	16.01%	15.32%	14.61%	14.16%

2.13 The indicator shown in Table 6 shows estimates of the revenue costs arising from proposed changes to the 2014-15 to 2017-18 capital programme recommended in this year's 'Capital Programme and Proposed Schemes' report compared to the Council's existing approved commitments and current plans.

Table 6: Incremental impact of capital investment decisions on council tax

	2013/14 Actual	2014/15 Estimate	2015/16 Estimate	2016/17 Estimate	2017/18 Estimate
Council Tax - Band D	-£0.04	-£0.08	£0.95	£0.05	£0.08

2.14 Similar to the council tax calculation, Table 7 indicator identifies the cost of proposed changes in the housing capital programme recommended in this budget report compared to the Council's existing commitments and current plans, expressed as a discrete impact on weekly rent levels.

Table 7: Estimates of the incremental impact of capital investment decisions on housing rent levels

	2013/14 Actual	2014/15 Estimate	2015/16 Estimate	2016/17 Estimate	2017/18 Estimate
Weekly Housing Rents	£0.31	-£0.89	£0.75	£0.21	£0.01

3. BORROWING

3.1 Amongst the objectives of the treasury management function are to ensure that the Council's cash is managed in accordance with relevant professional codes and that sufficient cash is available at the right times to facilitate revenue and capital spending plans. Capital expenditure plans as set out in section 2 indicate if borrowing is required.

3.2 Table 8 shows the actual external debt (the treasury management operations), compared against the underlying capital borrowing need (the Capital Financing Requirement - CFR), highlighting any over or under borrowing.

Table 8: Gross Debt compared with Capital Financing Requirement (CFR)

	2013/14 £m Actual	2014/15 £m Estimate	2015/16 £m Estimate	2016/17 £m Estimate	2017/18 £m Estimate
External Debt					
Debt at 1 April	91.717	94.717	95.717	103.479	103.479
Expected change in debt	3.000	1.000	7.762	-	-
Other long term liabilities at 1 Apr	-	-	-	-	-
Actual Gross Debt at 31 March	94.717	95.717	103.479	103.479	103.479
Capital Financing Requirement	95.549	95.549	104.311	104.311	104.311
Under / (over) borrowing	0.832	-0.168	0.832	0.832	0.832

3.3 Within the prudential indicators, there are a number of key indicators to ensure that the Council operates its activities within well-defined limits.

One of these is that the Council needs to ensure that its gross debt does not, except in the short term, exceed the total of the CFR in the preceding year plus the estimates of any additional CFR for 2015/16 and the following two financial years. This allows some flexibility for limited early borrowing for future years, but ensures that borrowing is not for revenue purposes.

3.4 The Strategic Head (Finance & Business Services) reports that the Council complied with this prudential indicator in the current year and does not expect any breaches up to and including financial year 2017-18. This view takes into account current commitments, existing plans, and the proposals in this budget report.

3.5 There are two Treasury indicators set which limit external debt. The operational boundary is the limit that external debt should not normally exceed. If external debt were to exceed this figure then it should prompt an internal investigation to establish the reasons why the breach had occurred.

Table 9: Operational Boundary

Operational Boundary	2014/15 £m Estimate	2015/16 £m Estimate	2016/17 £m Estimate	2017/18 £m Estimate
Debt	104	108	112	112
Other Long Term Liabilities	-	-	-	-
Total	104	108	112	112

3.6 The Authorised Limit is set or revised by full Council, and must not be exceeded. It represents the level of debt that is unsustainable in the longer term. It is the statutory limit determined under section 3 (1) of the Local Government Act 2003. The Government retains an option to control local government borrowing in total or for specific councils. This power has not been used to date.

3.7 The Council is asked to approve the following Authorised Limit:

Table 10: Authorised Limit for External Debt

Authorised Limit	2014/15 £m Estimate	2015/16 £m Estimate	2016/17 £m Estimate	2017/18 £m Estimate
Debt	110	114	118	118
Other Long Term Liabilities	-	-	-	-
Total	110	114	118	118

3.8 A separate control on the Council's borrowing is a limit on the maximum HRA CFR introduced as part of HRA self-financing. This Council has some headroom to borrow over and above the self-financing settlement amount. This is set out in the next table:

Table 11: HRA Debt Limit

HRA Debt Limit	2013/14 £m Actual	2014/15 £m Estimate	2015/16 £m Estimate	2016/17 £m Estimate	2017/18 £m Estimate
Actual HRA CFR	87.980	87.980	95.742	95.742	95.742
Limit	95.742	95.742	95.742	95.742	95.742
Headroom	7.762	7.762	-	-	-

3.9 CAS are treasury advisers to the Council and part of their service is to assist the Council to formulate a view on interest rates. The following table gives the CAS forecast as at 15 January 2015.

Table 12: Interest Rate Forecast

Month	Bank Rate	PWLB Borrowing Rates		
		5 year	25 year	50 year
Mar-15	0.5	2.2	3.4	3.4
Jun-15	0.5	2.2	3.5	3.5
Sep-15	0.5	2.3	3.7	3.7
Dec-15	0.75	2.5	3.8	3.8
Mar-16	0.75	2.6	4	4
Jun-16	1	2.8	4.2	4.2
Sep-16	1	2.9	4.3	4.3
Dec-16	1.25	3	4.4	4.4
Mar-17	1.25	3.2	4.5	4.5
Jun-17	1.5	3.3	4.6	4.6
Sep-17	1.75	3.4	4.7	4.7
Dec-17	1.75	3.5	4.7	4.7
Mar-18	2	3.6	4.8	4.8

Borrowing Strategy

3.10 Currently the Council has £95.717m of borrowing, compared with a Capital Financing Requirement (CFR) of £95.549m. This means that the capital borrowing need (the CFR), is exceeded by loan debt by £0.168m. The Council borrowed £1m of PWLB at a fixed rate of 3.55% on 21 November 2014 to take advantage of particularly low rates to fund part of the borrowing requirement.

3.11 There is a limit on HRA borrowing set by the Government in the Localism Act 2011 known as the HRA debt cap. The Council's HRA debt cap is £95.742m. This cap is the absolute limit for HRA borrowing under the Prudential Code, even if the Council considers further borrowing is affordable by the HRA. The current HRA CFR is £87.980m, which means a borrowing 'headroom' of £7.762m measured against the cap, as shown by table 11.

3.12 Current HRA capital plans are borrowings of £7.762m during 2015/16. The Strategic Head (Finance & Business Services) will decide on the length and type of borrowing, as well as the optimum time to borrow in consultation with CAS, and take into account the latest projections for interest rates and other relevant factors including any benefits arising from internal borrowing.

Treasury management limits on activity

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

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

3.14 The Council is asked to approve the following treasury indicators and limits:

Table 13: Limits on interest rate exposure

Interest Rate Exposures	2014/15 Upper	2015/16 Upper	2016/17 Upper
Limits on fixed interest rates based on net debt	100%	100%	100%
Limits on variable interest rates on net debt	100%	100%	100%

Table 14: Maturity structure of borrowing

Maturity structure of new fixed and variable rate borrowing during 2015/16	Upper Limit	Lower Limit
Under 12 months	100%	0%
12 months and within 24 months	100%	0%
24 months and within 5 years	100%	0%
5 years and within 10 years	100%	0%
10 years and above	100%	0%

Table 15: Non-specified investment limit

Upper Limit for total principal sums invested for over 364 days	2013/14	2014/15	2015/16	2016/17	2017/18
Investments	£6m	£8m	£8m	£8m	£8m

Policy on borrowing in advance of need

3.15 The Council will not borrow more than, or in advance of, need purely in order to profit from the investment of the extra sums borrowed. Any decision to borrow in advance will be within approved Capital Financing Requirement estimates as required by the Prudential Code (see paragraph 3.3). Decisions to borrow will seek to ensure value for money and security of funds.

3.16 In determining whether borrowing will be undertaken in advance of need the Council will, in addition to consulting with CAS;

- ensure the ongoing revenue liabilities created, and the implications for the future plans and budgets have been fully considered;
- evaluate the economic and market factors that might influence the manner and timing of any decision to borrow;
- consider the merits and demerits of alternative forms of funding;
- consider the alternative interest rate bases available, the most appropriate periods to fund and repayment profiles to use;
- consider the impacts of borrowing in advance of need, such as temporarily increasing investment cash balances and the resulting increase in exposure to counterparty risk.

3.17 Risks associated with any borrowing in advance will be subject to prior appraisal and subsequent reporting through the mid-year or annual reports.

Debt rescheduling

3.18 Now that the Council has £95.717m of long-term debt, the Strategic Head (Finance & Business Services) will keep under review opportunities for debt rescheduling. Debt rescheduling is reported to Council at the next meeting after it occurs.

4. ANNUAL INVESTMENT STRATEGY

Investment Policy

4.1 The Council will have regard to the DCLG's Guidance on Local Government Investments ("the Guidance") issued in March 2004, any revisions to that guidance such as the March 2010 revision, and the 2011 revised CIPFA Treasury Management in Public Services Code of Practice and Cross Sectoral Guidance Notes ("the CIPFA Treasury Management Code"). The Council's investment priorities in order are:

1) security of capital
2) liquidity of investments
3) rate of return

4.2 In accordance with the above, and in order to minimise the risk to investments, the Council has below clearly stipulated the minimum acceptable credit quality of counterparties for inclusion on the lending list. The creditworthiness methodology used to create the counterparty list fully accounts for the ratings, watches and outlooks published by all three ratings agencies with a full understanding of what the ratings mean for each agency. CAS's bank ratings service enables real-time monitoring of a bank's rating. Daily emails are sent to the Council to notify of any significant change to a bank rating.

4.3 Further, the Council's officers recognise that ratings should not be the sole determinant of the quality of an institution and that it is important to continually assess and monitor the financial sector. Assessment will also take account of information reflecting the opinion of the markets. To this end the Council will engage with its advisors to maintain a monitor on market pricing such as “credit default swaps” (CDS). Other information sources used will include the financial press, share price and other such information about the banking sector in order to establish the most robust scrutiny process on the suitability of potential investment counterparties.

4.4 The intention of the strategy is to provide security of investment and minimisation of risk.

4.5 The Council will also aim to achieve the optimum return on its investments commensurate with proper levels of security and liquidity. The risk appetite of this Council is low in order to give priority to security of investments.

4.6 Borrowing of monies purely to invest or on-lend and make a return is unlawful and this Council will not engage in such activity.

4.7 ‘Specified’ and ‘Non-Specified’ Investments categories identify investment instruments for use during the financial year.

Specified Investments

4.8 All specified investments will be sterling denominated, with maturities up to 1 year (including any forward deal time), subject to CAS’s colour coding rating system as set out in creditworthiness policy paragraphs 4.16 – 4.22.

Table 16: Specified Investments

Type of Investment	Minimum 'High' Credit Criteria	Max Sum per institution / group
Debt Management Agency Deposit Facility	*	£40m
Term deposits – local authorities	*	£8m
Term deposits – banks and building societies	Part-nationalised banks[a]	50% or £12m per group whichever is greater
Term deposits – banks and building societies	Colour coded as per Sector Weekly counterparty listing (AAA countries & UK only)	£8m
UK Government Gilts	*	£12m
Bonds issued by multilateral development banks	*	£8m
Bonds issued by a financial institution which is guaranteed by the UK government	*	£8m
Treasury Bills	*	£12m
Certificates of deposits issued by banks and building societies	Colour coded as per Sector Weekly counterparty listing (AAA countries & UK only)	£8m
Money Market Funds	Fitch AAA mmf or Moodys Aaa mf or S&P AAAm	£4m per MMF & £12m total in MMFs

[a] Lloyds Banking Group plc (Bank of Scotland plc and Lloyds TSB Bank plc) and Royal Bank of Scotland Group plc (National Westminster Bank plc, The Royal Bank of Scotland plc and Ulster Bank Ltd).

Non-Specified Investments

4.9 All investments will be sterling denominated.

Table 17: Non-specified Investments - Maturities in excess of 1 year

Financial instrument / institution	Minimum Credit Criteria	Max. maturity period	Max. Sum**
Term deposits – banks and building societies	Colour coded as per Sector Weekly counterparty listing (AAA countries & UK only)	3 years	£8m
Certificates of deposits issued by banks and building societies	Colour coded as per Sector Weekly counterparty listing (AAA countries & UK only)	3 years	£8m
Property Funds	***	25 years	£3m
Corporate Bonds	AA-	3 years	£3m
UK Local Authorities	*	3 years	£8m
UK Government Gilts	*	3 years	£8m
Bonds issued by multilateral development banks	*	3 years	£8m
Bonds issued by a financial institution which is guaranteed by the UK government	*	3 years	£8m

* Government institutions have the highest security, although they are not formally rated.
** A maximum sum refers to the combined total of specified and non-specified investments with a particular bank (except for part-nationalised banks where the maximum applies only to non-specified investments, subject to the overall 50% group limit).
*** Any investment would be subject to an evaluation process and a report to Strategy and Resources Committee.

4.10 Under the Local Authority Mortgage Scheme (LAMS) as per Cabinet report 15 December 2011 the Council has a 5-year deposit of £1m with Lloyds bank. This £1m LAMS investment is a service investment, rather than a treasury management investment, and is therefore outside of the Specified and Non-Specified investment categories where there is a 3-year limit for banks.

Investment Strategy

4.11 Cash flow forecast requirements and the outlook for short-term interest rates are important factors considered when making investments. During 2014 interest rates have fallen sharply, and the number of available counter-parties has remained limited. CAS advice is to invest for no more than a year with UK banks that are sufficiently highly rated, although there are some overseas bank where longer investments are permitted.

Increasingly the Council investments during 2014 have been up to a year with highly rated banks and government supported banks because there are now few attractive call rates on offer.

4.12 In 2015-16 the Council will continue to invest for the longest permitted duration with quality counterparties to maximise return without compromising security. In particular instances the Strategic Head (Finance & Business Services) will authorise UK investments in excess of a year for example to take advantage of enhanced interest rates on Lloyds 366-day notice deposit. Otherwise, the length of investments permitted will vary if necessary in line CAS advice subject to the Council's 3-year upper limit.

Table 18: Investments maturing after the end of the current financial year.

Financial Institution	Amount £	Maturity	Rate
Bank of Scotland	2,000,000	10/04/2015	0.95%
Bank of Scotland	2,000,000	15/05/2015	0.98%
Standard Chartered Bank Certificate of Deposit	1,000,000	05/06/2015	0.66%
Lloyds	2,000,000	03/07/2015	0.95%
RBS Certificate of Deposit	2,000,000	17/07/2015	1.01%
Lloyds	2,000,000	03/07/2015	0.95%
Lloyds	2,000,000	13/11/2015	1.00%

4.13 Bank Rate has been unchanged at 0.5% since March 2009. Bank Rate is forecast to commence rising in quarter 4 of 2015.

4.14 The Council will primarily make short-dated deposits of up to a year with appropriately rated banks or UK local authorities rather than utilising call accounts or money market funds in order to maximise interest. Transaction costs will be taken into account in any investment decision for smaller sums, which means balances of up to £1m may be retained in lower interest rate, but transaction cost free, accounts for short periods when this is cost-efficient.

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

Creditworthiness policy

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

- credit watches and credit outlooks from credit rating agencies;
- CDS spreads to give early warning of likely changes in credit ratings;
- sovereign ratings to select counterparties from only the most creditworthy countries.

4.17 This modelling approach combines credit ratings, credit watches and credit outlooks in a weighted scoring system which is then combined with an overlay of CDS spreads for which the end-product is a series of colour coded bands which indicate the relative creditworthiness of counterparties. These colour codes are used by the Council to determine the suggested duration for investments. The Council will therefore use counterparties within the following durational bands:

- **Yellow** 3 years
- **Dark pink** 3 years
- **Light pink** 3 years
- **Purple** 2 years
- **Blue** 1 year (only applies to nationalised or semi nationalised UK Banks)
- **Orange** 1 year
- **Red** 6 months
- **Green** 100 days
- **No colour** not to be used

4.18 This creditworthiness service uses a wider array of information than just primary ratings and by using a risk weighted scoring system, does not give undue preponderance to just one agency's ratings.

4.19 Typically the minimum credit ratings criteria the Council use will be a short term rating (Fitch or equivalents) of short term rating F1, long term rating A-, viability rating of A-, and a support rating of 1. There may be occasions when the counterparty ratings from one rating agency are marginally lower than these ratings, but may still be used. In these instances consideration will be given to the whole range of ratings available, or other topical market information, to support their use.

4.20 All credit ratings will be monitored prior to making an investment decision. The Council is alerted to changes to ratings of all three agencies through its use of the CAS creditworthiness service.

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

4.21 The Council will not place sole reliance on the use of this external service. In addition this Council will use market data and information on government support for banks and the credit ratings of particular countries.

Country limits

4.22 The Council has determined that it will only use approved counterparties outside of the UK from countries with a minimum sovereign credit rating of AAA from Fitch Ratings (or equivalent from other agencies if Fitch does not provide). Investment in any one country outside the UK will be limited to £8m. Below is a list of AAA-rated countries as at the date of this report.

Australia	Germany	Singapore
Canada	Luxembourg	Sweden
Denmark	Norway	Switzerland

5. MISCELLANEOUS TREASURY ISSUES

Use of external service providers

5.1 Capita Asset Services (CAS), formerly Sector, are the Council's treasury management advisers. As responsibility for treasury management decisions remains with the Council at all times, undue reliance will not be placed upon our external treasury management advisers.

5.2 From 1 October 2012, the Council agreed a contract renewal with CAS for 3 years, with an option to extend for 1 year.

Tender for Banking Services

5.3 The current contract for banking services expires on 31 March 2015. A tender process is underway and subject to contract the Council will appoint NatWest to continue as bankers until 31 March 2025, with an option to extend for a further 5 years.

Icelandic bank investment

5.4 Following a decision by the Icelandic Supreme Court to uphold the Council's status as a priority creditor, during March 2012 there was a distribution in a basket of currencies. An Icelandic Kroner amount equivalent to £667k is compulsorily retained in an escrow account in Iceland earning 4.2% interest, due to controls affecting the Icelandic currency.

Member Training

5.5 The CIPFA Code requires the provision of adequate training for members by the Section 151 officer. CAS provided training open to all members 21 October 2014 and 21 January 2015. Training is necessary to enable Audit and Standards Committee members to fulfil their role more effectively.

INVESTMENTS AS AT 8 JANUARY 2015

Counterparty	**£**	**%**	**S / NS**	**Type**	**Issue**	**Maturity**
NatWest Treasury Reserve	249,751	0.25%	S	Call		
RBS CD	2,000,000	1.01%	S	Fixed	18/07/2014	17/07/2015
RBS Deposit Account	7,425	0.25%	S	Call		
NatWest/RBS GroupTotal	**2,257,176**					
Federated Prime Rate	3,813,149	0.45%	S	Call		
Ignis	647,005	0.42%	S	Call		
Money Market Fund Total	**4,460,154**					
Santander	**5,959,000**	0.80%	S	Call		
Standard Chartered Bank	**1,000,000**	0.66%	S	Fixed	05/12/2014	05/06/2015
Bank of Scotland	2,000,000	0.70%	S	Fixed	17/07/2014	19/01/2015
Bank of Scotland	2,000,000	0.98%	S	Fixed	14/05/2014	15/05/2015
Bank of Scotland	2,000,000	0.95%	S	Fixed	10/04/2014	10/04/2015
Lloyds	1,000,000	0.57%	S	Fixed	18/12/2014	18/03/2015
Lloyds	2,000,000	0.95%	S	Fixed	03/07/2014	03/07/2015
Lloyds	2,000,000	1.00%	S	Fixed	14/11/2014	13/11/2015
Lloyds/BOS Group Total	**11,000,000**					
Barclays FIBCA	4,959,016	0.55%	S	Call		
Barclays	1,000,000	0.61%	S	Fixed	04/09/2014	04/03/2015
Barclays FIBCA	**5,959,016**					
TOTAL INVESTMENTS	**30,635,346**					

S = Specified Investment - less than 1 year
NS = Non-specified investment - 1 year and over

The Council has £0.667m held in an escrow account in Glitnir bank in Iceland. The amount is held in Icelandic Kroner and is earning and interest rate of 4.2%. This amount will be repaid to the Council when currency controls have been lifted.

EXPLANATION OF PRUDENTIAL INDICATORS

Central government control of borrowing was ended and replaced with Prudential borrowing by the Local Government Act 2003. Prudential borrowing permits local government organisations to borrow to fund capital spending plans provided they can demonstrate their affordability. Prudential indicators are the means to demonstate affordability.

Capital expenditure – table 1 shows last year's capital expenditure, this year's projected capital expenditure and the approved programme until 2017/18.

Ratio of financing costs to net revenue stream – table 5 shows that the General Fund receives an income from the investment of balances, whilst HRA self financing means that interest on net borrowing now accounts for between 14.16% and 16.01% of net revenue.

Net borrowing need – table 2 shows borrowing planned to fund the capital programme.

Capital financing requirment (CFR) as at 31 March – table 3 shows the CFR which is the council's underlying need to borrow for capital purposes as determined from the balance sheet. Table 8 shows the overall CFR is £95.549m. As the Council has borrowing of £95.717m the balance sheet shows there is over borrowing of £0.168m.

HRA debt limit – table 11 shows the absolute limit for HRA indebtedness which is measured against the HRA CFR. This shows that the HRA has borrowing 'headroom' of £95.742m - £87.980m = £7.762m.

Incremental impact of capital investment decisions – increase in Council Tax (band D) per annum – table 6 shows the effect of the latest capital programme report on annual council tax. This indicator is based on the estimated decrease or increase in interest payable to or by the General Fund each year due to the changed funding of the capital programme in the latest capital report to January 2015 Strategy and Resources as compared with the previous capital report in June 2014.

Incremental impact of capital investment decisions – increase in average housing rent per week – table 7 shows the effect of the latest capital programme report on weekly housing rent. This indicator is based on the estimated decrease or increase in interest payable to or by the HRA each year due to the changed funding of the capital programme in the latest capital report to January 2015 Strategy and Resources as compared with the previous capital report in June 2014.

Authorised limit for external debt - table 10 shows the maximum limit for external borrowing. This is the statutory limit determined under section 3(1) of the Local Government Act 2003. This limit is set to allow sufficient headroom for day to day operational management of cashflows.

Operational boundary for external debt – table 9 shows the more likely limit to the level of external debt that may be required for day to day cashflow.

Upper limit for fixed and variable interest rate exposure – table 13 shows these limits that allow the Council flexibility in its investment and borrowing options.

Upper limit for total principal sums invested for over 364 days – table 15 shows the amount it is considered can be prudently invested for period in excess of a year.

Economic Background

UK. Strong UK GDP quarterly **growth** of 0.7%, 0.8% and 0.7% in quarters 2, 3 and 4 respectively in 2013, (2013 annual rate 2.7%), and 0.7% in Q1, 0.9% in Q2 and a first estimate of 0.7% in Q3 2014 (annual rate 3.1% in Q3), means that the UK will have the strongest rate of growth of any G7 country in 2014. It also appears very likely that strong growth will continue through the second half of 2014 and into 2015 as forward surveys for the services and construction sectors are very encouraging and business investment is also strongly recovering. The manufacturing sector has also been encouraging though recent figures indicate a weakening in the future trend rate of growth. However, for this recovery to become more balanced and sustainable in the longer term, the recovery needs to move away from dependence on consumer expenditure and the housing market to exporting, and particularly of manufactured goods, both of which need to substantially improve on their recent lacklustre performance.

This overall strong growth has resulted in **unemployment** falling much faster through the initial threshold of 7%, set by the **Monetary Policy Committee (MPC)** last August, before it said it would consider any increases in Bank Rate. The MPC has, therefore, subsequently broadened its forward guidance by adopting five qualitative principles and looking at a much wider range of about eighteen indicators in order to form a view on how much slack there is in the economy and how quickly slack is being used up. The MPC is particularly concerned that the current squeeze on the disposable incomes of consumers should be reversed by wage inflation rising back above the level of inflation in order to ensure that the recovery will be sustainable. There also needs to be a major improvement in labour productivity, which has languished at dismal levels since 2008, to support increases in pay rates. Most economic forecasters are expecting growth to peak in 2014 and then to ease off a little, though still remaining strong, in 2015 and 2016. Unemployment is therefore expected to keep on its downward trend and this is likely to eventually feed through into a return to significant increases in pay rates at some point during the next three years. However, just how much those future increases in pay rates will counteract the depressive effect of increases in Bank Rate on consumer confidence, the rate of growth in consumer expenditure and the buoyancy of the housing market, are areas that will need to be kept under regular review.

Also encouraging has been the sharp fall in **inflation** (CPI) during 2014 after being consistently above the MPC's 2% target between December 2009 and December 2013. Inflation fell to 1.2% in September, a five year low. Forward indications are that inflation is likely to fall further in 2014 to possibly near to 1% and then to remain near to, or under, the 2% target level over the MPC's two year ahead time horizon. Overall, markets are expecting that the MPC will be cautious in raising **Bank Rate** as it will want to protect heavily indebted consumers from too early an increase in Bank Rate at a time when inflationary pressures are also weak. A first increase in Bank Rate is therefore expected in Q2 2015 and they expect increases after that to be at a slow pace to lower levels than prevailed before 2008 as increases in Bank Rate will have a much bigger effect on heavily indebted consumers than they did before 2008.

The return to strong growth has also helped lower forecasts for the increase in **Government debt** by £73bn over the next five years, as announced in the 2013 Autumn Statement, and by an additional £24bn, as announced in the March 2014 Budget - which also forecast a return to a significant budget surplus, (of £5bn), in 2018-19. However, monthly public sector deficit figures have disappointed so far in 2014/15.

The Eurozone (EZ). The Eurozone is facing an increasing threat from weak or negative growth and from deflation. In September, the inflation rate fell further, to reach a low of 0.3%. However, this is an average for all EZ countries and includes some countries with negative rates of inflation. Accordingly, the ECB took some rather limited action in June to loosen monetary policy in order to promote growth. In September it took further action to cut its benchmark rate to only 0.05%, its deposit rate to -0.2% and to start a programme of purchases of corporate debt. However, it has not embarked yet on full quantitative easing (purchase of sovereign debt).

Concern in financial markets for the Eurozone subsided considerably during 2013. However, sovereign debt difficulties have not gone away and major issues could return in respect of any countries that do not dynamically address fundamental issues of low growth, international uncompetitiveness and the need for overdue reforms of the economy, (as Ireland has done). It is, therefore, possible over the next few years that levels of government debt to GDP ratios could continue to rise for some countries. This could mean that sovereign debt concerns have not disappeared but, rather, have only been postponed. The ECB's pledge in 2012 to buy unlimited amounts of bonds of countries which ask for a bailout has provided heavily indebted countries with a strong defence against market forces. This has bought them time to make progress with their economies to return to growth or to reduce the degree of recession. However, debt to GDP ratios (2013 figures) of Greece 180%, Italy 133%, Portugal 129%, Ireland 124% and Cyprus 112%, remain a cause of concern, especially as some of these countries are experiencing continuing rates of increase in debt in excess of their rate of economic growth i.e. these debt ratios are likely to continue to deteriorate. Any sharp downturn in economic growth would make these countries particularly vulnerable to a new bout of sovereign debt crisis. It should also be noted that Italy has the third biggest debt mountain in the world behind Japan and the US. Greece remains particularly vulnerable but has made good progress in reducing its annual budget deficit and in returning, at last, to marginal economic growth. Whilst a Greek exit from the Euro is now improbable in the short term, some commentators still view the inevitable end game as either being another major write off of debt or an eventual exit.

There are also particular concerns as to whether democratically elected governments will lose the support of electorates suffering under EZ imposed austerity programmes, especially in countries like Greece and Spain which have unemployment rates of over 24% and unemployment among younger people of over 50 – 60%. There are also major concerns as to whether the governments of France and Italy will effectively implement austerity programmes and undertake overdue reforms to improve national competitiveness. Any loss of market confidence in the two largest Eurozone economies after Germany would present a huge challenge to the resources of the ECB to defend their debt.

USA. The Federal Reserve started to reduce its monthly asset purchases of $85bn in December 2013 by $10bn per month; these ended in October 2014, signalling confidence the US economic recovery would remain on track. First quarter GDP figures for the US were depressed by exceptionally bad winter weather, but growth rebounded very strongly in Q2 to 4.6% (annualised). The first estimate of Q3 showed growth of 3.5% (annualised). Annual growth during 2014 is likely to be just over 2%.
The U.S. faces similar debt problems to those of the UK, but thanks to reasonable growth, cuts in government expenditure and tax rises, the annual government deficit has been halved from its peak without appearing to do too much damage to growth, although the weak labour force participation rate remains a matter of key concern for the Federal Reserve when considering the amount of slack in the economy and monetary policy decisions. It is currently expected that the Fed. will start increasing rates in mid 2015.

China. Government action in 2014 to stimulate the economy appeared to be putting the target of 7.5% growth within achievable reach but recent data has been mixed. There are also concerns that the Chinese leadership have only started to address an unbalanced economy which is heavily dependent on new investment expenditure, and for a potential bubble in the property sector to burst, as it did in Japan in the 1990s, with its consequent impact on the financial health of the banking sector. There are also concerns around the potential size, and dubious creditworthiness, of some bank lending to local government organisations and major corporates. This primarily occurred during the government promoted expansion of credit, which was aimed at protecting the overall rate of growth in the economy after the Lehmans crisis.

Japan. Japan is causing considerable concern as the increase in sales tax in April 2014 has suppressed consumer expenditure and growth. In Q2 growth was -1.8% q/q and -7.1% over the previous year. The Government is hoping that this is a temporary blip.

CAPITA ASSET SERVICES FORWARD VIEW

Economic forecasting remains difficult with so many external influences weighing on the UK. Major volatility in bond yields is likely to endure as investor fears and confidence ebb and flow between favouring more risky assets i.e. equities, or the safe haven of bonds.

The overall longer run trend is for gilt yields and PWLB rates to rise, due to the high volume of gilt issuance in the UK, and of bond issuance in other major western countries. Over time, an increase in investor confidence in world economic recovery is also likely to compound this effect as recovery will further encourage investors to switch from bonds to equities.

The overall balance of risks to economic recovery in the UK is currently evenly weighted. However, only time will tell just how long this period of strong economic growth will last; it also remains exposed to vulnerabilities in a number of key areas.

The interest rate forecasts in this report are based on an initial assumption that there will not be a major resurgence of the EZ debt crisis, or a break-up of the EZ, but rather that there will be a managed, albeit painful and tortuous, resolution of the debt crisis where EZ institutions and governments eventually do what is necessary - but only when all else has been tried and failed. Under this assumed scenario, growth within the EZ will be tepid for the next couple of years and some EZ countries experiencing low or negative growth, will, over that time period, see an increase in total government debt to GDP ratios. There is a significant danger that these ratios could rise to the point where markets lose confidence in the financial viability of one, or more, countries, especially if growth disappoints and / or efforts to reduce government deficits fail to deliver the necessary reductions. However, it is impossible to forecast whether any individual country will lose such confidence, or when, and so precipitate a sharp resurgence of the EZ debt crisis. While the ECB has adequate resources to manage a debt crisis in a small EZ country, if one, or more, of the large countries were to experience a major crisis of market confidence, this would present a serious challenge to the ECB and to EZ politicians.

Downside risks currently include:

- The situation over Ukraine poses a major threat to EZ and world growth if it was to deteriorate into economic warfare between the West and Russia where Russia resorted to using its control over gas supplies to Europe.
- Fears generated by the potential impact of Ebola around the world
- UK strong economic growth is currently mainly dependent on consumer spending and the potentially unsustainable boom in the housing market. The boost from these sources is likely to fade after 2014.
- A weak rebalancing of UK growth to exporting and business investment causing a weakening of overall economic growth beyond 2014.
- Weak growth or recession in the UK's main trading partner - the EU, inhibiting economic recovery in the UK.
- A return to weak economic growth in the US, UK and China causing major disappointment in investor and market expectations.
- A resurgence of the Eurozone sovereign debt crisis caused by ongoing deterioration in government debt to GDP ratios to the point where financial markets lose confidence in the financial viability of one or more countries and in the ability of the ECB and Eurozone governments to deal with the potential size of the crisis.
- Recapitalisation of European banks requiring considerable government financial support.

- Lack of support by populaces in Eurozone countries for austerity programmes, especially in countries with very high unemployment rates e.g. Greece and Spain, which face huge challenges in engineering economic growth to correct their budget deficits on a sustainable basis.
- Italy: the political situation has improved but it remains to be seen whether the new government is able to deliver the austerity programme required and a programme of overdue reforms. Italy has the third highest government debt mountain in the world.
- France: after being elected on an anti austerity platform, President Hollande has embraced a €50bn programme of public sector cuts over the next three years. However, there could be major obstacles in implementing this programme. Major overdue reforms of employment practices and an increase in competiveness are also urgently required to lift the economy out of stagnation.
- Monetary policy action failing to stimulate sustainable growth in western economies, especially the Eurozone and Japan.
- Heightened political risks in the Middle East and East Asia could trigger safe haven flows back into bonds.
- There are also increasing concerns at the reluctance of western central banks to raise interest rates significantly for some years, plus the huge QE measures which remain in place (and may be added to by the ECB in the near future). This has created potentially unstable flows of liquidity searching for yield and, therefore, heightened the potential for an increase in risks in order to get higher returns. This is a return to a similar environment to the one which led to the 2008 financial crisis.

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

- A further surge in investor confidence that robust world economic growth is firmly expected, causing a flow of funds out of bonds into equities.
- UK inflation returning to significantly higher levels than in the wider EU and US, causing an increase in the inflation premium inherent to gilt yields.

TREASURY MANAGEMENT SCHEME OF DELEGATION AND ROLE OF THE SECTION 151 OFFICER

1. Council

- Approval of annual strategy, mid-year report and outturn report

2. Audit and Standards Committee

- Receipt, review and recommendation to Council of quarterly monitoring reports
- Receipt, review and recommendation to Council of reports on treasury strategy, policy and activity

3. Section 151 Officer / Strategic Head (Finance & Business Services)

- Reviewing the treasury management policy, procedures, strategy and making recommendations to the Audit and Standards Committee;
- Approving the selection of external service providers and agreeing terms of appointment;
- Submitting regular treasury management strategy reports;
- Receiving and reviewing management information reports;
- Reviewing the performance of the treasury management function;
- Ensuring the adequacy of treasury management resources and skills, and the effective division of responsibilities within the treasury management function;
- Ensuring the adequacy on internal audit and liaising with external audit.

STROUD DISTRICT COUNCIL

AUDIT & STANDARDS COMMITTEE

3 FEBRUARY 2015

AGENDA ITEM NO

10

Report Title	**INTERNAL AUDIT & RISK MANAGEMENT SHARED SERVICE**
Purpose of Report	1) To provide the background and rationale underlying the proposals to form an Internal Audit and Risk Management Shared Service between Stroud District Council, Gloucester City Council, and Gloucestershire County Council. 2) To seek authority to delegate this Council's Internal Audit Function to Gloucestershire County Council in accordance with the provisions of Section 101 of the Local Government Act 1972, Sections 19 and 20 of the Local Government Act 2000 and all other enabling powers.
Decision(s)	1) Audit & Standards Committee is asked to note the information contained in the report and make any recommendations to Council. 2) The Committee RECOMMENDS to Council that it be resolved to: (1) Have a Shared Internal Audit and Risk Management Service ("the Service") with effect from 1 April 2015 (or such other date as is agreed between the Council, Gloucester City Council and Gloucestershire County Council) as outlined in the report, SUBJECT TO: (a) the entering into of an Administrative Collaboration Agreement for the Service with the partner authorities on terms approved by the Strategic Head (Finance and Business Services); and (b) the formation of an Internal Audit and Risk Management Shared Services Board involving the Section 151 officers from each of the participating authorities, to oversee the implementation and ongoing monitoring of the Service;

	Delegate its Internal Audit Function to Gloucestershire County Council in accordance with the provisions of Section 101 of the Local Government Act 1972.
Consultation and Feedback	The audit teams of the three partnership authorities have been made aware of the proposed shared service and have been kept informed of progress to date.
Financial implications and Risk Assessment	Opportunities for financial savings during 2015/2016 are limited given the transition phase required. Any costs associated with transition will be shared between the three authorities, as agreed by the s151 Officers, and will be contained within existing budgets. The restructure and rationalisation of processes and procedures will be completed by the end of 2015/16 and therefore a minimum 3% savings target has been identified for 2016/17 across partners. This is within the context of continuing to deliver a quality, professional service. An investment in training is essential to the recruitment and retention of staff. The Shared Service would be expected to continue to focus on opportunities for further efficiencies. <u>Risk Assessment</u> The main risk to the Council is the loss of control by delegating its functions to a host authority. In order to address this, a Shared Services Partnership Board would need to be created: it would comprise the s151 officers (or duly authorised senior financial representative) in each Council to oversee the implementation of the s101 Agency Agreement, quality, performance, risks and consider major changes to the service. In addition, to mitigate the risk of pension liabilities to the host authority, the s101 Agreement would specify that, up to the date of transfer, all pension liabilities remain with the originating authority and they would not be transferred to the host authority. Sandra Cowley Strategic Head (Finance & Business Services) Tel: 01453 754136 Email: sandra.cowley@stroud.gov.uk

Legal Implications	The Committee need not resolve to note the report (i.e. decision 1), but if it wishes to proceed with the proposed service arrangements, it will need to recommend to Council as per paragraph 2(1) and in particular 2(2) of the decision box. The effect of these proposed decisions is to permit the performance of the Council's internal audit work (currently by Gloucester City Council) by the County Council and requires a termination of the existing arrangements. The new agreement between the proposed partners which will complement the Council's decision to exercise its powers under Section 101 Local Government Act 1972, should address various issues as well as those to which the report refers (e.g. the quality of the service required to be provided to the Council; and any agreed potential financial liabilities which the Council will incur should staff not be required by the new service provider (which could be nil for the Council) or should the Council exercise its discretion in future to return the function to Council control, bearing in mind that the Council does not currently employ any audit staff, all such staff being that of Gloucester City Council). All such terms and conditions will need to be approved as per decision box paragraph 2(1)(a). Karen Trickey, Legal Services Manager Tel: 01453 754369 Email:karen.trickey@stroud.gov.uk
Report Author	Sandra Cowley Strategic Head (Finance & Business Services) Tel: 01453 754136 Email: sandra.cowley@stroud.gov.uk
Options	The alternative options identified and considered for the provision of Internal Audit Services, are as follows: a) No Change This option was considered. However, the Internal Audit and Risk Management services at all three Councils have limited capacity and resilience to respond to peaks in demand, increased irregularity work and absence of staff. There are limited opportunities for progression and training within the current audit and risk teams, which is not beneficial to staff morale and/or a quality service being sustained. b) Outsourcing

	Research has identified that the large accountancy firms do not have the appetite for taking on Local Authority Internal Audit services due to the pension liabilities associated with TUPE transfers. The Councils concerned would be duty bound to ensure ongoing pension protection for the transferring staff outsourced under TUPE, under the Local Government Pensions Direction 2007. This would entail any prospective bidder either offering continued and ongoing membership of the Local Government Pension Scheme under an admissions agreement or a broadly comparable scheme certified as such by the Government Actuary's Department (GAD). Both of these options would involve employer contribution rates from the contractors in line with, if not more than, the current employer rates being paid by the County and the District Councils. This would clearly inflate their bid price and the cost per audit day would be significantly higher than is currently paid. c) Other Partnerships A growing number of Internal Audit Partnerships are being set up around the country as the benefits of doing so are realised. They vary in scale and membership. Some benchmark costs were obtained for comparison and it was established that the partnership would benchmark in the bottom quartile. The option to join other partnerships cannot be ruled out. Equally, to continue to grow the Gloucestershire shared service arrangement is also an option that can be pursued once the new shared service has been established.
Performance Management Follow Up	It is proposed that, with effect from 1 April 2015, new arrangements are developed and implemented. This will include a review of the management arrangements for the new shared service, the development of a new structure, implementation of the structure and review of processes and procedures to deliver efficiencies. This restructure and rationalisation of processes and procedures will be completed by the end of 2015/16. This detailed review will ensure that the revised structure delivers the most effective outcome for each authority and will deliver a minimum 3% savings target from 2016/17 across partners.
Background Papers/ Appendices	Sharing the Gain, Collaborating for Cost Effectiveness – CIPFA 2010

1.0 Background and Key Issues

1.1 "A range of factors are forcing councils to think of new approaches to the delivery of both front-line and back-office services. These include external drivers (particularly government policies, grant settlements and customer expectations) as well as internal pressures, such as improving service quality, bringing down costs, attracting skilled staff, and accessing best practice techniques and technologies" – *Sharing the Gain, Collaborating for Cost Effectiveness – CIPFA 2010.*

1.2 In responding to this challenge, public service leaders and managers will need to consider radical changes to their organisational structures and operating models. One option they will need to explore is whether greater collaboration with other bodies offers a route to reducing costs while maintaining service quality.

1.3 Stroud District Council (SDC), Gloucester City Council (GCC), and Gloucestershire County Council (Glos CC) are all committed to improved service delivery and efficiency within their respective Councils.

1.4 SDC's Corporate Delivery Plan for 2014-18 sets out five key tasks, one of which is to "provide value for money to our taxpayers and high quality services to our customers". Achieving this will include redesigning services and innovation.

1.5 GCC's Council Plan 2014-2017 sets out four priorities, one of which is "sound finances and strong performance". One of the key measures within this priority is savings delivered through joint and collaborative working.

1.6 Glos CC's Council Strategy 2011-15 (2014/15 update): "Meeting the Challenge" sets out three council values, one of which is "living within our means". This will be achieved by being as efficient as possible, saving money by joining up with partners, and by finding the best, most efficient, way of delivering services which satisfy customers.

2.0 The Rationale for Change

2.1 Discussions have taken place over many years between the various Councils within Gloucestershire regarding the benefits of joint working between the authorities' respective internal audit teams.

2.2 Following the successful partnering agreement for the management of the internal audit team in Stroud which had been in place for the preceding 15 months, in December 2010 SDC and GCC entered into a formal shared internal audit service for the provision of an internal audit service to both Councils.

2.3 Known as ***G A A P*** (Gloucestershire Audit & Assurance Partnership) the service is hosted by Gloucester City Council, and is managed by the City

Council's Audit, Risk & Assurance Manager. Both Councils agree that the shared service arrangement is a success with the sharing of audit skills between the two teams and the development of a common audit approach and documentation.

2.4 Due to the success of the current internal audit shared service arrangements between SDC and GCC, the s151 Officers of SDC, GCC and Glos CC agreed to consider extending the current shared service arrangement to include Glos CC and review the opportunities available to:

- Formally share internal audit and risk management services between the three Councils; and
- Bring the management of an extended shared service under one manager

3.0 Proposed Shared Service Arrangements

3.1 Governance Arrangements

3.1.1 The recommended option for the delivery of the shared service is via a Delegated Function Model. Under this option, one Council (the Lead Authority) undertakes the functions of another Council under delegated powers set out in an Administrative Collaboration Agreement entered into under s101 Local Government Act 1972 ("s101 Agreement"). The Lead Authority employs all staff (i.e. staff who work for the Council which has delegated its functions to the Lead Authority, transfer to the Lead Authority).

3.1.2 This option is recommended for the following reasons:

- It has a proven track record through benchmarking for delivering services between Councils. Examples include the current Audit & Assurance partnership in operation between Gloucester City Council and Stroud District Council; Devon Audit Partnership (Devon County Council, Plymouth City and Torbay Council); and The Southern Internal Audit Partnership (Hampshire County Council, Southampton City Council and West Sussex County Council); and

- It is relatively straightforward to set up, in that it only requires a s101 Agreement to be prepared and implemented and staff to TUPE to the Lead Authority.

3.1.3 The main risk to the Council is the loss of control by delegating its functions to a host authority. In order to address this, a Shared Services Board would need to be created comprising of the s151 officers (or duly authorised senior financial representative) in each Council to oversee the implementation of and delivery of the function under the s101 Agreement, quality, performance, risks and consider major changes to the service.

3.1.4 In addition, to mitigate the risk of pension liabilities to the host authority, the s101 Agreement would specify that up to the date of transfer, all pension liabilities remain with the originating authority and that they would not be transferred to the host authority.

3.2 Recommended Shared Services Framework

3.2.1 The main driver behind the sharing of back office services such as Internal Audit & Risk Management is, essentially, to produce efficiency savings but, importantly, also to improve business resilience.

3.2.2 It is recommended that Glos CC becomes the host authority under a section 101 Agreement with effect from 1 April 2015. The duration of the agreement will be for a three year period initially (from the commencement date) and shall continue in force thereafter, unless and until one year's notice in writing is given by any of the Councils to withdraw from the agreement.

3.2.3 As a result of the above recommendation, the IA staff based at SDC and GCC (i.e. 6.6 FTE staff) will be transferred, under TUPE arrangements, to Glos CC from the commencement date of the Agreement. During most of the first year of operation, i.e. 2015/2016, all of the three councils' audit staff will remain within their existing organisational structures and work bases and will retain their existing roles and responsibilities.

3.2.4 It is proposed that, with effect from 1 April 2015, new arrangements are developed and implemented. This will include a review of the management arrangements for the new shared service, development of a new structure, implementation of the structure and review of processes and procedures to deliver efficiencies. This restructure and rationalisation of processes and procedures will be completed by the end of 2015/16.

3.2.5 This detailed review will ensure that the revised structure delivers the most effective outcome for each authority and will deliver a minimum 3% savings target from 2016/17 across partners.

3.3 The Key Benefits for Change

3.3.1 It is felt that the shared service proposal represents a real opportunity across the three authorities, namely:

- Economies of scale from the employment of a single Chief Internal Auditor across the three authorities;
- Pooling of expertise to strengthen business delivery to the benefit of the clients;
- Provision of a critical mass and improved business resilience e.g. enabling the risk of sickness and vacancies to be better managed;
- Enhanced ability to undertake thematic reviews across the three authorities to share best practice across the partnership;

- Enabling succession planning, career opportunities and development for staff;
- Optimising use of resources through a modern collaborative approach;
- Achieving economies of scale through shared training and procurement; and
- Benefits of adopting common day to day audit reporting and procedural approaches driven by a single Audit Management System for the shared service.

3.3.2 In addition, the following benefits have been identified from Glos CC being the host authority for the shared service:

- The Audit Management IT System used by Glos CC could be used to enable the automated management of the audit and risk functions across the shared service.
- Access to additional IT audit skills via the current ICT audit provision contract Glos CC has with a third party supplier.
- Access to additional support for the National Fraud Initiative work and investigatory work under the current agreement between Glos CC and the Gloucestershire NHS Counter Fraud Service; and
- GlosCC can offer the Partnership the expertise of IDEA, a powerful and user-friendly data analysis tool designed to help auditors and other financial professionals perform data analysis quickly to help improve audits and identify control breakdowns.