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

26 January 2018

AUDIT AND STANDARDS COMMITTEE

A meeting of the Audit and Standards Committee will be held on **TUESDAY 6 FEBRUARY 2018** in the Council Chamber, Ebley Mill, Ebley Wharf, Stroud at **7.00 pm.**

David Hagg
Chief Executive

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.

A G E N D A

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1. APOLOGIES
To receive apologies for absence

2. DECLARATIONS OF INTEREST
To receive declarations of interest

3. MINUTES
To approve the minutes of the meeting held on 28 November 2017.

4. PUBLIC QUESTION TIME
The Chair of Committee will answer questions from members of the public submitted in accordance with the Council's procedures.
DEADLINE FOR RECIEPT OF QUESTIONS
Noon on THURSDAY 1 FEBRUARY 2018
Questions must be submitted in writing to the Chief Executive, Democratic Services, Ebley Mill, Ebley Wharf, Stroud and sent by post or by Email: democratic.services@stroud.gov.uk.

5. STANDING ITEMS
(a) To consider the work programme.
(b) To receive a verbal update on Risk Management.

6. **REVIEW OF ETHICAL FRAMEWORK**
To receive a report on the establishment of a member group to undertake a review and make recommendations back to Committee.

7. **EXTERNAL AUDIT PLAN 2017/18**
To receive a verbal update from KPMG.

8. **ANNUAL REPORT ON GRANTS AND RETURNS 2016/17**
To receive a verbal update summarising the key findings from KPMG audit.

9. **INTERNAL AUDIT ACTIVITY PROGRESS REPORT 2017/18**
To inform Members of the internal audit activity progress in relation to the approved internal audit plan.

10 **ANNUAL GOVERNANCE STATEMENT 2016/17 IMPROVEMENT PLAN – PROGRESS REPORT**
To receive an update of the Council's Corporate Governance arrangements.

11 **3RD QUARTER TREASURY MANAGEMENT ACTIVITY REPORT 2017/18**
To provide an update on treasury management activity as at 31/12/2017.

12. **TREASURY MANAGEMENT STRATEGY, ANNUAL INVESTMENT STRATEGY AND MINIMUM REVENUE PROVISION POLICY STATEMENT 2018/19**
To consider the Council's prudential indicators for 2018/19 – 2020/21 together with the treasury strategy for this period and make recommendations to Council as set out within the report.

13. **MEMBERS' QUESTIONS**
See Agenda Item 4 for deadline for submission

Members of Audit and Standards Committee

Councillor Nigel Studdert-Kennedy (Chair)
Councillor Rachel Curley (Vice Chair)
Councillor Martin Baxendale
Councillor Stephen Davies
Councillor Colin Fryer
Councillor Keith Pearson
Councillor Mark Reeves
Councillor Tom Williams
Councillor Penny Wride

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AUDIT AND STANDARDS COMMITTEE

3

28 November 2017

7.00 pm – 8.15 pm

Council Chamber, Ebley Mill, Stroud

Minutes

<u>Membership</u>

Councillor Nigel Studdert-Kennedy (Chair)	P	Councillor Keith Pearson	P
Councillor Rachel Curley (Vice-Chair)	P	Councillor Mark Reeves	P
Councillor Martin Baxendale	P	Councillor Tom Williams	A
Councillor Stephen Davies	P	Councillor Penny Wride	P
Councillor Colin Fryer	A		

A = Absent P = Present

<u>Officers in attendance</u>

Accountancy Manager and Acting Section 151 Officer
Head of Audit Risk Assurance
Head of Legal Services and Monitoring Officer
Democratic Services Officer
Principal Accountant

<u>Also present</u>
Matthew Arthur from KPMG, the Council's External Auditors.

AC.022 APOLOGIES

An apology for absence had been received from Councillor Tom Williams.

AC.023 DECLARATIONS OF INTEREST

There were none.

AC.024 MINUTES

RESOLVED That the Minutes of the meeting held on 12 September 2017, are approved as a correct record.

AC.025 PUBLIC QUESTION TIME

There were none.

AC.026 WORK PROGRAMME

The following items were added to the Work Programme:

- Regular item on Risk Management
- Review of the Audit Shared Service – September 2018
- Further update on the Local Government Pension Scheme.

RESOLVED To note the current work programme.

AC.027 REVIEW OF RISK MANAGEMENT

The Head of Legal Services presented the report which promoted effective risk management across the Council. The Audit Committee will be reviewing risk management on a regular basis.

A Task and Finish Group is reviewing performance monitoring and conclusions and recommendations will be discussed at Strategy and Resources Committee.

RESOLVED That as required by the Adopted Risk Management Policy (adopted April 2017):

1. Member Performance Monitoring Champions for each committee be requested to specifically consider as part of their regular meetings with Corporate Team officers, progress being made to effectively manage the strategic risks for which the officers are responsible.
2. The said members and / or officers be requested to report back to the Audit and Standards Committee to help in its considerations as to whether it can provide independent assurance of the adequacy and effectiveness of the risk management arrangements.

AC.028 ANNUAL AUDIT LETTER

Matthew Arthur from KPMG presented this item. The letter summarises the outcome of the audits carried out in 2016/17.

AC.029 INTERNAL AUDIT ACTIVITY PROGRESS REPORT 2017-18

The Head of Audit Risk Assurance presented this report which provided an update as to the progress made against the 2017/2018 Internal Audit Plan. Updates against the approved plan will be provided at each Committee meeting.

RESOLVED

1. To accept the progress against the Internal Audit Plan 2017/18; and
2. To accept the assurance opinions provided in relation to the effectiveness of the Council's control environment comprising risk management, control and governance arrangements as a result of the Internal Audit activity completed to date.

AC.030 LIMITED ASSURANCE – LOCAL GOVERNMENT PENSION SCHEME INTERNAL AUDIT – MANAGEMENT UPDATE

The Principal Accountant presented this report and gave a detailed update to Committee on the pension issues raised in the Internal Audit report, implications arising from the Council's additional leave scheme on employee tax and pension treatment, and training of Finance and HR staff in pension administration. He explained that the administration of payroll was taken back in house in April 2016, with pensions administration now being undertaken by Finance (previously HR after poor performance by NgA). Committee will receive further updates at future meetings.

RESOLVED To accept the report and note the progress made against the audit recommendations.

AC.031 REVIEW OF AUDIT RISK ASSURANCE (ARA) SHARED SERVICE

The Head of Audit Risk Assurance presented the report and explained the progress made against the original business case objectives of the ARA Shared Service. The reported noted that all objectives have been met.

RESOLVED To accept the report and note the progress made against the original business case objectives.

AC.032 HALF YEAR TREASURY MANAGEMENT ACTIVITY REPORT 2017/18

The Principal Accountant presented the report which provided an update on treasury management activity for the first half of the financial year.

RECOMMENDED TO COUNCIL

1. That it approves the Treasury Management Activity Half-year Report for 2017/2018, and
2. That Council **RESOLVES** to make the amendment to investment duration to 2 years for up to £3million with government supported banks, as set out in paragraph 17 of this report.

AC.033 MEMBERS' QUESTIONS

Questions were received from Councillor Norman Kay. The questions and answers have been published on the Council website.

The meeting closed at 8.15 pm.

Chair

STROUD DISTRICT COUNCIL

AUDIT AND STANDARDS COMMITTEE

6 FEBRUARY 2018

WORK PROGRAMME

AGENDA ITEM NO

5a

Proposed Meeting Date	**Report Description**	**Responsible Officer / Member**
10.04.2018	External Audit Plan 2017/18	KPMG
	Internal Audit Activity Progress Report 2017/18	Chief Internal Auditor
	Internal Audit Plan 2018/19	Chief Internal Auditor
	Annual Report of the Audit and Standards Committee (prepared by the Chairman) for agreement prior to presentation to Council	Chair
	Consideration of the Work Programme for 2018/19	Chair
Civic Year 2018/19		
17 July 2018*		
9 October 2018	Review of Audit Shared Service	Chief Internal Auditor
	Further Internal Audit Management Update – Local Government Pension Scheme	Chief Internal Auditor
29 January 2019		
7 May 2019		

Information sheets relevant to the Committee

Date sent & (Ref No)	**Topic**
1 June 2017 SR-2017/18-001	ICT Infrastructure Investment Plan 2017/18 to 2019/20
1 September 2017 AS-2017/18-001	Standards Update
5 September 2017 AS-2017/18-002	Review of Risk Management Framework
19 October 2017 AS-2017/18-003	Local Spend and Suppiers

*Committee to confirm a change of date to Thursday 26 July 2018.

STROUD DISTRICT COUNCIL

AUDIT AND STANDARDS COMMITTEE

6 FEBRUARY 2018

AGENDA ITEM NO

6

Report Title	**REVIEW OF ETHICAL FRAMEWORK**
Purpose of Report	To establish a member group which will undertake a review / audit of the Council's ethical framework and make recommendations to committee
Decision(s)	**The Committee RESOLVES to establish a task and finish group to consider member standards of conduct as outlined in the Report**
Financial Implications	The report recommends the establishment of a task and finish group to consider member standards of conduct. Whilst there are no direct financial implications arising from this report, point (d) under paragraph 2.2 does ask members to consider whether (financial) penalties should be considered if a member accepts a breach in the code of conduct. There is a cost to the Council in undertaking reviews into potential breaches of the code of conduct in terms of officer time and other expenditure that may be required. David Stanley – Accountancy Manager Tel: 01453 754100 Email: david.stanley@stroud.gov.uk
Legal Implications	Failure of the Council to meet is legal duty to promote and maintain high standards of conduct opens the Council to legal challenge as well as reputational risk.
Report Author	K Trickey, Head of Legal Services and Monitoring Officer Tel: 01453 754369 Email: karen.trickey@stroud.gov.uk

1. INTRODUCTION

1.1 The Council is subject to a duty to promote and maintain high standards of conduct amongst its members. The Council's ethical framework which exists to help meet that duty comprises:

a. the Council’s Member Code of Conduct (including its complaints procedure) which sets the overall standards of conduct required of members, and was last reviewed in 2016;

b. the Planning Code (last reviewed in 2015); and

c. the Member / Member Relations Protocol and the Member / Officer Protocol (both adopted in 2004, but apparently not reviewed since).

1.2 In recent years, changes to this ethical framework have centred around the rules for declaring interests. Other provisions regarding the general behaviour expected and required of all members set out in Part 3 of the Code and Item 1.1c above in particular, having not been reconsidered in any detail.

2. PROPOSED REVIEW

2.1 It is recommended that the committee should carry out a review / audit of the Council’s ethical framework. Given the need to seek full and frank views on the behaviour of members, a small task and finish group should be established (comprising say, two or three members experienced in advising on conduct issues) including the Chair of the Committee, with support being provided by the Monitoring Officer. Such a small and experienced group should be able to convene quickly to consider pertinent issues, seek views of key stakeholders (e.g. officers, complainants and members who have been the subject of complaints) and report back to committee in April on progress / its findings. Any recommendations from the committee on substantive changes to the Constitution (e.g. to the Code of Conduct) will need to be referred to full Council for approval.

2.2 It is suggested that the group consider a range of issues including the contents of the Code itself; the extent of member engagement in promoting and upholding high standards; and the value of the complaints process and sanctions in terms of discouraging breaches. Questions which might be investigated include:

a) What do members consider when reference is made to the Code? Is it simply interests as opposed to behaviour in a wider sense, including the key principles (e.g. integrity, honesty, respect for others) and specific obligations (e.g. not to disclose confidential information; not to bully / intimidate any person; not to bring the Council into disrepute). If so, is this a training issue; or does the Code need redrafting / strengthening in this respect?

b) The obligation not to bring the Council into disrepute within the existing Code is largely a ‘catch all’ provision, but is that sufficient to make it clear what is expected of members? For example, would it be recognised as including a situation where individuals present information knowingly in a misleading or inappropriate manner without consideration of the consequences for the Council and the wider public interest (or are reckless as to whether such is the case). Would a guide to members or more specific provisions in the Code help improve behaviour?

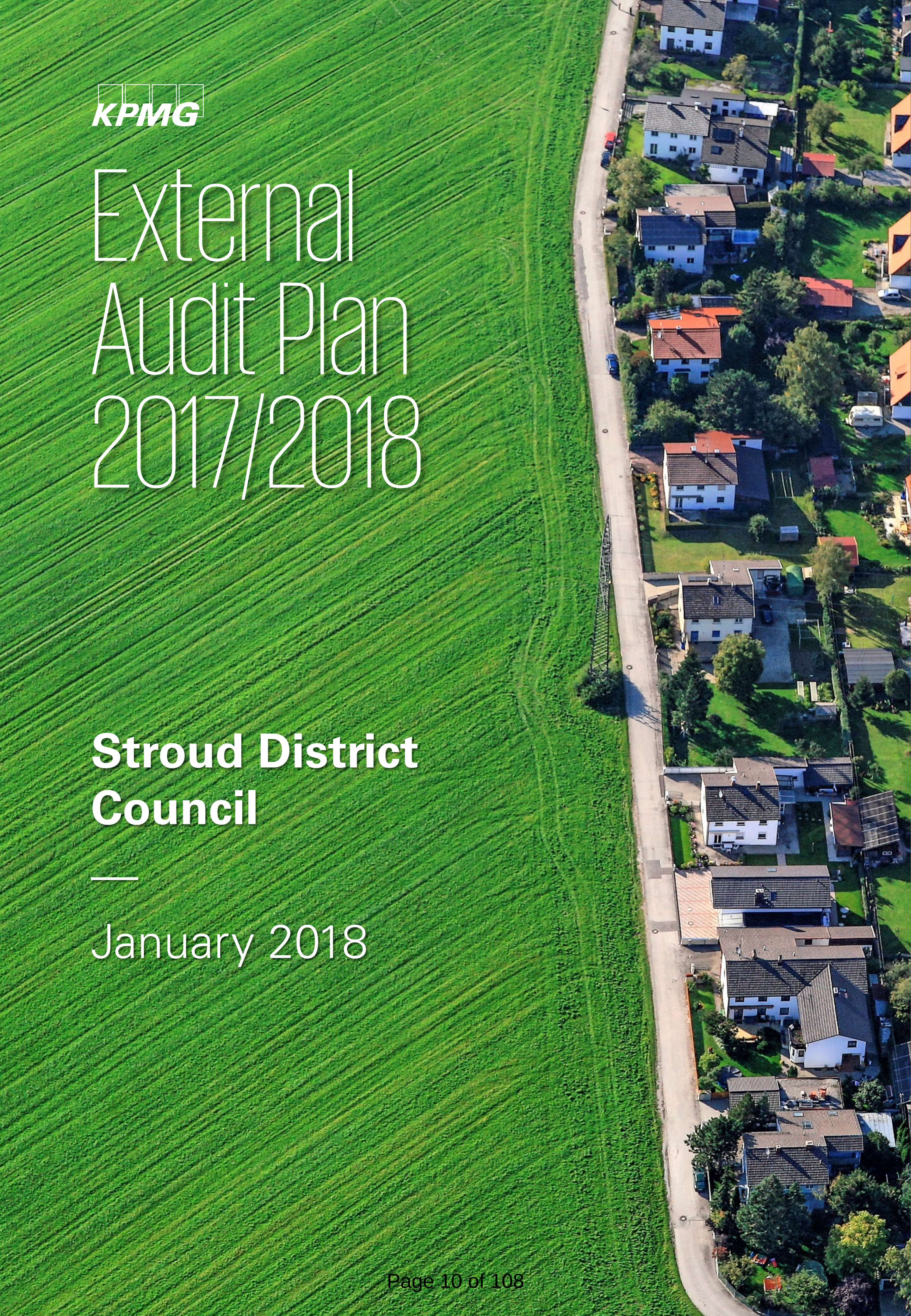
c) Is the Code given appropriate regard? If not, what would address such? Would strengthening the consequences of breaching the Code help?

d) Do the various protocols within the Constitution add value? Would it be helpful to include key protocol provisions within a revised Code so there is only one point of reference for standards?

e) Would it help if the Council better engaged senior members (e.g. Group Leaders) in promoting and upholding high standards of conduct?

f) Should Audit and Standards Committee members be involved at a preliminary stage of the complaint process via a small informal panel which would convene at short notice to review complaints which the Monitoring Officer considered indicated a breach?

g) If a member accepts he / she has breached the Code, should lesser penalties be imposed in appropriate cases to quickly remedy the issue (e.g. training, public apology) rather than requiring a Standards Panel investigation and hearing in all cases; and only failing that, should the complaint proceed to a full hearing of the Standards Panel with new and substantial financial penalties (e.g. the costs to the public purse of undertaking the investigation to be borne by the member if a breach was upheld)?



External Audit Plan 2017/2018

Stroud District Council

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January 2018

Summary for Audit & Standards Committee

Financial statements

There are no significant changes to the Code of Practice on Local Authority Accounting ("the Code") in 2017/18, which provides stability in terms of the accounting standards the Authority need to comply with. Despite this, the deadline for the production and signing of the financial statements has been significantly advanced in comparison to year ended 31 March 2017. Whilst the Authority chose to advance its own accounts production timetable last year, further advances will be required this in order to ensure that deadlines are met. As a result we have recognised a significant risk in relation to this matter.

In order to meet the revised deadlines it will be essential that the draft financial statements and all prepared by client documentation is available in line with agreed timetables. Where this is not achieved there is a significant likelihood that the audit report will not be issued by 31 July 2018.

Materiality

Materiality for planning purposes has been set at **£1.5 million**.

We are obliged to report uncorrected omissions or misstatements other than those which are 'clearly trivial' to those charged with governance and this has been set at **£75,000**.

Significant risks

Those risks requiring specific audit attention and procedures to address the likelihood of a material financial statement error have been identified as:

- **Valuation of PPE** – Whilst the Authority operates a cyclical revaluation approach, the Code requires that all land and buildings be held at fair value. We will consider the way in which the Authority ensures that assets not subject to in-year revaluation are not materially misstated, as well as reviewing the basis of valuation for those assets that have been revalued;
- **Pension Liabilities** – The valuation of the Authority's pension liability, as calculated by the Actuary, is dependent upon both the completeness and accuracy of the data provided and the assumptions adopted. We will review the processes in place to ensure accuracy of data provided to the Actuary and consider the assumptions used in determining the valuation. We will also consider the treatment of the lump sum prepayments totalling £6.5m that the Council has made into the pension scheme this year; and
- **Faster Close** – As set out above, the timetable for the production of the financial statements has been significantly advanced with draft accounts having to be prepared by 31 May (2017: 30 June) and the final accounts signed by 31 July (2017: 30 September). We will work with the Authority in advance of our audit to understand the steps being taken to meet these deadlines and the impact on our work.

Summary for Audit & Standards Committee (cont.)

Value for Money Arrangements work	We have not yet carried out our detailed risk assessment regarding your arrangements to secure value for money, however our initial VFM audit planning has identified the following VFM significant risks to date: – **Delivery of Budgets –** As a result of reductions in central government funding, and other pressures, the Authority is having to make additional savings beyond those from prior years. We will consider the way in which the Authority identifies, approves, and monitors savings plans and how budgets are monitored throughout the year; and – **Multi-service contract** – A recent internal audit report has highlighted that improvements are required relating to the governance and contract management processes of the multi-service contract for the provision of waste/recycling, street cleaning, maintenance and fleet management services. We will review internal audit findings to consider in further detail and review the progress against the resultant action plan with relevant officers, in order to consider the impact of the issues identified on our VFM conclusion. **See pages 10 to 14 for more details**
Logistics	Our team is: – Darren Gilbert – Director – Matt Arthur – Senior Manager – Ming Hui Ng – On-site team lead More details are in **Appendix 2**. Our work will be completed in four phases from November to July and our key deliverables are this Audit Plan, an Interim Report and a Report to Those Charged With Governance as outlined on **page 17.** Our fee for the 2017/18 audit is £51,975 (2016/17: £51,975) see **page 16**. These fees are in line with the scale fees published by PSAA.
Acknowledgements	We would like to take this opportunity to thank officers and Members for their continuing help and co-operation throughout our audit work.

Introduction

Background and Statutory responsibilities

This document supplements our Audit Fee Letter 2017/18 presented to you in April 2017, which also sets out details of our appointment by Public Sector Audit Appointments Ltd (PSAA).

Our statutory responsibilities and powers are set out in the Local Audit and Accountability Act 2014, the National Audit Office's Code of Audit Practice and the PSAA Statement of Responsibilities.

Our audit has two key objectives, requiring us to audit/review and report on your:

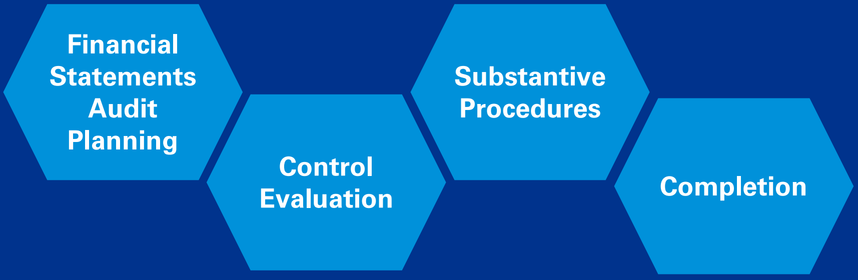
01 **Financial statements:**
Providing an opinion on your accounts. We also review the Annual Governance Statement and Narrative Report and report by exception on these; and

02 **Use of resources:**
Concluding on the arrangements in place for securing economy, efficiency and effectiveness in your use of resources (the value for money conclusion).

The audit planning process and risk assessment is an on-going process and the assessment and fees in this plan will be kept under review and updated if necessary. Any change to our identified risks will be reporting to the Audit & Standards Committee.

Financial Statements Audit

Our financial statements audit work follows a four stage audit process which is identified below. Appendix 1 provides more detail on the activities that this includes. This report concentrates on the Financial Statements Audit Planning stage of the Financial Statements Audit.



Value for Money Arrangements Work

Our Value for Money (VFM) Arrangements Work follows a five stage process which is identified below. Page 10 provides more detail on the activities that this includes. This report concentrates on explaining the VFM approach for 2017/18.

Financial statements audit planning

Financial Statements Audit Planning

Our planning work takes place during November 2017 to February 2018. This involves the following key aspects:

- Determining our materiality level;
- Risk assessment;
- Identification of significant risks;
- Consideration of potential fraud risks;
- Identification of key account balances in the financial statements and related assertions, estimates and disclosures;
- Consideration of management's use of experts; and
- Issuing this audit plan to communicate our audit strategy.

Risk assessment

Auditing standards require us to consider two standard risks for all organisations. We are not elaborating on these standard risks in this plan but consider them as a matter of course in our audit and will include any findings arising from our work in our ISA 260 Report.

01

Management override of controls

Management is typically in a powerful position to perpetrate fraud owing to its ability to manipulate accounting records and prepare fraudulent financial statements by overriding controls that otherwise appear to be operating effectively. Our audit methodology incorporates the risk of management override as a default significant risk. In line with our methodology, we carry out appropriate controls testing and substantive procedures, including over journal entries, accounting estimates and significant transactions that are outside the normal course of business, or are otherwise unusual.

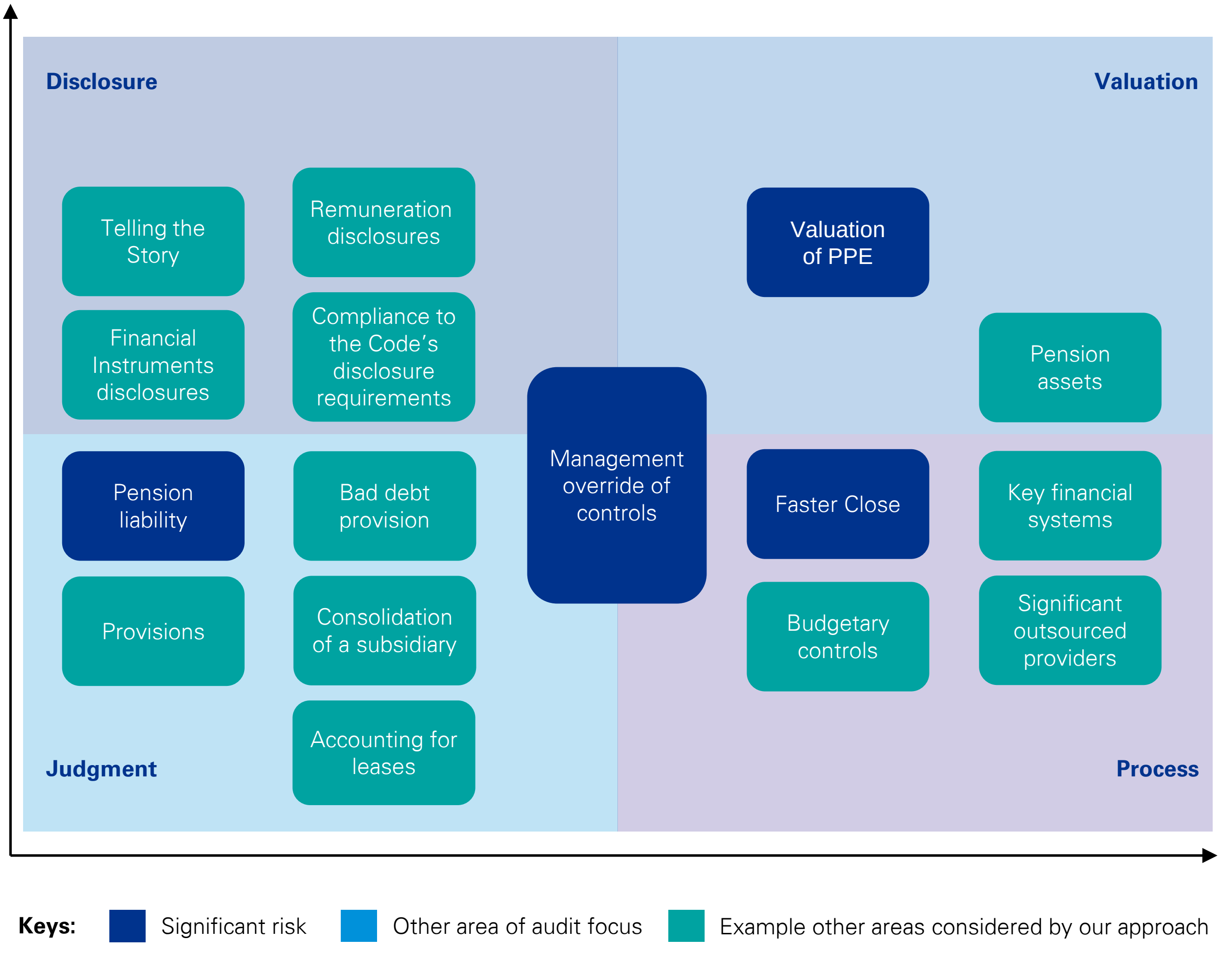
02

Fraudulent revenue recognition

We do not consider this to be a significant risk for local authorities as there are limited incentives and opportunities to manipulate the way income is recognised. We therefore rebut this risk and do not incorporate specific work into our audit plan in this area over and above our standard fraud procedures.

Financial statements audit planning (cont.)

The diagram below identifies significant risks and other areas of audit focus, which we expand on overleaf. The diagram also identifies a range of other areas considered by our audit approach.



Document Classification: KPMG Confidential

Financial statements audit planning (cont.)

Significant Audit Risks

Those risks requiring specific audit attention and procedures to address the likelihood of a material financial statement error in relation to the Authority.

Risk:

Valuation of PPE

The Code requires that where assets are subject to revaluation, their year end carrying value should reflect the appropriate fair value at that date. The Authority has adopted a rolling revaluation model which sees all non-housing land and buildings revalued over a five year cycle. As a result of this, individual assets may not be revalued for four years.

This creates a risk that the carrying value of those assets not revalued in year differs materially from the year end fair value.

Housing assets are revalued each year in-between full valuations using an index based on local sales. Last year we raised an audit adjustment as the December 2016 index used by the Council had been adjusted down by the Land Registry (due to new sales information) subsequent to the Council having obtained the index from the Land Registry website which resulted in a material misstatement. There is a risk of this issue arising again in future, which may be increased if a more local index is used as the lower total sales mean that each new sale has a higher impact on the index.

The Council is considering options to avoid this in 2017/18, for example, by using an index covering a wider area that is hopefully less volatile, or by using an index from earlier in the year which has less risk of moving (but does result in a risk if there is significant price fluctuation between the index date and the year-end).

Approach:

We will review the approach that the Authority has adopted to assess the risk that assets not subject to valuation are materially misstated and consider the robustness of that approach.

In addition, we will consider movement in market indices between revaluation dates and the year end in order to determine whether these indicate that fair values have moved materially over that time.

In relation to those assets which have been revalued during the year we will assess the valuer's qualifications, objectivity and independence to carry out such valuations and review the methodology used (including testing the underlying data and assumptions).

In relation to housing assets, we will verify the index used by the Council back to the underlying index data on the land registry website. Should the index have moved, we will consider the impact on the asset balance. We will consider the impact of any significant price fluctuation between the index date used and the year-end date.

Financial statements audit planning (cont.)

Significant Audit Risks (cont.)

Risk:	**Pension Liabilities** The net pension liability represents a material element of the Authority's balance sheet. The Authority is an admitted body of Gloucestershire County Council Local Government Pension Fund, which had its last triennial valuation completed as at 31 March 2016. This forms an integral basis of the valuation as at 31 March 2018. The valuation of the Local Government Pension Scheme relies on a number of assumptions, most notably around the actuarial assumptions, and actuarial methodology which results in the Authority's overall valuation. There are financial assumptions and demographic assumptions used in the calculation of the Authority's valuation, such as the discount rate, inflation rates, mortality rates etc. The assumptions should also reflect the profile of the Authority's employees, and should be based on appropriate data. The basis of the assumptions is derived on a consistent basis year to year, or updated to reflect any changes. There is a risk that the assumptions and methodology used in the valuation of the Authority's pension obligation are not reasonable. This could have a material impact to net pension liability accounted for in the financial statements. In addition, the Council has agreed with the Actuary that it will make prepayments of lump sum contributions totalling £6.5m to the scheme during 2017/18, so that the lump sum contributions for the next three years are fully paid in advance by 1 January 2018. This will result in a cash saving of £312,000. The treatment and potential legality of this is dependent on whether the prepayment or the option to make an up-front payment is set out within the actuary's rates and adjustments certificate.
Approach:	As part of our work we will review the controls that the Authority has in place over the information sent directly to the Scheme Actuary, Hymans Robertson. We will also liaise with the auditors of the Pension Fund in order to gain an understanding of the effectiveness of those controls operated by the Pension Fund. This will include consideration of the process and controls with respect to the assumptions used in the valuation. We will also evaluate the competency, objectivity and independence of Hymans Robertson. We will review the appropriateness of the key assumptions included within the valuation, compare them to expected ranges, and consider the need to make use of a KPMG Actuary. We will review the methodology applied in the valuation by Hymans Robertson. In addition, we will review the overall Actuarial valuation and consider the disclosure implications in the financial statements. In relation to the prepayment, we will understand the circumstances and the information and advice provided by the actuary, including that presented in the rates and adjustments certificate, and consider the impact on this, consulting with our specialists if considered necessary.

Financial statements audit planning (cont.)

Significant Audit Risks (cont.)

Risk: **Faster Close**

In prior years, the Authority has been required to prepare draft financial statements by 30 June and then final signed accounts by 30 September. For years ending on and after 31 March 2018 however, revised deadlines apply which require draft accounts by 31 May and then publish final signed accounts by 31 July.

During 2016/17, the Authority continued its preparation for these revised deadlines and advanced its own accounts production timetable so that draft accounts were ready by 16 June. Whilst this was an advancement on the timetable applied in preceding years, further work is still required in order to ensure that the statutory deadlines for 2017/18 are met, including ensuring that all audit queries and accounts updates are resolved in accordance with the new deadline for signing, as the final Audit & Standards Committee date was 12 September last year so there is still the need for significant movement in the signing timetable.

In order to meet the revised deadlines, the Authority may need to make greater use of accounting estimates. In doing so, consideration will need to be given to ensuring that these estimates remain valid at the point of finalising the financial statements. In addition, there are a number of logistical challenges that will need to be managed. These include:

- Ensuring that any third parties involved in the production of the accounts (including valuers and actuaries) are aware of the revised deadlines and have made arrangements to provide the output of their work in accordance with this;
- Revising the closedown and accounts production timetable in order to ensure that all working papers and other supporting documentation are available at the start of the audit process;
- Ensuring that the Audit & Standards Committee meeting schedules have been updated to permit signing in July; and
- Applying a shorter paper deadline to the July meeting of the Audit & Standards Committee meeting in order to accommodate the production of the final version of the accounts and our ISA 260 report.

In the event that the above areas are not effectively managed there is a significant risk that the audit will not be completed by the 31 July deadline.

There is also an increased likelihood that the Audit Certificate (which confirms that all audit work for the year has been completed) may be issued separately at a later date if work is still ongoing in relation to the Authority's Whole of Government Accounts return. This is not a matter of concern and is not seen as a breach of deadlines.

Approach: We will continue to liaise with officers in preparation for our audit in order to understand the steps that the Authority is taking to ensure it meets the revised deadlines. We will also look to advance audit work into the interim visit in order to streamline the year end audit work.

Where there is greater reliance upon accounting estimates we will consider the assumptions used and challenge the robustness of those estimates.

Financial statements audit planning (cont.)

Materiality

We are required to plan our audit to determine with reasonable confidence whether or not the financial statements are free from material misstatement. An omission or misstatement is regarded as material if it would reasonably influence the user of financial statements. This therefore involves an assessment of the qualitative and quantitative nature of omissions and misstatements.

Generally, we would not consider differences in opinion in respect of areas of judgement to represent 'misstatements' unless the application of that judgement results in a financial amount falling outside of a range which we consider to be acceptable.

For the Authority, materiality for planning purposes has been set at £1.5 million, which equates to 2% percent of gross expenditure.

We design our procedures to detect errors in specific accounts at a lower level of precision.

Authority Prior Year Gross Expenditure: £75m (2016/17: £78m)

Materiality

£1.5m

2% of Expenditure

(2016/17: £1.5m, 1.9%)

£75k Misstatements reported to the Audit & Standards Committee (2016/17: £75k)

£1.1m Procedures designed to detect individual errors (2016/17: £1.1m)

£1.5m Materiality for the financial statements as a whole (2016/17: £1.5m)

Reporting to the Audit & Standards Committee

Whilst our audit procedures are designed to identify misstatements which are material to our opinion on the financial statements as a whole, we nevertheless report to the Audit & Standards Committee any unadjusted misstatements of lesser amounts to the extent that these are identified by our audit work.

Under ISA 260(UK&I) 'Communication with those charged with governance', we are obliged to report uncorrected omissions or misstatements other than those which are 'clearly trivial' to those charged with governance. ISA 260 (UK&I) defines 'clearly trivial' as matters that are clearly inconsequential, whether taken individually or in aggregate and whether judged by any quantitative or qualitative criteria.

In the context of the Authority, we propose that an individual difference could normally be considered to be clearly trivial if it is less than £75,000.

If management has corrected material misstatements identified during the course of the audit, we will consider whether those corrections should be communicated to the Audit & Standards Committee to assist it in fulfilling its governance responsibilities.

We will report:

- Non-Trivial corrected audit misstatements
- Non-trivial uncorrected audit misstatements
- Note 1 — Errors and omissions in disclosure (Corrected and uncorrected)

Value for money arrangements work

VFM audit approach

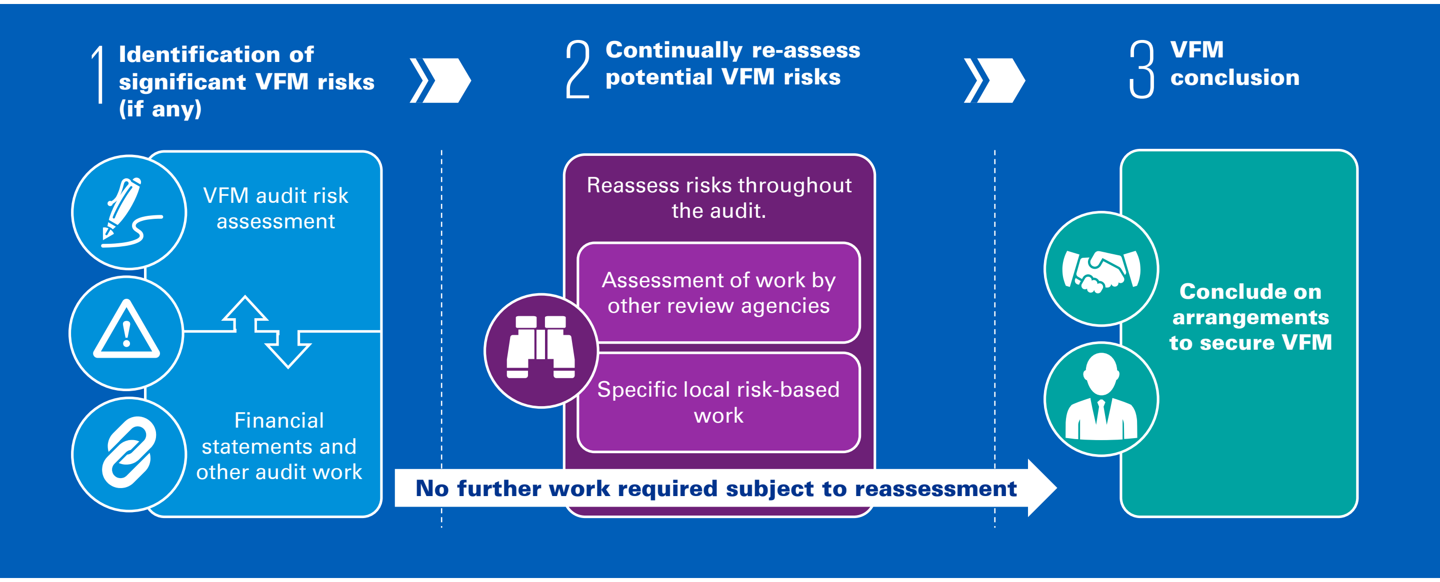
The Local Audit and Accountability Act 2014 requires auditors of local government bodies to be satisfied that the authority 'has made proper arrangements for securing economy, efficiency and effectiveness in its use of resources'.

This is supported by the Code of Audit Practice, published by the NAO in April 2015, which requires auditors to 'take into account their knowledge of the relevant local sector as a whole, and the audited body specifically, to identify any risks that, in the auditor's judgement, have the potential to cause the auditor to reach an inappropriate conclusion on the audited body's arrangements.'

Overall criterion

In all significant respects, the audited body had proper arrangements to ensure it took properly informed decisions and deployed resources to achieve planned and sustainable outcomes for taxpayers and local people.

The VFM approach is fundamentally unchanged from that adopted in 2016/17 and the process is shown in the diagram below. The diagram overleaf shows the details of the sub-criteria for our VFM work.



Value for money arrangements work (cont.)

Value for Money sub-criterion

Informed decision making

Proper arrangements:

- Acting in the public interest, through demonstrating and applying the principles and values of sound governance.
- Understanding and using appropriate and reliable financial and performance information to support informed decision making and performance management.
- Reliable and timely financial reporting that supports the delivery of strategic priorities.
- Managing risks effectively and maintaining a sound system of internal control.

Sustainable resource deployment

Proper arrangements:

- Planning finances effectively to support the sustainable delivery of strategic priorities and maintain statutory functions.
- Managing and utilising assets to support the delivery of strategic priorities.
- Planning, organising and developing the workforce effectively to deliver strategic priorities.

Working with partners and third parties

Proper arrangements:

- Working with third parties effectively to deliver strategic priorities.
- Commissioning services effectively to support the delivery of strategic priorities.
- Procuring supplies and services effectively to support the delivery of strategic priorities.

Value for money arrangements work (cont.)

VFM audit stage

VFM audit risk assessment

Linkages with financial statements and other audit work

Identification of significant risks

Audit approach

We consider the relevance and significance of the potential business risks faced by all local authorities, and other risks that apply specifically to the Authority. These are the significant operational and financial risks in achieving statutory functions and objectives, which are relevant to auditors' responsibilities under the *Code of Audit Practice.*

In doing so we consider:

- The Authority's own assessment of the risks it faces, and its arrangements to manage and address its risks;
- Information from the Public Sector Auditor Appointments Limited VFM profile tool;
- Evidence gained from previous audit work, including the response to that work; and
- The work of other inspectorates and review agencies.

Audit approach

There is a degree of overlap between the work we do as part of the VFM audit and our financial statements audit. For example, our financial statements audit includes an assessment and testing of the Authority's organisational control environment, including the Authority's financial management and governance arrangements, many aspects of which are relevant to our VFM audit responsibilities.

We have always sought to avoid duplication of audit effort by integrating our financial statements and VFM work, and this will continue. We will therefore draw upon relevant aspects of our financial statements audit work to inform the VFM audit.

Audit approach

The Code identifies a matter as significant *'if, in the auditor's professional view, it is reasonable to conclude that the matter would be of interest to the audited body or the wider public. Significance has both qualitative and quantitative aspects.'*

If we identify significant VFM risks, then we will highlight the risk to the Authority and consider the most appropriate audit response in each case, including:

- Considering the results of work by the Authority, inspectorates and other review agencies; and
- Carrying out local risk-based work to form a view on the adequacy of the Authority's arrangements for securing economy, efficiency and effectiveness in its use of resources.

Value for money arrangements work (cont.)

VFM audit stage

Assessment of work by other review agencies, and Delivery of local risk based work

Audit approach

Depending on the nature of the significant VFM risk identified, we may be able to draw on the work of other inspectorates, review agencies and other relevant bodies to provide us with the necessary evidence to reach our conclusion on the risk.

We will also consider the evidence obtained by way of our financial statements audit work and other work already undertaken.

If evidence from other inspectorates, agencies and bodies is not available and our other audit work is not sufficient, we will need to consider what additional work we will be required to undertake to satisfy ourselves that we have reasonable evidence to support the conclusion that we will draw. Such work may include:

- Additional meetings with senior managers across the Authority;
- Review of specific related minutes and internal reports;
- Examination of financial models for reasonableness, using our own experience and benchmarking data from within and without the sector.

Concluding on VFM arrangements

Audit approach

At the conclusion of the VFM audit we will consider the results of the work undertaken and assess the assurance obtained against each of the VFM themes regarding the adequacy of the Authority's arrangements for securing economy, efficiency and effectiveness in the use of resources.

If any issues are identified that may be significant to this assessment, and in particular if there are issues that indicate we may need to consider qualifying our VFM conclusion, we will discuss these with management as soon as possible. Such issues will also be considered more widely as part of KPMG's quality control processes, to help ensure the consistency of auditors' decisions.

Reporting

Audit approach

On the following page, we report the results of our initial risk assessment.

We will report on the results of the VFM audit through our ISA 260 Report. This will summarise any specific matters arising, and the basis for our overall conclusion.

The key output from the work will be the VFM conclusion (i.e. our opinion on the Authority's arrangements for securing VFM), which forms part of our audit report.

Value for money arrangements work (cont.)

Significant VFM Risks

Those risks requiring specific audit attention and procedures to address the likelihood that proper arrangements are not in place to deliver value for money. These are based on our initial risk assessment and knowledge of the Authority from prior years.

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Risk: **Delivery of budgets**

In its 2017/18 budget, the Authority budgeted to draw down £567k from reserves to address financial pressures, in addition to a further £25k of budgeted savings. The 31 August 2017 forecast shows that the Authority will deliver an underspend of approximately £319k.

The Authority's proposed budget strategy presented to members in January 2018 highlighted continuing financial uncertainty and volatility, in particular relating to the loss of Revenue Support Grant (RSG) from 2018/19 (turning into a negative tariff in 2019/20) and to the funding streams outside the multi-year settlement, as well as service cost pressures such as the multi-service contract. This budget strategy highlights planned savings of £1.3m in 2018/19 and additional savings of £6m over the following three years, the majority of which have already been agreed but will require regular review and reporting. The plan also included utilisation of general fund reserves of £3.4m over this four year period.

This need for savings and utilisation of built-up reserves will continue to have a significant impact on the Authority's financial resilience.

Approach: As part of our additional risk based work, we will review the controls the Authority has in place to ensure financial resilience, specifically that the Medium Term Financial Plan has duly taken into consideration factors such as funding reductions, salary and general inflation, demand pressures, and sensitivity analysis given the degree of volatility, as well as its progress in establishing and crystallising savings proposals.

VFM Sub-criterion: This risk is related to the following Value For Money sub-criterion

— Informed decision making;
— Sustainable resource deployment; and
— Working with partners and third parties

Risk: **Multi-service contract**

A recent internal audit report has highlighted that improvements are required relating to the governance and contract management processes of the multi-service contract for the provision of waste/recycling, street cleaning, maintenance and fleet management services.

Subsequent to this report (which was issued on a consultancy basis and thus had no assurance rating), an action plan has been developed to implement these improvements, which mainly related to establishment of clear roles and responsibilities in relation to governance, establishment of agreed actions under the contract and regular monitoring of these actions, regular review and update of contract risks and mitigating controls, more effective financial and KPI reporting from Ubico, and improvements to the service specification detail.

Approach: We will review internal audit findings to consider in further detail and review the progress against the resultant action plan with relevant officers, in order to consider the impact of the issues identified on our VFM conclusion.

VFM Sub-criterion: This risk is related to the following Value For Money sub-criterion

— Informed decision making;

— Sustainable resource deployment; and

— Working with partners and third parties

Other matters

Whole of government accounts (WGA)

We are required to issue an assurance statement to the National Audit Office confirming the income, expenditure, asset and liabilities of the Authority. Deadlines for completion of this for 2017/18 have not yet been confirmed.

Elector challenge

The Local Audit and Accountability Act 2014 gives electors certain rights. These are:

- The right to inspect the accounts;
- The right to ask the auditor questions about the accounts; and
- The right to object to the accounts.

As a result of these rights, in particular the right to object to the accounts, we may need to undertake additional work to form our decision on the elector's objection. The additional work could range from a small piece of work where we interview an officer and review evidence to form our decision, to a more detailed piece of work, where we have to interview a range of officers, review significant amounts of evidence and seek legal representations on the issues raised.

The costs incurred in responding to specific questions or objections raised by electors is not part of the fee. This work will be charged in accordance with the PSAA's fee scales.

Other matters

Reporting and communication

Reporting is a key part of the audit process, not only in communicating the audit findings for the year, but also in ensuring the audit team are accountable to you in addressing the issues identified as part of the audit strategy. Throughout the year we will communicate with you through meetings with the finance team and the Audit & Standards Committee. Our communication outputs are included in Appendix 1.

Independence and Objectivity

Auditors are also required to be independent and objective. Appendix 3 provides more details of our confirmation of independence and objectivity.

Audit fee

Our Audit Fee Letter 2017/2018 presented to you in April2017 first set out our fees for the 2017/2018 audit. This letter also set out our assumptions. We have not considered it necessary to seek approval for any changes to the agreed fees at this stage.

Should there be a need to charge additional audit fees then this will be agreed with the s.151 Officer and PSAA. If such a variation is agreed, we will report that to you in due course.

The planned audit fee for 2017/18 is £51,975, which is the same as the final fee for 2016/17.

These fees are in line with the scale fees published by PSAA.

Appendix 1:

Key elements of our financial statements audit approach

Driving more value from the audit through data and analytics

Technology is embedded throughout our audit approach to deliver a high quality audit opinion. Use of Data and Analytics (D&A) to analyse large populations of transactions in order to identify key areas for our audit focus is just one element. Data and Analytics allows us to:

— Obtain greater understanding of your processes, to automatically extract control configurations and to obtain higher levels assurance.

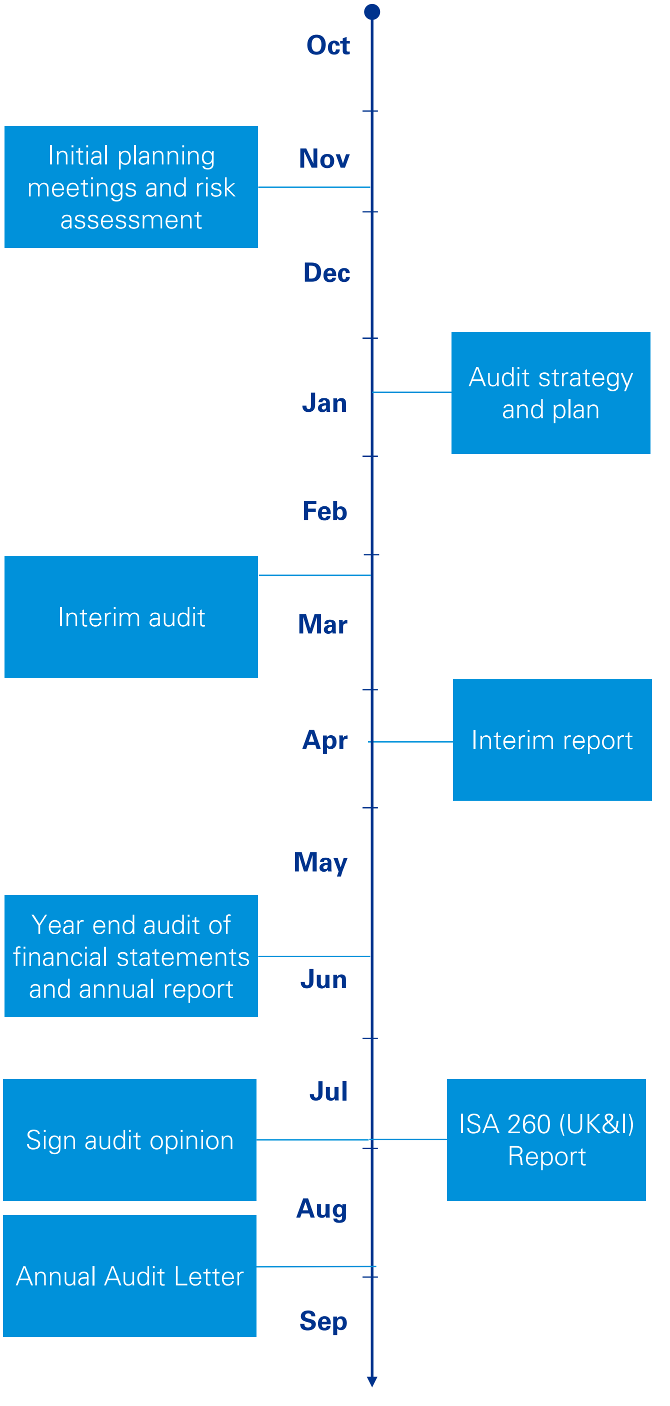
— Focus manual procedures on key areas of risk and on transactional exceptions.

— Identify data patterns and the root cause of issues to increase forward-looking insight.

We anticipate using data and analytics in our work around key areas such as journals.

Communication

Continuous communication involving regular meetings between Audit & Standards Committee, Senior Management and audit team.



Appendix 1:

Key elements of our financial statements audit approach (cont.)

Audit workflow

Planning

- Determining our materiality level;
- Risk assessment;
- Identification of significant risks;
- Consideration of potential fraud risks;
- Identification of key account balances in the financial statements and related assertions, estimates and disclosures;
- Consideration of managements use or experts; and
- Issuing this audit plan to communicate our audit strategy.

Control evaluation

- Understand accounting and reporting activities
- Evaluate design and implementation of selected controls
- Test operating effectiveness of selected controls
- Assess control risk and risk of the accounts being misstated

Substantive testing

- Plan substantive procedures
- Perform substantive procedures
- Consider if audit evidence is sufficient and appropriate

Completion

- Perform completion procedures
- Perform overall evaluation
- Form an audit opinion
- Audit & Standards Committee reporting

Appendix 2:

Audit team

Your audit team has been drawn from our specialist public sector assurance department. Our audit team were all part of the Stroud audit last year.

Darren Gilbert
Director

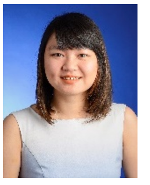
T: +44 (0)29 2046 8205
E: darren.gilbert@kpmg.co.uk

‘My role is to lead our team and ensure the delivery of a high quality, valued added external audit opinion.
I will be the main point of contact for the Audit & Standards Committee and Chief Executive.’

Matt Arthur
Senior Manager

T: +44 (0)29 2046 8006
E: matthew.arthur@kpmg.co.uk

‘I provide quality assurance for the audit work and specifically any technical accounting and risk areas.
I will work closely with Darren to ensure we add value.
I will liaise with the s151 officer and other senior officers.’



Ming Hui
On-site team lead

T: +44 (0)117 9054 672
E: minghui.ng@kpmg.co.uk

‘I will be responsible for the on-site delivery of our work and will supervise the work of our audit assistants.’

Appendix 3:

Independence and objectivity requirements

ASSESSMENT OF OUR OBJECTIVITY AND INDEPENDENCE AS AUDITOR OF STROUD DISTRICT COUNCIL

Professional ethical standards require us to provide to you at the planning stage of the audit a written disclosure of relationships (including the provision of non-audit services) that bear on KPMG LLP's objectivity and independence, the threats to KPMG LLP's independence that these create, any safeguards that have been put in place and why they address such threats, together with any other information necessary to enable KPMG LLP's objectivity and independence to be assessed.

In considering issues of independence and objectivity we consider relevant professional, regulatory and legal requirements and guidance, including the provisions of the Code of Audit Practice, the provisions of Public Sector Audit Appointments Ltd's ('PSAA's') Terms of Appointment relating to independence and the requirements of the FRC Ethical Standard and General Guidance Supporting Local Audit (Auditor General Guidance 1 – AGN01) issued by the National Audit Office ('NAO').

This Appendix is intended to comply with this requirement and facilitate a subsequent discussion with you on audit independence and addresses:

- General procedures to safeguard independence and objectivity;
- Independence and objectivity considerations relating to the provision of non-audit services; and
- Independence and objectivity considerations relating to other matters.

General procedures to safeguard independence and objectivity

KPMG LLP is committed to being and being seen to be independent. As part of our ethics and independence policies, all KPMG LLP partners, Audit Directors and staff annually confirm their compliance with our ethics and independence policies and procedures. Our ethics and independence policies and procedures are fully consistent with the requirements of the FRC Ethical Standard. As a result we have underlying safeguards in place to maintain independence through:

- Instilling professional values
- Communications
- Internal accountability
- Risk management
- Independent reviews.

We are satisfied that our general procedures support our independence and objectivity.

Appendix 3:

Independence and objectivity requirements (cont.)

Independence and objectivity considerations relating to the provision of non-audit services

Summary of fees

We have considered the fees charged by us to the authority and its affiliates for professional services provided by us during the reporting period.

Facts and matters related to the provision of non-audit services and the safeguards put in place that bear upon our independence and objectivity, are set out in the following table

Analysis of Non-audit services for the year ended 31 March 2018

Description of scope of services	Principal threats to independence	Safeguards Applied	Basis of fee	Value of Services Delivered in the year ended 31 March 2018 £	Value of Services Committed but not yet delivered £
Certification of Housing Benefit subsidy claim 2017/18	Self-review Self-interest	This is an audit-related engagement involving the review of historical financial information and as such no self-review threat is identified. The fee is immaterial to the audit as a whole and is part of the PSAA fee regime.	Fixed	0	7,590
Certification of pooling of Housing Capital Receipts Return 2017/18	Self-review Self-interest	This is an audit-related engagement involved the review of historical financial information and as such no self-review threat is identified. The fee is immaterial to the audit as a whole and below the PSAA approval threshold.	Fixed	0	3,000
Performance of HCA Social Housing Assistance agreed upon procedures 2017/18	Self-review Self-interest	This is an audit-related engagement involved the review of historical financial and non-financial information and as such no self-review threat is identified. The fee is immaterial to the audit as a whole and below the PSAA approval threshold.	Fixed	0	2,000

Non-audit services provided during the period do not exceed the relevant PSAA deminimis threshold individually or in aggregate and therefore have not required PSAA approval. In addition, we monitor our fees to ensure that we comply with the 70% non-audit fee cap set by the NAO.

Independence and objectivity considerations relating to other matters

There are no other matters that, in our professional judgment, bear on our independence which need to be disclosed to the Audit & Standards Committee.

Independence and objectivity requirements (cont.)

Confirmation of audit independence

We confirm that as of the date of this report, in our professional judgment, KPMG LLP is independent within the meaning of regulatory and professional requirements and the objectivity of the Audit Director and audit staff is not impaired.

This report is intended solely for the information of the Audit & Standards Committee of the authority and should not be used for any other purposes.

We would be very happy to discuss the matters identified above (or any other matters relating to our objectivity and independence) should you wish to do so.

KPMG LLP

kpmg.com/uk

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. We draw your attention to the Statement of Responsibilities of auditors and audited bodies, which is available on Public Sector Audit Appointment's website (www.psaa.co.uk).

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.

We are committed to providing you with a high quality service. If you have any concerns or are dissatisfied with any part of KPMG's work, in the first instance you should contact Darren Gilbert, the engagement lead to the Authority, who will try to resolve your complaint. If you are dissatisfied with your response please contact the national lead partner for all of KPMG's work under our contract with Public Sector Audit Appointments Limited, Andrew Sayers, by email to Andrew.Sayers@kpmg.co.uk. After this, if you are still dissatisfied with how your complaint has been handled you can access PSAA's complaints procedure by emailing generalenquiries@psaa.co.uk by telephoning 020 7072 7445 or by writing to Public Sector Audit Appointments Limited, 3rd Floor, Local Government House, Smith Square, London, SW1P 3HZ.

CREATE: CRT086281A

Annual Report on grants and returns 2016/17

Stroud District Council

—

January 2018

Contents

The contacts at KPMG in connection with this report are:

Darren Gilbert
Director

KPMG LLP (UK)

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Matthew Arthur
Senior Manager

KPMG LLP (UK)

Tel: 029 2046 8006
matthew.arthur@kpmg.co.uk

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. Public Sector Audit Appointments issued a document entitled Statement of Responsibilities of Auditors and Audited Bodies summarising where the responsibilities of auditors begin and end and what is expected from audited bodies. We draw your attention to this document which is available on Public Sector Audit Appointment's website (www.psaa.co.uk).

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Headlines

Introduction and background

This report summarises the results of work we have carried out on the Council's 2016/17 grant claims and returns.

This includes the work we have completed under the Public Sector Audit Appointment certification arrangements, as well as the work we have completed on other grants/returns under separate engagement terms. The work completed in 2016/17 is:

- Under the Public Sector Audit Appointments arrangements we certified one claim – the Council's 2016/17 Housing Benefit Subsidy claim. This had a value of £24.1m.
- Under separate assurance engagements we performed work over two claims/returns:
  - The Pooling of Housing Capital Receipts 2016/17 Return to Department for Communities and Local Government (DCLG); and
  - One Housing and Communities Agency (HCA) Compliance report on a specific housing development project.

Certification and assurance results (Pages 4-5)

Our certification work on Housing Subsidy Benefit claim included:

- agreeing standard rates, such as for allowances and benefit incomes, to the DWP Circular communicating the value of each rate for the year;
- sample testing of benefit claims to confirm that the entitlement had been correctly calculated and was supported by appropriate evidence;
- undertaking an analytical review of the claim form considering year-on-year variances and key ratios;
- confirming that the subsidy claim had been prepared using the correct benefits system version; and
- completing testing in relation to modified schemes payments, uncashed cheques and verifying the accurate completion of the claim form.

Following the completion of our work, the claim was unqualified.

Our work on the other grant assurance engagements resulted in the following findings:

- Our report to DCLG relating to the Pooling of Housing Capital Receipts Return will be qualified as a result of the lack of retained evidence for us to verify the historic 1999 housing valuations used in certain aspects of the return. A similar qualification was also required for the 2014/15 and 2015/16 reports. The original reporting deadline for this return was 30 November 2017 but we have not yet reported due to the Council experiencing technical issues in completing the return in DCLG's Logasnet system. At the time of writing, the Council has liaised with DCLG and successfully completed the return for audit on 4 January 2018, and we expect to be able to conclude our work within the next few weeks (see page 7).
- One audit findings statement to HCA which contained no significant non-compliance issues.

Adjustments were necessary to one of the Council's grants and returns as a result of our certification work this year.

- Adjustment the Housing Benefit Subsidy Claim to three of the in-year reconciliation cells which did not reconcile through to the headline cells – net impact on claim £45 subsidy reduction.

Recommendations (Page 7)

We have made one recommendation to the Council from our work this year and agreed an action plan with officers. There were no recommendations arising from previous years' work on grants and returns.

Fees (Page 6)

Our fee for certifying the Council's 2016/17 Housing Benefit Subsidy grant was £7,590, which is in line with the indicative fee set by PSAA.

Our fees for the other grant/return engagements were subject to agreement directly with the Council and were: £3,000 for the Pooling of Housing Capital Receipts return and £2,000 for the HCA compliance report.

Summary of reporting outcomes

Overall, we carried out work on three grants and returns:

- **One was unqualified with no amendment;**
- **One was unqualified but required some amendment to the final figures; and**
- **One will require a qualification to our audit certificate.**

Detailed comments are provided overleaf.

Detailed below is a summary of the reporting outcomes from our work on the Council's 2016/17 grants and returns, showing where either audit amendments were made as a result of our work or where we had to qualify our audit certificate or assurance report.

A qualification means that issues were identified concerning the Council's compliance with a scheme's requirements that could not be resolved through adjustment. In these circumstances, it is likely that the relevant grant paying body will require further information from the Council to satisfy itself that the full amounts of grant claimed are appropriate.

	Comments overleaf	Qualified	Significant adjustment	Minor adjustment	Unqualified
Public Sector Audit Appointments regime					
— Housing Benefit Subsidy					
Other grant/return engagements					
— Pooling of Housing Capital Receipts Return 2016/17	1				
— HCA Compliance report					
		1	**0**	**1**	**2**

Summary of certification work outcomes

This table summarises the key issues behind each of the adjustments or qualifications that were identified on the previous page.

Ref	Summary observations	Amendment
1	**Pooling of Housing Capital Receipts Return 2016/17** — The return will be qualified as a result of our inability to perform the test to agree a sample of Right to Buy disposals included in the quarterly 'input data' worksheet to confirm that the archetypes and 1999 valuations have been recorded correctly, as the relevant prime housing records used to populate the Council's housing records spreadsheet could not be located by the Council. — This qualification was also applied to the 2014/15 and 2015/16 return. — The original reporting deadline for this return was 30 November 2017 but we have not yet reported due to the Council experiencing technical issues in completing the return in DCLG's Logasnet system. At the time of writing, the Council has liaised with DCLG and successfully managed to complete the return, and we expect to be able to conclude our work within the next few weeks (see page 7).	N/A

Fees

Our fees for the Housing Benefit Subsidy claim are set by Public Sector Audit Appointments.

Our fees for other assurance engagements on grants/returns are agreed directly with the Council.

The overall fees we charged for carrying out all our work on grants/returns in 2016/17 was £12.590.

Public Sector Audit Appointments certification arrangements

Public Sector Audit Appointments set an indicative fee for our work on the Council's Housing Benefit Subsidy claim in 2016/17 of £7,590 Our actual fee was the same as the indicative fee, and this compares to the 2015/16 fee for this claim of £9,900.

Grants subject to other engagements

The fees for our work on other grants/returns are agreed directly with the Council. Our fees for 2016/17 were in line with those in 2015/16 except for the HCA audit as we had two projects to test in 2016 and one in 2017.

Breakdown of fees for grants and returns work

Breakdown of fee by grant/return		
	2016/17 (£)	**2015/16 (£)**
Housing Benefit Subsidy claim	7,590	9,900
Pooling of Housing Capital Receipts Return	3,000	3,000
HCA Compliance reports (2017: 1, 2016: 2)	2,000	3,500
Total fee	**12,590**	**16,400**

Recommendations

We have given each recommendation a risk rating and agreed what action management will need to take.

Priority rating for recommendations		
1 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.	2 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.	3 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.

Issue	Implication	Recommendation		Priority	Comment	Responsible officer and target date
Pooling of Housing Capital Receipts						
Logasnet system issue We are currently unable to report on the DCLG Pooling of Housing Capital Receipts return due to technical issues which are preventing the Authority from completing the return correctly in DCLG's Logasnet system	Without resolution of this issue, we will be unable to complete this reporting.	**1**	Liaise with DCLG to enable completion of an accurate report as soon as possible to enable timely reporting. Logasnet is due to be decommissioned in Spring 2018 and so the issue must be resolved prior to decommissioning (also allowing sufficient time for test once the system return is populated).	2	We have liaised with DCLG and have successfully completed the Logasnet return on 4 January 2018. This should now allow KPMG to conclude their testing in early 2018.	Lucy Clothier, January 2018

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STROUD DISTRICT COUNCIL

AGENDA ITEM NO

AUDIT AND STANDARDS COMMITTEE

6 FEBRUARY 2018

9

Report Title	**INTERNAL AUDIT ACTIVITY PROGRESS REPORT 2017/18**
Purpose of Report	To inform Members of the Internal Audit activity progress in relation to the approved Internal Audit Plan 2017/18.
Decisions(s)	The Committee RESOLVES to: 1. Accept the progress against the Internal Audit Plan 2017/18; and 2. Accept the assurance opinions provided in relation to the effectiveness of the Council's control environment comprising risk management, control and governance arrangements as a result of the Internal Audit activity completed to date.
Consultation and Feedback	Internal Audit findings are discussed with Service Heads/Managers. Management responses to recommendations are included in each assignment report.
Financial Implications and Risk Assessment	There are no financial implications arising from the report. David Stanley, Accountancy Manager (Section 151 Officer) Tel: 01453 754100 Email: david.stanley@stroud.gov.uk Risk Assessment: Failure to deliver an effective Internal Audit service will prevent an independent, objective assurance opinion from being provided to those charged with governance that the key risks associated with the achievement of the Council's objectives are being adequately controlled.
Legal Implications	No specific legal implications concerning the information within the report. The report largely refers to matters which amount to operational as opposed to current strategic risks. (Ref.r161c191d251) Karen Trickey, Head of Legal Services Tel: 01453 754369 Email: karen.trickey@stroud.gov.uk
Report Author	Theresa Mortimer, Head of Audit Risk Assurance (Chief Internal Auditor) Tel: 01453 754319 Email: theresa.mortimer@stroud.gov.uk

Options	There are no alternative options that are relevant to this matter.
Performance Management Follow Up	In accordance with the Public Sector Internal Audit Standards 2017 (PSIAS) and reflected within the Audit and Standards Committee work programme, Internal Audit reports on progress against the approved Internal Audit Plan 2017/18.
Background Papers/ Appendices	**Appendix A** – Internal Audit Activity Progress Report 2017/18. **Background papers:** ➢ Internal Audit Plan 2017/18; ➢ PSIAS; and the ➢ CIPFA Local Government Application Note for the UK PSIAS.

1.0 Background

1.1 Members approved the Internal Audit Plan 2017/18 at 11th April 2017 Audit and Standards Committee meeting. In accordance with the Public Sector Internal Audit Standards 2017 (PSIAS), this report (through **Appendix A**) details the outcomes of Internal Audit work carried out in accordance with the approved Plan.

1.2 The Internal Audit Activity Progress Report 2017/18 at **Appendix A** summarises:

- The progress against the 2017/18 Internal Audit Plan, including the assurance opinions on the effectiveness of risk management and control processes;
- The outcomes of the Internal Audit activity during the period November 2017 to December 2017; and
- Special investigations/counter fraud activity.

1.3 The report is the third progress report in relation to the Internal Audit Plan 2017/18.

1.4 In relation to the areas covered in the Internal Audit Activity Progress Report 2017/18 at **Appendix A**, Members of the Audit and Standards Committee may wish to refer to the Council's risk register on Excelsis for further information relating to the management of risks. Specifically Benefit Services has acknowledged the associated inherent risk relating to Discretionary Housing Payments (DHPs) and has captured this using the corporate system for risk recording (Excelsis) as follows:

- R&B11: "If Benefit assessments are made incorrectly by staff then there is a risk that an incorrect award of benefit will be made. This could result in either an overpayment or underpayment of benefit. Equally if benefits are paid on the basis of inaccurate or incomplete applications then there is a risk of error entering the system resulting in incorrect awards of benefit."

Appendix A

Internal Audit Activity
Progress Report
2017-2018

Audit and Standards Committee
6 February 2018

Agenda Item 9
Appendix A

(1) Introduction

All local authorities must make proper provision for internal audit in line with the 1972 Local Government Act (S151) and the Accounts and Audit Regulations 2015. The latter states that a relevant authority “must undertake an effective internal audit to evaluate the effectiveness of its risk management, control and governance processes, taking into account public sector internal auditing standards or guidance”. The Internal Audit Service is provided by Audit Risk Assurance under a Shared Service agreement between Stroud District Council, Gloucester City Council and Gloucestershire County Council and carries out the work required to satisfy this legislative requirement and reports its findings and conclusions to management and to this Committee.

The guidance accompanying the Regulations recognises the Public Sector Internal Audit Standards 2017 (PSIAS) as representing “proper internal audit practices”. The standards define the way in which the Internal Audit Service should be established and undertake its functions.

(2) Responsibilities

Management are responsible for establishing and maintaining appropriate risk management processes, control systems (financial and non financial) and governance arrangements.

Internal Audit plays a key role in providing independent assurance and advising the organisation that these arrangements are in place and operating effectively.

Internal Audit is not the only source of assurance for the Council. There are a range of external audit and inspection agencies as well as management processes which also provide assurance and these are set out in the Council’s Code of Corporate Governance and its Annual Governance Statement.

(3) Purpose of this Report

One of the key requirements of the standards is that the Chief Internal Auditor should provide progress reports on internal audit activity to those charged with governance. This report summarises:

- The progress against the 2017/18 Internal Audit Plan, including the assurance opinions on the effectiveness of risk management and control processes;
- The outcomes of the Internal Audit activity during the period November 2017 to December 2017; and
- Special investigations/counter fraud activity.

(4) Progress against the 2017/18 Internal Audit Plan, including the assurance opinions on risk and control

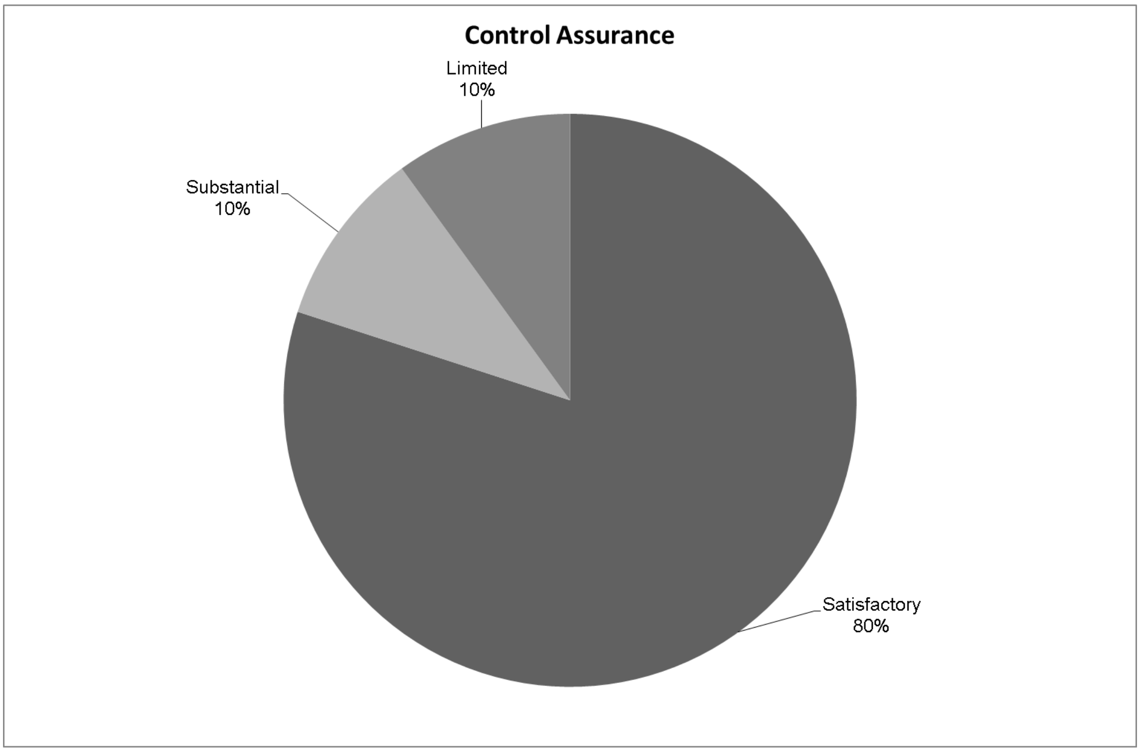
The schedule provided at **Attachment 1** provides the summary of 2017/18 audits which have not previously been reported to the Audit and Standards Committee.

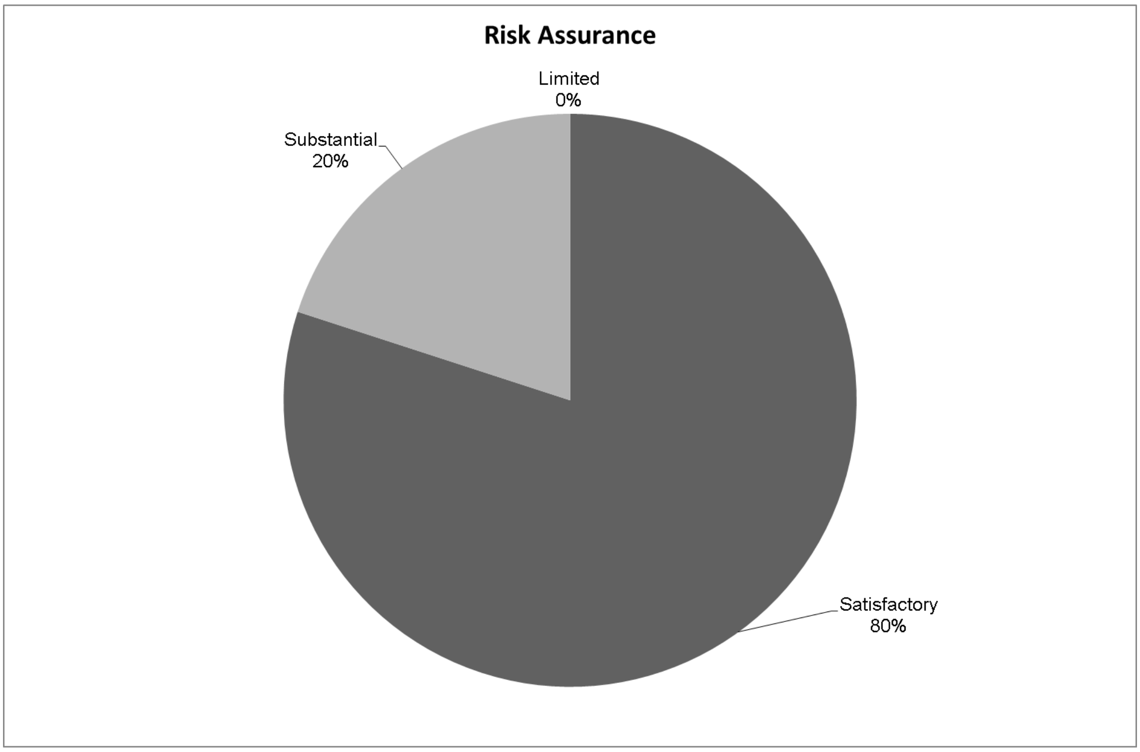
The schedule provided at **Attachment 2** contains a list of all of the 2017/18 Internal Audit Plan activity undertaken during the financial year to date, which includes, where relevant, the assurance opinions on the effectiveness of risk management arrangements and control processes in place to manage those risks and the dates where a summary of the activities outcomes has been presented to the Audit and Standards Committee. Explanations of the meaning of these opinions are shown in the below table.

(4a) Summary of Internal Audit Assurance Opinions on Risk and Control

The pie charts below show the summary of the risk and control assurance opinions provided within each category of opinion i.e. substantial, satisfactory and limited in relation to the audit activity undertaken during the period April 2017 to December 2017.

Assurance Levels	Risk Identification Maturity	Control Environment
Substantial	**Risk Managed** Service area fully aware of the risks relating to the area under review and the impact that these may have on service delivery, other service areas, finance, reputation, legal, the environment, client/customer/partners, and staff. All key risks are accurately reported and monitored in line with the Council's Risk Management Policy.	• System Adequacy – Robust framework of controls ensures that there is a high likelihood of objectives being achieved • Control Application – Controls are applied continuously or with minor lapses
Satisfactory	**Risk Aware** Service area has an awareness of the risks relating to the area under review and the impact that these may have on service delivery, other service areas, finance, reputation, legal, the environment, client/customer/partners, and staff, however some key risks are not being accurately reported and monitored in line with the Council's Risk Management Policy.	• System Adequacy – Sufficient framework of key controls for objectives to be achieved but, control framework could be stronger • Control Application – Controls are applied but with some lapses
Limited	**Risk Naïve** **Due to an absence of accurate and regular reporting and monitoring of the key risks in line with the Council's Risk Management Policy, the service area has not demonstrated a satisfactory awareness of the risks relating to the area under review and the impact that these may have on service delivery, other service areas, finance, reputation, legal, the environment, client/customer/partners and staff.**	• **System Adequacy – Risk of objectives not being achieved due to the absence of key internal controls** • **Control Application – Significant breakdown in the application of control**


Control Assurance
Limited
10%
Substantial
10%
Satisfactory
80%


Risk Assurance
Limited
0%
Substantial
20%
Satisfactory
80%

(4b) Limited Control Assurance Opinions

Where audit activities record that a limited assurance opinion on control has been provided, the Audit and Standards Committee may request Senior Management attendance to the next meeting of the Committee to provide an update as to their actions taken to address the risks and associated recommendations identified by Internal Audit.

(4c) Audit Activity where a Limited Assurance Opinion has been provided on Control

During the period November 2017 to December 2017, no limited assurance opinions on control have been provided on completed audits from the 2017/18 Internal Audit Plan.

(4d) Satisfactory Control Assurance Opinions

Where audit activities record that a satisfactory assurance opinion on control has been provided, where recommendations have been made to reflect some improvements in control, the Committee can take assurance that improvement actions have been agreed with management to address these.

(4e) Internal Audit Recommendations

During the period November 2017 to December 2017 Internal Audit made, in total, **3** recommendations to improve the control environment, **none** of these being high priority recommendations and **3** being medium priority recommendations (**100%** accepted by management).

The Committee can take assurance that all high priority recommendations will remain under review by Internal Audit, by obtaining regular management updates, until the required action has been fully completed.

(4f) Risk Assurance Opinions

During the period November 2017 to December 2017, no limited assurance opinions on risk have been provided on completed audits from the 2017/18 Internal Audit Plan.

Where a limited assurance opinion is given, the Shared Service Senior Risk Management Advisor will be provided with the Internal Audit report(s) to enable the prioritisation of risk management support.

Completed Internal Audit Activity during the period November 2017 to December 2017

Summary of Satisfactory Assurance Opinions on Control

Service Area: Customer Services

Audit Activity: Discretionary Housing Payments

Background

A Discretionary Housing Payment (DHP) is a payment to help people, in receipt of Housing Benefit or the housing element of Universal Credit, meet their housing costs. These costs include help towards rent, tenancy start up and moving costs.

DHPs must operate in line with the Discretionary Financial Assistance Regulations 2001 and the guidance manual issued by the Department for Work and Pensions (DWP). Local authorities can use their own funds to top up their Government contribution by an additional 150% in England and Wales. Any unspent DHP funding from the Government contribution is returned at the end of the financial year.

The Government contribution to DHP funding for 2016/17 was £117,588 and Stroud District Council contributed an additional £4,090 resulting in a total expenditure on DHP's of £121,678. The Government contribution to DHP funding for 2017/18 increased to £153,989, as Universal Credit started on 4th October in Stroud Job Centre.

Scope

The objective of this review was to provide assurance that there is an effective control framework in place for the award and monitoring of DHPs, in compliance with internal policy and external regulations.

Risk Assurance – Substantial

Control Assurance – Satisfactory

Key findings

During 2016/17, in England and Wales, 241 local authorities underspent an estimated £7.2 million of the total £150 million DHP Government contribution provided to authorities; 92 local authorities spent the Government contribution, including Stroud District Council. In Gloucestershire only Stroud District Council and one other authority used 100% of the Government contribution allocated to them, the other four authorities underspent.

The Revenue and Benefits Manager regularly monitors the expenditure of the Government contribution and this enabled him, in 2016/17, to arrange for additional funding to be allocated to DHPs.

The submission of forms and local authority certificates, providing details of DHP expenditure to the Government, is timely and meets the expectations of external regulations.

Benefit Services have acknowledged the inherent associated risk and mitigating controls relating to DHPs and has captured this using the corporate system for risk recording (Excelsis).

Stroud District Council's DHP policy and guidance meets the expectations of external regulations. In addition, overall the process that Benefit Services follow for administering DHPs meets the requirements of external regulations and internal policy.

The DWP guidance manual however suggests that as best practice a second member of staff could check DHP awards to ensure consistency of decision making among Officers; this does not currently happen; and there are no controls in place to prevent a DHP being awarded or declined to a claimant an Officer may know.

Internal Audit sampled 15 DHP claims that had been approved and five DHP claims that had been declined, for the period 1st April 2017 to 30th September 2017, and found that the decisions were fair and consistent.

The CIVICA module that will enable regular automated DHPs for Universal Credit claimants to be processed has not been implemented by ICT due to connectivity issues. A manual solution has been developed by Benefit Services to ensure that Universal Credit DHP claimants are fully supported.

Conclusions

Internal Audit conclude that it is evident that there is a control framework in place for the award and monitoring of DHPs, in compliance with internal policy and external regulations; however the framework could be improved by:

- Strengthening the administration of DHPs by documenting the decision making and award process, ensuring consistency of decision making;
- Introducing an 'Officer Declaration' statement to further mitigate the risk of any potential allegations of suspected irregularities through collusion or misuse of funding; and

- Implementing the CIVICA module to enable regular DHPs for Universal Credit claimants to be processed.

Internal Audit has made three medium priority recommendations to support Benefit Services in further strengthening the current control framework for the award and monitoring of DHPs.

Management Actions

Management have responded positively to the three medium recommendations made.

Summary of Special Investigations/Counter Fraud Activities

Current Status

During 2017/18 to date (1st April 2017 to 31st December 2017) there have been four potential irregularities referred to Internal Audit, all relating to tenancy issues. All four of these cases are now closed, two of which previously been reported to the Audit and Standards Committee. In respect of the other two cases, both pertaining to allegations of subletting; one tenant has been evicted after failing to pay the rent and not engaging with the Council to resolve the situation. The final case has been closed due to allegation not containing sufficient information/evidence to enable the investigation to progress.

Audit, Risk Assurance (ARA) through the Gloucestershire Counter Fraud Unit has recently commissioned a bespoke piece of work on the Stroud District Council (SDC) housing list. The results of this review will be reported at the next Audit and Standards Committee.

Any fraud alerts received by Internal Audit from the National Anti-Fraud Network (NAFN) are passed onto the relevant service area within the Council, to alert staff to the potential fraud.

National Fraud Initiative (NFI)

Internal Audit continues to support the NFI which is a biennial data matching exercise administered by the Cabinet Office. The data collections were collected throughout October 2016 and reports have been provided for investigation. Examples of data sets include housing, insurance, payroll, creditors, council tax, electoral register and licences for market trader/operator, taxi drivers and personal licences to supply alcohol. Not all matches are investigated but where possible all recommended matches are reviewed by either Internal Audit or the appropriate service area.

Work to review the NFI data matches between Revenues (benefit and Council Tax), the Housing System and the Electoral Register has recently been commissioned by Audit, Risk Assurance (ARA) through the Gloucestershire Counter Fraud Unit. This work is ongoing and the high level outcomes of the review will be provided to the Audit and Standards Committee.

In addition, there is an annual data matching exercise undertaken relating to matching the electoral register data to the single person discount data held within the Council. Once all relevant data has been uploaded onto the NFI portal, a data match report is instantly produced and available for analysis. As above, the high level outcomes of the review will be provided to the Audit and Standards Committee.

STROUD DISTRICT COUNCIL

AUDIT AND STANDARDS COMMITTEE

6 FEBRUARY 2018

AGENDA ITEM NO

10

Report Title	**ANNUAL GOVERNANCE STATEMENT 2016/17 IMPROVEMENT PLAN – PROGRESS REPORT**
Purpose of Report	To provide assurance to the Committee that the improvement areas and associated actions identified as part of the annual review of governance arrangements operating within the Council have been/are being addressed.
Decision(s)	The Committee **RESOLVES** that it has reviewed and considered the actions taken to address the governance improvement areas identified.
Consultation and Feedback	Corporate Team.
Financial Implications and Risk Assessment	There are no direct financial implications arising from this report. David Stanley Accountancy Manager Tel: 01453 754100 Email: david.stanley@stroud.gov.uk **Risk Assessment:** Failure to deliver an effective corporate governance framework prevents the Council in directing and controlling its resources effectively and efficiently, to enable the Council's objectives to be met.
Legal Implications	There are no direct legal implications to report beyond the committee being satisfied that the progress reported is at least satisfactory. (Refr171c191d251) Karen Trickey, Head of Legal Services Tel: 01453 754369 Email: karen.trickey@stroud.gov.uk
Report Author	Theresa Mortimer, Head of Audit Risk Assurance Tel: 01453 754319 Email: theresa.mortimer@stroud.gov.uk

Options	None
Performance Management Follow Up	The Council's Annual Governance Statement 2017/18 is due to be presented to Audit and Standards Committee in July 2018, and will include a final progress report against the Annual Governance Statement 2016/17 Improvement Plan.
Background Papers/ Appendices	**Appendix A:** Annual Governance Statement 2016/17 Improvement Plan – Progress Report **Background papers:** Annual Governance Statement 2016/17

1.0 Background

1.1 Governance comprises the systems and processes, and cultures and values, by which local government bodies are directed and controlled and through which they account to, engage with and, where appropriate, lead their communities.

1.2 The Council is required by the Accounts and Audit Regulations 2015 to publish an Annual Governance Statement, in accordance with '*proper practices'* in order to report publicly on the extent to which we comply with our own Local Code of Corporate Governance. This approach includes how the Council has monitored the effectiveness of arrangements in year and on any planned changes to governance arrangements in the coming year. Through the Council's Constitution, the Audit and Standards Committee has responsibility for review and approval of the Statement.

1.3 Members approved the Council's Annual Governance Statement 2016/17 (including the Annual Governance Statement 2016/17 Improvement Plan) at the 4th July 2017 Audit and Standards Committee meeting.

1.4 This report is the first update presented to Members on the Council's progress (detailed in **Appendix A**) against agreed actions from the Annual Governance Statement 2016/17 Improvement Plan.

Progress on 2016/17 Stroud District Council's Governance Improvement Actions

AGS 2016/17 review reference	Governance matters identified/actions taken	Position as at January 2018
Chief Financial Officer Assurance Statement	**Future Financial Sustainability** The 2017/18 Medium Term Financial Plan (MTFP) identified core deficit of £3.4m by 2020/21. **Actions:** Work is currently underway with Strategic Heads and key members of the administration to produce a balanced savings plan that addresses the funding shortfall. **Lead Officer:** Chief Financial Officer (S151)	The latest January 2018 MTFP up to 2021/22 includes a cumulative core deficit of £3.456m in the latter years of the plan. It is a core deficit which is currently projected to increase further in future years. Progress has been made with the savings plan to date (as set out in the General Fund Budget 2018/19, Capital Programme, and Medium Term Financial Plan report to Strategy and Resources Committee 18/01/18 and Council 25/01/18), but that progress in implementing the savings will need to be maintained and reviewed regularly.

AGS 2016/17 review reference	Governance matters identified/actions taken	Position as at January 2018
		Also, where planned savings cannot be realised, senior managers will need to have identified alternatives that can be brought forward for consideration and implementation.
Corporate Team Review	**ICT Strategy / Infrastructure Investment Plan 2017/18 to 2019/20** The Council has allocated up to £600k between 2017/18 and 2019/20 to upgrade the ICT infrastructure and has developed an investment plan summarising how these funds are to be utilised to ensure that the ICT infrastructure continues to meet the business needs of the Council and is able to protect itself against key risks such as cyber threats. **Actions:** The delivery of the plan will be monitored by Corporate Team and key outcomes reported to Strategy and Resources Committee. **Lead Officer**: Investment Manager (ICT)	**ICT Investment** A strategic review of our ICT is currently being undertaken by SOCITM (the society of IT managers). They are reviewing our current systems, infrastructure, service needs and the likely future use and demands on our ICT service by the wider council service areas, including associated risks. This report will be available by the end of January, although key recommendations will be available before this time.

AGS 2016/17 review reference	Governance matters identified/actions taken	Position as at January 2018
		This review is being undertaken alongside a wider review which seeks to identify, assess and design even more efficient ways of working including: office provision, systems processes and structures and to address issues related to organisational culture. The outcome from which will be to identify how we can work in a more efficient, flexible and outcome focussed manner; for example: by using ICT to support greater mobile working, automation of processes and customer self-service.

AGS 2016/17 review reference	Governance matters identified/actions taken	Position as at January 2018
		As a result of this and the possibility that investment priorities may change, we have reduced the predicted capital spending for 2017/18, to a level which will support only essential investment, with the remainder carried forward into 2018/19, whereupon, we will be ready to implement the findings of the review and will have a focussed investment plan to meet future priorities, challenges and risks. We anticipate that the current capital programme will change, possibly significantly, as a result of this wide ranging review and that implementation of it.

AGS 2016/17 review reference	Governance matters identified/actions taken	Position as at January 2018
		It is also anticipated that the budget currently set for ICT investment £600K over three years (2017-2020) will need to increase; however, this is expected to partly support an element of invest to save spending. There is an identified need to develop a continuous ICT capital investment programme linked to projected ICT product life cycles. We should also note that in order to ensure the implementation of our revised ICT investment strategy that we draw upon the best sector based learning and experience. We have worked with the LGA on a project to share information supporting councils to lever the highest levels of productivity from their use of ICT.

AGS 2016/17 review reference	Governance matters identified/actions taken	Position as at January 2018
		Through this we have been awarded funding from the LGA to support the employment of an ICT productivity expert, with previous experience in other Local Authorities, who can support us in planning and implementing the delivery of the right ICT infrastructure and systems, drawing on past lessons and the SOCITM review. These projects will be managed so that one leads straight into the other through quarter 4 of the financial year.
Strategic Head's Composite Assurance Statement	**Multi Service Contract** The multi services contract provides for the provision of waste and recycling, street cleaning, grounds maintenance, fleet management and maintenance services.	The scheduled Service Management Review has commenced focussing on initially implementing immediate cost savings.

AGS 2016/17 review reference	Governance matters identified/actions taken	Position as at January 2018
	There has been a significant increase in costs of the new waste and recycling service which has resulted in additional resources allocated in the 2017/2018 Medium Term Financial Plan. **Actions:** A full service management review is being undertaken in early 2017/2018 which includes detailed resource analysis. In addition, Internal Audit will provide support to the development of a control framework to effectively manage and monitor the contract. **Lead Officer:** Director of Customer Services.	The first phase of the efficiency programme has been completed; phase two is due to be completed in March 2018. The Review by Internal Audit on the Control Framework has nine recommendations, including the need to review the Multi Services Contract; all recommendations should be completed by 31st March 2018.
Strategic Head's Composite Assurance Statement	**Council Tax and Business Rates Direct Debit issues** In December 2016 an error occurred in two Direct Debit payment runs and payments were taken from customers' bank accounts a few days earlier than the due date. A full review was immediately undertaken that examined what had happened and how it can be prevented from happening again. A Members Information sheet was produced which was published on the Council's website which included an improvement action plan.	Completed. Final outcomes reported to the Audit and Standards Committee 4th July 2017.

AGS 2016/17 review reference	Governance matters identified/actions taken	Position as at January 2018
	In consultation with Internal Audit, six key recommendations were agreed around the following areas: (1) Procedure guidance notes and procedures documented and process defined, (2) additional staff training, (3) Internal User Group meetings, (4) Business Continuity Plan, (5) Automate Process, and (6) Internal Audit Review. **Actions:** An Internal Audit review is undertaken to provide the relevant assurances that the Improvement Action Plan has been addressed and implemented. **Target Date:** 31st May 2017 **Lead Officer:** Chief Internal Auditor	Internal Audit to include a further follow up review in the 2018/2019 Internal Audit Plan to ensure the outstanding recommendation relating to Business Continuity arrangements has been implemented.
Brought Forward from 2015/16	**HRA balances investigation:** The investigation of HRA balances reported to Members between 2014/15 and 2015/16 (requested by the Chief Executive and reported to Strategy and Resources Committee on 15th June 2016) confirmed that reported HRA balances in committee reports considered by Members had been overstated by £909,000. The overstatement has impacted on the HRA budget and business plan for 2016/17 (and subsequent years).	Completed. Final outcomes reported to the Audit and Standards Committee 12th September 2017.

AGS 2016/17 review reference	Governance matters identified/actions taken	Position as at January 2018
	The investigation report raised eight recommendations to improve controls surrounding budget and outturn reporting to Members. Responsibility for control implementation and governance improvement has been allocated to the S151 Officer. **Action(s):** Internal Audit to complete follow up reviews on the implementation of the HRA balances investigation recommended controls. Review to be completed in two stages within quarters 2 and 3 2016/17 (completed) and a final full follow up of all recommendations raised within the original HRA balances investigation report within quarter 2 of 2017/2018. The follow up review findings will be reported to Audit and Standards Committee. **Target Date:** Audit and Standards Committee 12th September 2017 **Lead Officer:** Chief Internal Auditor	

AGS 2016/17 review reference	Governance matters identified/actions taken	Position as at January 2018
Brought forward from 2015/16	**Procurement Action Plan:** Weakness in the use and management of procurement and contract management increases the risk of legal challenge from suppliers and contractors of not complying with relevant regulations and internal Council Contract and Procurement Rules. It also increases the risk that the Council cannot demonstrate that it is securing value for money when procuring. The Council drafted the Procurement Action Plan 2015/16 to mitigate against the above risks. Implementation in 2015/16 was delivered through the Procurement Board and progress reported to the Audit and Standards Committee. At 2015/16 year end, governance of procurement and contract management was transferred from the Procurement Board to the Corporate Team. To continue development of the area, Audit and Standards Committee approved the proposed 2016/17 Action Plan on 5th April 2016. **Action:** Corporate Team to lead on delivery and implementation of the approved Procurement Action Plan 2016/17. Progress against the 2016/17 Plan will continue to be reported to Audit and Standards Committee during 2017/18.	In response to the Action: 1. Corporate Team has received regular updates (i.e. on a quarterly basis) on work undertaken by the Principal Procurement Officer in accordance with the 2016/17 Action Plan. Two updates on progress have also been provided to Audit and Standards Committee. 2. The main areas of work in the Action Plan (all of which have been completed by the Procurement Team) include: a. Continuation with South West Procurement Portal;

AGS 2016/17 review reference	Governance matters identified/actions taken	Position as at January 2018
	Lead Officer: Principal Procurement Officer	b. Project oversight by the relevant service manager to consolidate Council contracts for agency staff and consultants, which has resulted in a new process for the procurement and appointment of agency staff being implemented by Human Resources Manager using a framework agreement; c. Update of Council's Contract Procedure Rules (CPPR);

AGS 2016/17 review reference	Governance matters identified/actions taken	Position as at January 2018
		d. Production of guides for officers on contract management as well as regular officer updates on changes in relevant requirements e.g. procurement thresholds; and e. Completion of a comprehensive programme of procurement training in 2017 to improve the skills and knowledge of all staff who undertake procurement activities within the Council (see below).

AGS 2016/17 review reference	Governance matters identified/actions taken	Position as at January 2018
		3. The corporate training included all staff from Corporate Team through to relatively junior staff who act under instruction from delegated officers (i.e. Directors and certain Heads of Services). Following the training an assessment of the value and the improvement in procurement activity was undertaken, with most staff commenting that the training was informative, their knowledge had increased, which should in turn improve the Council's future procurement activities, minimising risks of challenge and increasing value for money of goods, services and works received.

AGS 2016/17 review reference	Governance matters identified/actions taken	Position as at January 2018
		4. Additional work has also been undertaken by the Procurement Officer including: a. Commencement of review of template contracts for use in any procurement activity; b. Development of an induction checklist with Human Resources Team for new members of staff, whereby new staff are informed of their obligations under the Council's Constitution including CPPRs (this is adapted for each new member of staff, depending on the amount of procurement activity they are likely to undertake); and

AGS 2016/17 review reference	Governance matters identified/actions taken	Position as at January 2018
		c. Leading projects to consolidate Council expenditure on postage, printing and marketing services. 5. The importance of compliance with relevant legislation and the Council's CPPRs is recognised by the Council continuing to allocate responsibility for such to Corporate Team and relevant Heads of Service. 6. Following a reorganisation of Tenant Services and in recognition of fact that a significant amount of large value contracts are the responsibility of that team, a new role of Head of Contract Services was created to

AGS 2016/17 review reference	Governance matters identified/actions taken	Position as at January 2018
		oversee contracts and contract management across the Council.
Brought forward from 2015/16	**Business Continuity and Disaster Recovery**: The Council's Excelsis risk register includes the risk 'if the Council does not regularly review it's business continuity/disaster recovery plans to ensure they are fit for purpose, the delivery of frontline and back office services will be disrupted in the event of an incident'. To support mitigation of this risk the s151 Officer and the previous ICT Delivery Manager raised the area for inclusion within the Risk Based Internal Audit Plan 2016/17. A Business Continuity and Disaster Recovery consultancy review was therefore completed by Internal Audit in liaison with the ICT Delivery Manager, to support control improvement. An action plan was subsequently developed which highlighted improvement areas. **Action:** During 2017/2018 Internal Audit will review progress with the recommendations made and report the outcomes to the Audit and Standards Committee.	Draft reports have been issued within January 2018, with the final outcomes to be reported to the 10th April 2018 Audit and Standards Committee. The reason for the delay on ICT audit delivery within 2017/18 was the reduced ICT resources within the SDC team and the delay on appointment and start date of the Infrastructure Manager. The client (through the ICT Investment Manager and with agreement of the relevant Director) requested delay of the audits until November 2017. This request has impacted the AGS target date.

AGS 2016/17 review reference	Governance matters identified/actions taken	Position as at January 2018
	Target Date: Audit and Standards Committee 28th November 2017 **Lead Officer:** Chief Internal Auditor	

ARA AuditRiskAssurance

Progress Report including Assurance Opinions

Department	Activity Name	Priority	Activity Status	Risk Opinion	Control Opinion	Reported to Audit and Standards Committee	Comments
Council Wide	Delivery of Savings Target	High	Final Report Issued	Satisfactory	Satisfactory	28/11/2017	Brought Forward from 2016/17 plan
Council Wide	ICT Business Process follow up	High	Audit in Progress				
Council Wide	Capital Programme	High	Draft Report Issued				
Council Wide	Contract Management	High	Planned				
Council Wide	Gifts and Hospitality	High	Planned				Terms of Reference issued
Council Wide	Information Governance	High	Consultancy				Reported in annual report
Council Wide	Members Allowances and Expenses	Medium	Audit in Progress				
Council Wide	Post Project Reviews	High	Planned				Terms of Reference issued
Council Wide	Procurement	High	Planned				
Council Wide	Legacy software	High	Audit in Progress				
Council Wide	Data Protection	High	Cancelled				Cancelled based on updated client risk
Council Wide	Critical ICT systems back up	High	Audit in Progress				New Activity
Development Services	Community Infrastructure Levy	High	Planned				Agreed with manager to commence Q4
Development Services	Licensing (Business Licences)	Medium	Planned				To progress Q4
Customer Services	Homelessness	Medium	Deferred				Defer to 18/19 plan to ensure consideration of
Customer Services	Discretionary Housing Payments	Medium	Final Report Issued	Substantial	Satisfactory	06/02/2018	
Customer Services	Multi Services Contract	High	Final Report Issued	Not Applicable	Not Applicable	28/11/2017	
Customer Services	The Pulse Dursley	Medium	Audit in Progress				
Finance	Housing Revenue Account (HRA) Balances final follow up	High	Final Report Issued	Not Applicable	Not Applicable	12/09/2017	Brought Forward
Finance	Budget Setting	High	Audit in Progress				
Finance	Cash and Bank	High	Audit in Progress				
Finance	General Ledger	High	Audit in Progress				
Finance	National Non Domestic Rates (NNDR)	High	Final Report Issued	Satisfactory	Satisfactory	28/11/2017	
Council Wide	IT Disaster Recovery follow up	High	Audit in Progress				
Finance	Benefits Uprating 2017/18	High	Final Report Issued	Substantial	Substantial	12/09/2017	
Finance	Council Tax Opening Debit - 2017/18	High	Final Report Issued	Satisfactory	Satisfactory	12/09/2017	
Finance	Local Government Pension Scheme Regulations (LGPS) Regulations 2014	High	Final Report Issued	Satisfactory	Limited	12/09/2017	Brought Forward from 2016/17 plan
Tenant & Corporate Services	Response Repairs Contract	High	Final Report Issued	Satisfactory	Satisfactory	12/09/2017	Brought Forward from 2016/17 plan
Tenant & Corporate Services	Brimscombe Port Redevelopment	High	Final Report Issued	Satisfactory	Satisfactory	12/09/2017	
Council Wide	Banks Automated Clearing System (BACS)	High	Final Report Issued	Satisfactory	Satisfactory	04/07/2017	
Council Wide	Network Access Controls	High	Final Report Issued	Satisfactory	Satisfactory	12/09/2017	Brought Forward from 2016/17 plan
Council Wide	Sub Rooms	High	Audit in Progress				New Activity

STROUD DISTRICT COUNCIL

AUDIT AND STANDARDS COMMITTEE

6 FEBRUARY 2018

AGENDA ITEM NO

11

Report Title	**3RD QUARTER TREASURY MANAGEMENT ACTIVITY REPORT 2017/18**
Purpose of Report	To provide an update on treasury management activity as at 31/12/2017.
Decision(s)	**The Audit and Standards Committee APPROVES the treasury management activity third quarter report for 2017/2018.**
Consultation and Feedback	Link Asset Services Limited
Financial Implications & Risk Assessment	Bank base interest rate was increased from 0.25% to 0.5% in November 2017. This was the first increase for a decade. This will increase the interest income earned by investment of the Council's balances and cash flow funds. Graham Bailey, Principal Accountant Tel: 01453 754133 Email: graham.bailey@stroud.gov.uk
Legal Implications	The report indicates that the Council is operating its investment strategy in accordance with the statutory Treasury and Prudential Limits in view of which there are no legal concerns arising from the report. Alan Carr, Solicitor Email alan.carr@stroud.gov.uk Tel 01453754357
Report Author	Maxine Bell, Snr Accounting Officer Tel: 01453 754133 E-mail: maxine.bell@stroud.gov.uk
Options	None
Performance Management Follow Up	A full 2017/18 annual report.
Appendices	A – Prudential Indicators as at 31 December 2017 B – 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 third quarter of the financial year, (and to report on prudential indicators and compliance with treasury limits). A quarterly report is regarded as good practice, but is not 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:

    - A review of the Treasury Management Strategy Statement (TMSS) and Investment Strategy
    - A review of the Council's investment portfolio for 2017/18
    - A review of the Council's borrowing strategy for 2017/18
    - A review of compliance with Treasury and Prudential Limits for 2017/18
    - Other Treasury issues

Treasury Management Strategy Statement and Investment Strategy update

4. The TMSS for 2017/18 was approved by Council on 23 February 2017. 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. In the current low interest rate environment the Council is seeking to invest for longer periods of up to a year, with highly credit rated financial institutions, using Capita's suggested creditworthiness approach, which includes a sovereign credit rating and Credit Default Swap (CDS) overlay.

6. A breakdown of the Council's investment portfolio as at 31 December and 30 September 2017 is shown in Table 2 of this report. Investments and borrowing during the year have been in line with the Strategy.

Investment Portfolio 2017/18

7. 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 for the third quarter is shown in the table below:

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
01/04/17 - 30/06/17	£43,103	£33.207m	0.52%	0.11%	0.17%
01/07/17 - 30/09/17	£45,235	£39.001m	0.47%	0.11%	0.18%
01/09/17 - 31/12/17	£47,553	£40.215m	0.47%	0.35%	0.37%
Total	£135,891	£37.490m	0.48%	0.19%	0.24%

8. The Local Area Mortgage Scheme investment of £1m which matured on the 24th April 2017 at 3.8% with Lloyds is excluded from the above table. If this interest is included the interest earned is £138k at an average interest rate of 0.4904%.

9. Table 2 below shows the investments and borrowing position at the end of December 2017.

10. The approved limits as set out in the Treasury Management Strategy report to Council 23 February 2017 within the Annual Investment Strategy have been complied with during the first three quarters of 2017/18.

11. 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 £8m core cash balances for investment purposes (i.e. funds that potentially could be invested for more than one year).

TABLE 2: Investments & Borrowing

	Sep 2017 £'000		Dec 2017 £'000	
Standard Life	2,034		415	
Federated Prime Rate	3,264		3,985	
Goldman Sachs	1		3,991	
Deutsche	0		2,000	
Money Market Funds Total		**5,299**		**10,391**
Bank of Scotland	0		1,500	
Lloyds	6,428		6,431	
Lloyds Banking Group Total		**6,428**		**7,931**
NatWest	-		1,798	
Royal Bank of Scotland	4,008		4,007	
RBS Banking Group Total		**4,008**		**5,805**
Goldman Sachs	8,000		8,000	
Standard Chartered	2,000		2,000	
Santander	4,607		2,053	
Barclays Bank Plc	1		2,001	
Svenska Handelsbanken	7,802		5,918	
Rabobank	2,000		0	
Other Banks Total		**24,410**		**19,972**
TOTAL INVESTMENTS		**£40,145**		**44,099**
Local Authority		2,000		2,000
PWLB		104,717		104,717
TOTAL BORROWING		**£106,717**		**£106,717**

Borrowing

12. The Council's Capital Financing Requirements (CFR) for 2017/18 is £113.984m. 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 external borrowing of £106.717m as at 31 December 2017. There is also £5.589m of internal borrowing, which includes year to date spending on Littlecombe Industrial Units and Multi Service Contract vehicles of £0.849k.

Compliance with Treasury and Prudential Limits

13. It is a statutory duty for the Council to determine and keep under review the "Affordable Borrowing Limits". Council's approved Treasury and Prudential Indicators are outlined in the approved TMSS.

14. During the period to 31 December 2017 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 A.

MIFID II

15. The Markets in Financial Instruments Directives is EU legislation changed from 3rd January 2018, this is a regulatory environment for local authorities using certain financial investment types. Local authorities have been classified as retail rather than professional investors which will limit the range of investments available. There is an option within the legislation for local authorities to opt up to the professional classification on an institution by institution basis. The Council meets the criteria to opt up to professional status and has done so to maintain the range of investments available. An example of where the Council is opting up is with Money Market Funds.

Prudential Indicators as at December 2017

Prudential Indicator	2017/18 Indicator £'000	Actual as at 31 Dec 2017 £'000
Capital Financing Requirement (CFR)	113,984	112,306
Gross Borrowing	107,717	106,717
Authorised Limit for external debt	128,000	106,717
Operational Boundary for external debt	120,000	106,717
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	8,000	0
Maturity structure of borrowing limits		
Under 12 months	100%	1%
12 months to 2 years	100%	2%
2 years to 5 years	100%	1%
5 years to 10 years	100%	2%
10 years and above	100%	94%

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 2017 strategy with actual gross borrowing as at 31 December 2017.

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 CFR of £113,984m provides the Council with the opportunity to borrow if appropriate. No external borrowing is planned for 2017/18.

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 2017 to 31 December 2017.

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 2017 to 31 December 2017.

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 only permits lending beyond 1 year with other Local Authorities up to a maximum of 3 years.

STROUD DISTRICT COUNCIL

AGENDA ITEM NO

AUDIT AND STANDARDS COMMITTEE

6 FEBRUARY 2018

12

Report Title	**TREASURY MANAGEMENT STRATEGY, ANNUAL INVESTMENT STRATEGY AND MINIMUM REVENUE PROVISION POLICY STATEMENT 2018/19**
Purpose of Report	This report outlines the Council's prudential indicators for 2018/19 – 2020/21 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 MHCLG investment guidance. It also fulfils the statutory duty to approve a minimum revenue policy (MRP) statement for 2018/19.
Decision(s)	**The Audit and Standards Committee RECOMMEND that Council:** **1. adopt the prudential indicators and limits for 2018/19 to 2020/21;** **2. approve the treasury management strategy 2018/19, and the treasury prudential indicators;** **3. approve the investment strategy 2018/19, and the detailed criteria for specified and non-specified investments; and** **4. approve the MRP Statement 2018/19.**

Consultation and Feedback	Link Asset Services (LAS) formerly Capita Asset Services.
Financial Implications and Risk Assessment	This report sets out the expected activities of the Council's Treasury function for 2018/19 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. Paragraph 5 of the report highlights changes in statutory guidance issued by Ministry of Housing, Communities and Local Government that will require the council to amend this strategy during the course of 2018/19. The Council has £106.717m of external borrowing (£112.521 including internal borrowing) and the Council's capital spending plans increase the borrowing to £113.213m by 31 March 2021. It is worth noting that the Council's proposed capital programme proposes a further £0.4m of borrowing in 2021/22, but this is not reflected in the prudential indicators in this report due to the differing timescales covered by the Treasury Management Strategy and the Capital Programme. 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. An under borrowing position has been assumed in the short term to minimise the impact of the difference between borrowing and investment rates. This position will be kept under review in conjunction with our Treasury Management advisers as the council's balances are utilised over the medium term. 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. David Stanley, Accountancy Manager (Section 151) Tel: 01453 754100 Email: david.stanley@stroud.gov.uk
Legal Implications	The report and recommendations do not raise any direct issues and concerns with regard to non-compliance with statutory requirements. Alan Carr, Solicitor Email alan.carr@stroud.gov.uk Tel 01453754357

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 2018/19 Council Tax, Housing rent levels and the capital programme.
Performance Management Follow Up	A revised Treasury Management Strategy, Annual Investment Strategy and Minimum Revenue Provision Policy Statement 2018/19 will be presented as the half year report to fully comply with the recently revised CIPFA Prudential Code, CIPFA Treasury Management Code, as well as revised Ministry of Housing, Communities and Local Government (MHCLG) MRP and Investment guidance. Quarterly and annual Treasury Management reports of actual compared with estimated prudential indicators for 2018/19. 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 for Capital Finance in Local Authorities (2017) 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 (2017).
Appendices	A. Investments at 31 December 2017 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. Both these CIPFA codes have been reviewed and revised and published in December 2017. This report is based on the new codes, with the exception of introducing a Capital Strategy, which will be presented to Strategy and Resources during 2018/19 and then on to Council, and included in the half-year report Treasury Management report, together with details of any Non-Treasury Investments.

4. 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 – 2.11 of this report.

5. Ministry of Housing, Communities and Local Government (MHCLG) have consulted on changes to Statutory Guidance on Local Authority Investments and Statutory Guidance on Minimum Revenue Provision. The consultation closed on 22 December 2017, and the resulting revised guidance is applicable for financial year 2018/19, however it has not been issued at the time of the drafting of this report. Changes to be introduced concern firstly, a tightening up of perceived abuses of MRP, whereby Councils may have imprudently loaded debt repayment liabilities onto future council tax payers, and secondly to ensure that Councils conduct proper due diligence around more speculative investments, particularly around major property acquisitions and other investments funded by PWLB borrowing. This report is based on the pre-existing guidance. Full compliance with the newly revised guidance will be presented in the half-year report.

6. CIPFA Code of Practice on Treasury Management (revised December 2017) 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 is not subject to approval by Members. The manual incorporates the following documentation relating to Treasury management:

   - <u>Treasury Management Policy Statement</u>. This is reviewed annually.
   - <u>Treasury Management Practices (TMP) – Main Principles</u>. 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 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. In future updates Non Treasury Investments will be included.
- Counterparty Lending List and lending criteria. The list used by the Council is provided by Link Asset Services (LAS), the Council's treasury advisors. A new list is provided weekly, and there are daily updates by email of any changes to ratings.

7. Other CIPFA requirements are:

- a Mid-year 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 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 2018/19

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 The 2018/19 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, LAS. 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 and minimum revenue provision 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 2018/19 TO 2020/21

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	2016/17 £000 Actual	2017/18 £000 Estimate	2018/19 £000 Estimate	2019/20 £000 Estimate	2020/21 £000 Estimate
Community Services	1,588	78	180	150	-
Environment	1,234	909	1,140	1,900	1,066
Housing General Fund	-	710	449	330	330
Strategy & Resources	7,706	3,148	2,820	1,582	900
General Fund	**10,528**	**4,845**	**4,589**	**3,962**	**2,296**
HRA	**10,975**	**9,189**	**11,720**	**6,414**	**6,489**
Total	**21,503**	**14,034**	**16,309**	**10,376**	**8,785**

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	2016/17 £000 Actual	2017/18 £000 Estimate	2018/19 £000 Estimate	2019/20 £000 Estimate	2020/21 £000 Estimate
General Fund	10,528	4,845	4,589	3,962	2,296
HRA	10,975	9,189	11,720	6,414	6,489
Total	**21,503**	**14,034**	**16,309**	**10,376**	**8,785**
Financed by:					
Capital receipts	2,761	2,755	2,184	304	400
Capital grants	1,561	838	2,146	812	330
Capital reserves	6,162	971	3,876	1,410	10
Revenue	208	7,286	7,153	5,750	6,729
Net Financing Need for the year	**10,811**	**2,184**	**950**	**2,100**	**1,316**

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	2016/17 £000 Actual	2017/18 £000 Estimate	2018/19 £000 Estimate	2019/20 £000 Estimate	2020/21 £000 Estimate
CFR - General Fund	15,715	16,779	16,438	17,431	17,471
CFR - HRA	95,742	95,742	95,742	95,742	95,742
Total CFR	111,457	112,521	112,180	113,173	113,213
Movement in CFR	10,252	1,064	-341	993	40

Movement in CFR represented by					
Net financing need for the year	10,811	2,184	950	2,100	1,316
Less MRP / VRP and other financing movements	-559	-1,120	-1,291	-1,107	-1,276
Movement in CFR	10,252	1,064	-341	993	40

Minimum Revenue Provision (MRP) Policy Statement 2018/19

2.6 The Council's MRP policy statement for 2018/19 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. However, following on from the introduction of HRA self-financing the HRA is required to charge depreciation on its assets for financial years commencing April 2017. As a result, depreciation is a real cost to the HRA from financial year 2017/18. The regulations had allowed for the Major Repairs Allowance to be used as a proxy for depreciation until 31 March 2017.

2.8 The government has protected the General Fund from any adverse MRP liability arising from HRA self-financing borrowing. Consequently, as there was no General Fund MRP liability prior to HRA Self-Financing, there has been no General Fund MRP liability until financial year 2016/17. From 2016/17 General Fund borrowing in respect of The Pulse fitness extension, the Multi-Service contract vehicles, premises and equipment, and more recently the Littlecombe Business Units has resulted in a requirement to charge the General Fund with MRP, as a prudent provision for the repayment of that debt.

2.9 Additional planned borrowing arising from the capital budget set in February 2017, which has been revised in 2018 budget setting has created higher MRP and interest revenue cost pressures to the General Fund Medium Term Financial Planning period and beyond.

2.10 MRP will be charged under Option 3 of the MHCLG guidance. Option 3 is an MRP charge over a time period reasonably commensurate with the estimated useful life of a new asset. This is a prudent method of repaying the debt associated with particular assets. The Council is also permitted to make additional Voluntary Revenue Provisions (VRP), and it would be considered prudent to make such additional provisions for the repayment of debt.

2.11 The status of £2m of funding received from the HCA in respect of capital development works to Brimscombe Port is effectively a loan, although a future capital receipt arising from the property asset transferred to the Council as part of the development agreement should be sufficient to repay that loan. At this stage no MRP provision is being charged to the General Fund, as if all goes to plan no MRP will be necessary. However, this position will be kept under review.

2.12 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	2016/17 £m Actual	2017/18 £m Estimate	2018/19 £m Estimate	2019/20 £m Estimate	2020/21 £m Estimate
Fund balances / reserves	24.381	21.328	19.256	17.563	16.124
Capital receipts	3.490	4.755	3.796	4.117	4.342
Provisions	0.525	0.665	0.665	0.665	0.665
Other	1.062	0.500	0.500	0.500	0.500
Total Core funds	**29.458**	**27.248**	**24.217**	**22.845**	**21.631**
Working capital	5.314	0.500	0.500	0.500	0.500
Under (-) / over borrowing	-4.740	-5.804	-4.463	-4.456	-3.496
Expected investments	**30.032**	**21.944**	**20.254**	**18.889**	**18.635**

Affordability of capital plans prudential indicators

2.13 A prudential indicator is required to assess the affordability of capital expenditure plans. This indicator provides an estimate of the impact of capital investment plans on the Council's overall finances. The Council is asked to approve the cost of capital expenditure plans as a ratio of the net revenue stream indicator shown in table 5.

Table 5: Ratio of financing costs to net revenue stream

	2016/17 Actual	2017/18 Estimate	2018/19 Estimate	2019/20 Estimate	2020/21 Estimate
Non-HRA	-0.68%	-0.95%	-0.69%	-0.36%	0.08%
HRA	16.03%	16.17%	16.56%	17.05%	16.64%

3. BORROWING

3.1 Amongst the objectives of the treasury management function are ensuring 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 6 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 6: Gross Debt compared with Capital Financing Requirement (CFR)

	2016/17 £m Actual	2017/18 £m Estimate	2018/19 £m Estimate	2019/20 £m Estimate	2020/21 £m Estimate
External Debt					
Debt at 1 April	104.717	106.717	106.717	107.717	108.717
Expected change in debt	2.000	-	1.000	1.000	1.000
Other long term liabilities at 1 Apr	-	-	-	-	-
Actual Gross Debt at 31 March	106.717	106.717	107.717	108.717	109.717
Capital Financing Requirement	111.457	112.521	112.180	113.173	113.213
Under / (-) over borrowing	4.740	5.804	4.463	4.456	3.496

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 2018/19 and the following two financial years. This allows some flexibility for limited early borrowing for future years, but ensures that borrowing is not for revenue purposes.

3.4 The Section 151 officer 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 2020/21. 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 7: Operational Boundary

Operational Boundary	2017/18 £m Estimate	2018/19 £m Estimate	2019/20 £m Estimate	2020/21 £m Estimate
Debt	120	122	122	122
Other Long Term Liabilities	-	-	-	-
Total	120	122	122	122

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 8: Authorised Limit for External Debt

Authorised Limit	2017/18 £m Estimate	2018/19 £m Estimate	2019/20 £m Estimate	2020/21 £m Estimate
Debt	128	130	130	130
Other Long Term Liabilities	-	-	-	-
Total	128	130	130	130

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 had some headroom to borrow over and above the self-financing settlement amount. The borrowing headroom was used up by 31 March 2017. No further borrowing by the HRA is permitted. This is shown in the next table:

Table 9: HRA Debt Limit

HRA Debt Limit	2016/17 £m Actual	2017/18 £m Estimate	2018/19 £m Estimate	2019/20 £m Estimate	2020/21 £m Estimate
Actual HRA CFR	95.742	95.742	95.742	95.742	95.742
Limit	95.742	95.742	95.742	95.742	95.742
Headroom	-	-	-	-	-

3.9 Link Asset Services (LAS) 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 latest LAS forecast as at November 2017.

Table 10: Interest Rate Forecast

Month	Bank Rate	PWLB Borrowing Rates		
		5 year	25 year	50 year
Dec-17	0.5	1.5	2.8	2.5
Mar-18	0.5	1.6	2.9	2.6
Jun-18	0.5	1.6	3	2.7
Sep-18	0.5	1.7	3	2.8
Dec-18	0.5	1.8	3.1	2.9
Mar-19	0.75	1.8	3.1	2.9
Jun-19	0.75	1.9	3.2	3
Sep-19	0.75	1.9	3.2	3
Dec-19	0.75	2	3.3	3.1
Mar-20	1	2.1	3.4	3.2

Borrowing Strategy

3.10 Currently the Council has £106.717m of borrowing, compared with a Capital Financing Requirement (CFR) of £111.457m. This means that the capital borrowing need (the CFR), is greater than loan debt by £4.740m. The Council has taken no borrowing during the 2017/18 financial year.

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 2017/18 HRA CFR is £95.742m and borrowing is £95.742m, this means that borrowing ‘headroom’ following HRA self-financing has been fully utilised measured against the cap, as shown by table 9.

3.12 HRA capital plans can include no further borrowing in 2018/19 and subsequent years, whilst General Fund capital plans include borrowing of £6.55m up to 2020/21. The Section 151 officer will decide on the length and type of borrowing, as well as the optimum time to borrow in consultation with LAS, and take into account the latest projections for interest rates and other relevant factors including any benefits arising from internal borrowing.

3.13 There is a £1m PWLB loan due for repayment in Mar 2018, and a £2m loan from Hampshire County Council due for repayment in February 2019. The HRA will refinance these loans as there is no budgetary provision within the HRA medium term financial plan for the loan repayment.

3.14 At the end of 2017/18 there is an estimated internal borrowing position of £5.804m. Internal borrowing is currently beneficial because it reduces the financial impact of the differential between borrowing and investment interest rates. This position is projected as continuing through the period to 2020/21. Although, with the MTFP forecasting the running down of balances, and possible future changes in interest rate forecasts the Section 151 officer will keep this under review, and adjust the strategy as necessary in consultation with our Treasury advisers LAS.

Treasury management limits on activity

3.15 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 indicator is maturity structure of borrowing. The 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

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

Table 11: Maturity structure of borrowing

Maturity structure of new fixed and variable rate borrowing during 2018/19	Upper Limit	Lower Limit
Under 12 months	25%	0%
12 months and within 24 months	50%	0%
24 months and within 5 years	75%	0%
5 years and within 10 years	100%	0%
10 years and above	100%	0%

Table 12: Non-specified investment limit

Upper Limit for total principal sums invested for over 364 days	2016/17	2017/18	2018/19	2019/20	2020/21
Investments	£8m	£8m	£7m	£6m	£5m

Policy on borrowing in advance of need

3.17 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.

3.18 The Council will consider borrowing up to 12 months ahead of capital spend:

- If such capital spend is considered very likely to occur within 12 months;
- treasury advisers demonstrate that rates are particularly low and likely to move higher within 12 months;
- treasury advisers evaluate a net saving after assessing cost of carry;
- a trigger rate(s) will be set by s151 officer in consultation with treasury advisers and treasury officers;
- borrowing will be conducted in parcels – eg £4m could be split into 4 x £1m or 2 x £2m;

- 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;

3.19 The foregoing usual procedure will not prevent the s151 officer from forward borrowing to the fullest extent permitted by the Prudential Code, CFR for the current year plus the following two years, if extraordinary conditions arise in the short term to make such action in the interests of the authority.

Debt rescheduling

3.20 Now that the Council has £106.7m of debt, the Section 151 officer 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 MHCLG'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. LAS'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, and are available on the Passport online portal.

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, however this does not preclude the consideration and implementation of higher risk investments as part of a balanced portfolio of investments, subject to proper due diligence in line with the changes to be introduced by MHCLG.

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 of 1 year or less (including any forward deal time), subject to LAS's colour coding rating system as set out in creditworthiness policy paragraphs 4.16 – 4.21.

Table 13: Specified Investments

Type of Investment	Minimum 'High' Credit Criteria	Max Sum** per institution / group
Debt Management Agency Deposit Facility	*	£45m
Term deposits – local authorities	*	£8m
Term deposits – banks and building societies	Colour coded as per CAS Weekly counterparty listing (AA- 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 CAS Weekly counterparty listing (AA- countries & UK only)	£8m
Money Market Funds	AAA	£4m per MMF & £12m total in MMFs
Enhanced Money Market Funds	AAA	£4m per MMF & £12m total in MMFs

Non-Specified Investments

4.9 All investments will be sterling denominated.

Table 14: 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 CAS Weekly counterparty listing (AA- countries & UK only)	3 years	£8m
Certificates of deposits issued by banks and building societies	Colour coded as per CAS Weekly counterparty listing (AA- 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, or group if specified.

*** Any investment would be subject to an evaluation process and a report to Strategy and Resources Committee.

Investment Strategy

4.10 Cash flow forecast requirements and the outlook for short-term interest rates are important factors considered when making investments. During 2017 base interest rate was 0.25% until November when the base interest rate rose to 0.5%. This was the first base interest rate rise since 2007.

4.11 In 2018-19 the Council will continue to invest for the longest permitted duration with quality counterparties to maximise return without compromising security, or liquidity. In particular instances the Section 151 Officer will authorise investments in the LAS blue category (see para 4.16) for a period of up to two years, which is currently longer than the LAS recommended duration of one year. Otherwise, the length of investments permitted will vary if necessary in line with LAS advice subject to the Council's 3-year upper limit.

Table 15: Investments maturing after the end of the current financial year.

Financial Institution	Amount £	Maturity	Rate
Goldman Sachs	2,000,000	01/06/2018	0.50%
Lloyds	2,000,000	22/05/2018	0.65%
RBS	1,000,000	20/07/2018	0.64%
RBS	2,000,000	10/09/2018	0.57%

4.12 Bank Rate is currently forecast to continue on a rising trend with further 0.25% increases forecast for March 2019 and March 2020, this would take base rate up to 1% in March 2020.

4.13 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 accounts. This will be done to save transaction costs, where transaction costs would exceed interest earned.

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

Creditworthiness policy

4.15 This Council applies the creditworthiness service provided by LAS. 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.

4.16 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 for Enhanced money market funds with credit score of 1.25
- **Light pink** 3 years for Enhanced money market funds with credit score of 1.5
- **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

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

4.18 Typically the minimum credit ratings criteria the Council uses will be a short term rating (Fitch or equivalents) of short term rating F1 and a long term rating of A-. 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.

4.19 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 LAS creditworthiness service.

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

4.20 The Council will not place sole reliance on the use of this external service. In addition this Council will use market data and market information, and information on external support for banks to help support its decision making process.

Country limits

4.21 The Council will only invest in the UK and countries with a sovereign rating of AA- or higher. The following countries currently have sovereign ratings of AA- or higher, and also have banks operating in sterling markets which have credit ratings of green or above in LAS credit worthiness service.

AAA	AA+	AA	AA-
Australia	Finland	Abu Dhabi (UAE)	Belgium
Canada	Hong Kong	France	Qatar
Denmark	USA	UK	
Luxemburg			
Germany			
Netherlands			
Norway			
Singapore			
Sweden			
Switzerland			

5. MISCELLANEOUS TREASURY ISSUES

Use of external service providers

5.1 Link Asset Services (LAS) formerly Capita Asset Services, are the Council's treasury management advisers. However, responsibility for treasury management decisions remains with the Council at all times, therefore undue reliance will not be placed upon our external treasury management advisers. The current contract has an end date of 30 September 2018, together with an option to extend until 30 September 2020.

MiFID II

5.2 The second Markets in Financial Instruments Directive (MiFID II) is now effective commencing 3 January 2018. In order to maintain the range of investments available to the Council there has been an administrative exercise to opt up from retail to professional classification for all counterparties where this has been required.

Member Training

5.3 The CIPFA Code requires the Section 151 officer to arrange the provision of adequate training for members. Member training was held on 1 November 2017. Training is necessary to enable Audit and Standards Committee members to fulfil their role more effectively.

INVESTMENTS AS AT 3 JANUARY 2018

Counterparty	£	%	S / NS	Type	Issue	Maturity
NatWest Treasury Reserve	906	0.25%	S	Call		
RBS Deposit Account	7,489	0.01%	S	Call		
RBS	1,000,000	0.64%	S	CD	21/07/2017	20/07/2018
RBS	1,000,000	0.62%	S	Fixed	17/01/2017	16/01/2018
RBS	2,000,000	0.57%	S	CD	11/09/2017	10/09/2018
NatWest/RBS GroupTotal	**4,008,395**					
Goldman	18,740	0.23%	S	Call		
Federated Prime Rate	3,985,358	0.28%	S	Call		
Deutsche	2,000,115	0.23%	S	Call		
SLI (Ignis)	1,914,539	0.25%	S	Call		
Money Market Fund Total	**7,918,752**					
Santander	30	0.10%	S	Call		
Santander - 180 day Notice	2,053,646	0.55%	S	Notice		
Santander Total	**2,053,676**					
Svenska call	2,118,487	0.20%	S	Call		
Svenska - 35 day notice	3,800,000	0.30%	S	Notice		
Svenska Total	**5,918,487**					
Bank of Scotland	1,500,000	0.50%	S	Fixed	17/11/2017	19/02/2018
Bank of Scotland Total	**1,500,000**					
32 day notice	2,001,860	0.57%	S	Notice		
Lloyds	2,000,000	0.65%	S	Fixed	22/11/2017	22/05/2018
175 day notice	2,430,002	0.90%	S	Notice		
Lloyds Total	**6,431,862**					
Barclays FIBCA	1,433	0.10%	S	Call		
Barclays 95 Day Notice	2,000,000	0.70%	S	Notice		
Barclays Total	**2,001,433**					
95 day notice	2,000,000	SONIA + 0.31%	S	Notice		
Standard Chartered Total	**2,000,000**					
Goldman Sachs 185 Day Notice	2,000,000	0.755%	S	Notice		
Goldman Sachs	2,000,000	0.61%			12/09/2017	12/03/2018
Goldman Sachs	2,000,000	0.69%			29/09/2017	29/03/2018
Goldman Sachs	2,000,000	0.71%			01/12/2017	01/06/2018
Goldman Sachs Total	**8,000,000**					
TOTAL INVESTMENTS	**39,832,605**					

S = Specified Investment - 1 year and less
NS = Non-specified investment - over 1 year
SONIA = Sterling Over Night Index Average

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 2020/21.

Ratio of financing costs to net revenue stream – table 5 shows that the General Fund currently receives a small income from the investment of balances which turns into a net expenditure in 2020/21 when the interest payments on General Fund borrowing exceed the interest earned on investments. The HRA borrowing means that interest on net borrowing now accounts for between 16.03% and 17.05% of net revenue.

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

Capital financing requirement (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 6 shows the overall CFR is £111.457m. As the Council has borrowing of £106.717m the balance sheet shows there is currently under borrowing of £4.740m, which is projected to increase to £5.804m by 31 March 2018.

HRA debt limit – table 9 shows the absolute limit has been reached for HRA indebtedness which is measured against the HRA CFR of £95.742m. No further HRA borrowing is permitted.

Authorised limit for external debt - table 8 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 7 shows the more likely limit to the level of external debt that may be required for day to day cashflow.

Upper limit for total principal sums invested for over 364 days – table 12 shows the amount it is considered can be prudently invested for period in excess of a year.

ECONOMIC BACKGROUND

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

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

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

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

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

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

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

UK. After the UK surprised on the upside with strong economic growth in 2016, **growth in 2017 has been disappointingly weak**; quarter 1 came in at only +0.2% (+2.0% y/y), quarter 2 was +0.3% (+1.7% y/y) and quarter 3 was +0.4% (+1.6% y/y). The main reason for this has been the sharp increase in inflation, caused by the devaluation of sterling after the EU referendum, feeding increases in the cost of imports into the economy. This has caused, in turn, a reduction in consumer disposable income and spending power and so the services sector of the economy, accounting for around 80% of GDP, has seen weak growth as consumers cut back on their expenditure. However, more recently there have been encouraging statistics from the **manufacturing sector** which is seeing strong growth, particularly as a result of increased demand for exports. It has helped that growth in the EU, our main trading partner, has improved significantly over the last year while robust world growth has also been supportive. However, this sector only accounts for around 10% of GDP so expansion in this sector will have a much more muted effect on the overall GDP growth figure for the UK economy as a whole.

While the Bank of England is expected to give forward guidance to prepare financial markets for gradual changes in policy, the **Monetary Policy Committee, (MPC), meeting of 14 September 2017** managed to shock financial markets and forecasters by suddenly switching to a much more aggressive tone in terms of its words around warning that Bank Rate will need to rise soon. The Bank of England Inflation Reports during 2017 have clearly flagged up that it expected CPI inflation to peak at just under 3% in 2017, before falling back to near to its target rate of 2% in two years' time. The Bank revised its forecast for the peak to just over 3% at the 14 September meeting MPC. (Inflation actually came in at 3.0% in September and is expected to rise slightly in the coming months.) This marginal revision in the Bank's forecast can hardly justify why the MPC became so aggressive with its wording; rather, the focus was on an emerging view that with unemployment having already fallen to only 4.3%, the lowest level since 1975, and improvements in productivity being so weak, that **the amount of spare capacity in the economy was significantly diminishing** towards a point at which they now needed to take action. In addition, the MPC took a more tolerant view of low wage inflation as this now looks like a common factor in nearly all western economies as a result of automation and globalisation. However, the Bank was also concerned that the withdrawal of the UK from the EU would effectively lead to a *decrease* in such globalisation pressures in the UK, and so this would cause additional inflationary pressure over the next few years.

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

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

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

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

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

EU. Economic growth in the EU, (the UK's biggest trading partner), had been lack lustre for several years after the financial crisis despite the ECB eventually cutting its main rate to -0.4% and embarking on a massive programme of QE. However, growth picked up in 2016 and has now gathered substantial strength and momentum thanks to this stimulus. GDP growth was 0.5% in quarter 1 (2.0% y/y), 0.6% in quarter 2 (2.3% y/y) and +0.6% in quarter 3 (2.5% y/y). However, despite providing massive monetary stimulus, the European Central Bank is still struggling to get inflation up to its 2% target and in October inflation was 1.4%. It is therefore unlikely to start on an upswing in rates until possibly 2019. It has, however, announced that it will slow down its monthly QE purchases of debt from €60bn to €30bn from January 2018 and continue to at least September 2018.

USA. Growth in the American economy was notably erratic and volatile in 2015 and 2016. 2017 is following that path again with quarter 1 coming in at only 1.2% but quarter 2 rebounding to 3.1% and quarter 3 coming in at 3.0%. Unemployment in the US has also fallen to the lowest level for many years, reaching 4.2%, while wage inflation pressures, and inflationary pressures in general, have been building. The Fed has started on a gradual upswing in rates with four increases in all and three increases since December 2016; and there could be one more rate rise in 2017, which would then lift the central rate to 1.25 – 1.50%. There could then be another four increases in 2018. At its September meeting, the Fed said it would start in October to gradually unwind its $4.5 trillion balance sheet holdings of bonds and mortgage backed securities by reducing its reinvestment of maturing holdings.

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

JAPAN. has been struggling to stimulate consistent significant growth and to get inflation up to its target of 2%, despite huge monetary and fiscal stimulus. It is also making little progress on fundamental reform of the economy.

<u>Brexit timetable and process</u>

- March 2017: UK government notifies the European Council of its intention to leave under the Treaty on European Union Article 50
- March 2019: initial two-year negotiation period on the terms of exit. In her Florence speech in September 2017, the Prime Minister proposed a two year transitional period after March 2019.
- UK continues as a full EU member until March 2019 with access to the single market and tariff free trade between the EU and UK. Different sectors of the UK economy will leave the single market and tariff free trade at different times during the two year transitional period.
- The UK and EU would attempt to negotiate, among other agreements, a bi-lateral trade agreement over that period.
- The UK would aim for a negotiated agreed withdrawal from the EU, although the UK could also exit without any such agreements in the event of a breakdown of negotiations.
- If the UK exits without an agreed deal with the EU, World Trade Organisation rules and tariffs could apply to trade between the UK and EU - but this is not certain.
- On full exit from the EU: the UK parliament would repeal the 1972 European Communities Act.
- The UK will then no longer participate in matters reserved for EU members, such as changes to the EU's budget, voting allocations and policies.

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

- 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;
- Treasury management/capital and revenue financial implications of the Capital Strategy