

Audit Committee

Thursday 23rd January 2020

10.00 am

**Council Chamber,
Council Offices, Brympton Way,
Yeovil, BA20 2HT**

(disabled access and a hearing loop are available at this meeting venue)



The following members are requested to attend the meeting:

Chairman: Martin Carnell
Vice-chairman: Mike Hewitson

Robin Bastable
Mike Best
Dave Bulmer

Malcolm Cavill
Brian Hamilton
Paul Maxwell

Robin Pailthorpe
Jeny Snell
Derek Yeomans (IM)

If you would like any further information on the items to be discussed, please contact the Case Officer on 01935 462038 or democracy@southsomerset.gov.uk

This Agenda was issued on Wednesday 15 January 2020.

Alex Parmley, Chief Executive Officer



This information is also available on our website
www.southsomerset.gov.uk and via the mod.gov app

Information for the Public

The purpose of the Audit Committee is to provide independent assurance of the adequacy of the risk management framework and the associated control environment, independent scrutiny of the authority's financial and non-financial performance, to the extent that it affects the authority's exposure to risk and weakens the control environment and to oversee the financial reporting process.

The Audit Committee should review the Code of Corporate Governance seeking assurance where appropriate from the Executive or referring matters to management on the scrutiny function.

The terms of reference of the Audit Committee are:

Internal Audit Activity

1. To approve the Internal Audit Charter and annual Internal Audit Plan;
2. To receive quarterly summaries of Internal Audit reports and seek assurance from management that action has been taken;
3. To receive an annual summary report and opinion, and consider the level of assurance it provides on the council's governance arrangements;
4. To monitor the action plans for Internal Audit reports assessed as "partial" or "no assurance;"
5. To consider specific internal audit reports as requested by the Head of Internal Audit, and monitor the implementation of agreed management actions;
6. To receive an annual report to review the effectiveness of internal audit to ensure compliance with statutory requirements and the level of assurance it provides on the council's governance arrangements;

External Audit Activity

7. To consider and note the annual external Audit Plan and Fees;
8. To consider the reports of external audit including the Annual Audit Letter and seek assurance from management that action has been taken;

Regulatory Framework

9. To consider the effectiveness of SSDC's risk management arrangements, the control environment and associated anti-fraud and corruption arrangements and seek assurance from management that action is being taken;
10. To review the Annual Governance Statement (AGS) and monitor associated action plans;
11. To review the Local Code of Corporate Governance and ensure it reflects best governance practice. This will include regular reviews of part of the Council's Constitution and an overview of risk management;
12. To receive reports from management on the promotion of good corporate governance;

Financial Management and Accounts

13. To review and approve the annual Statement of Accounts, external auditor's opinion and reports to members and monitor management action in response to issues raised;

14. To provide a scrutiny role in Treasury Management matters including regular monitoring of treasury activity and practices. The committee will also review and recommend the Annual Treasury Management Strategy Statement and Investment Strategy, MRP Strategy, and Prudential Indicators to Council;
15. To review and recommend to Council changes to Financial Procedure Rules and Procurement Procedure Rules;

Overall Governance

16. The Audit Committee can request of the Section 151 Officer, the Monitoring Officer, or the Chief Executive (Head of Paid Services) a report (including an independent review) on any matter covered within these Terms of Reference;
17. The Audit Committee will request action through District Executive if any issue remains unresolved;
18. The Audit Committee will report to each full Council a summary of its activities.

Meetings of the Audit Committee are usually held bi-monthly including at least one meeting with the Council's external auditor, although in practice the external auditor attends more frequently.

Agendas and minutes of this committee are published on the Council's website at www.southsomerset.gov.uk

Agendas and minutes can also be viewed via the mod.gov app (free) available for iPads and Android devices. Search for 'mod.gov' in the app store for your device and select 'South Somerset' from the list of publishers and then select the committees of interest. A wi-fi signal will be required for a very short time to download an agenda but once downloaded, documents will be viewable offline.

Members questions on reports prior to the Meeting

Members of the Committee are requested to contact report authors on points of clarification prior to the Committee meeting.

Recording and photography at council meetings

Recording of council meetings is permitted, however anyone wishing to do so should let the Chairperson of the meeting know prior to the start of the meeting. The recording should be overt and clearly visible to anyone at the meeting, but non-disruptive. If someone is recording the meeting, the Chairman will make an announcement at the beginning of the meeting. If anyone making public representation does not wish to be recorded they must let the Chairperson know.

The full 'Policy on Audio/Visual Recording and Photography at Council Meetings' can be viewed online at:

<http://modgov.southsomerset.gov.uk/documents/s3327/Policy%20on%20the%20recording%20of%20council%20meetings.pdf>

Audit Committee

Thursday 23 January 2020

Agenda

Preliminary Items

1. Minutes

To approve as a correct record the minutes of the previous meetings held on 24 October 2019 and 28 November 2019.

2. Apologies for absence

3. Declarations of Interest

In accordance with the Council's current Code of Conduct (as amended 26 February 2015), which includes all the provisions relating to Disclosable Pecuniary Interests (DPI), personal and prejudicial interests, Members are asked to declare any DPI and also any personal interests (and whether or not such personal interests are also "prejudicial") in relation to any matter on the agenda for this meeting.

4. Public question time

5. Date of next meeting

Councillors are requested to note that the next Audit Committee meeting is scheduled to be held at 10.00am on 26 March 2020 in the Council Chamber, Brympton Way, Yeovil.

Items for Discussion

6. External Audit Progress Report (Pages 5 - 21)

7. Certification of Claims Report (Pages 22 - 36)

8. Internal Audit Annual Activity Report 2019/20 (Pages 37 - 51)

9. Capital, Investment and Treasury Strategies 2020/21 to 2022/23 (Pages 52 - 111)

10. Audit Committee Forward Plan (Pages 112 - 113)

Agenda Item 6

External Audit Progress Report

Director: Netta Meadows, Strategy and Support Services
S151 Officer: Nicola Hix, Interim S151 Officer
Lead Officers: Nicola Hix, Interim S151 Officer
Catherine Hood, Specialist - Finance
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Purpose of Report

1. This report introduces Grant Thornton's Audit Progress and Sector Update Report for the year ending March 2020 and provides information on the additional work to be undertaken and the proposed fee for the 2019/20 audit.

Recommendations

2. The Audit Committee are asked to note:
 - (a) the Audit Progress and Sector Update Report, and
 - (b) the additional work and audit fee increase for the 2019/20 audit.

Introduction

3. The report from Grant Thornton, the Council's external auditor, provides the Audit Committee with an update on progress in delivering their responsibilities to the Council and its stakeholders.
4. The report also provides a summary of emerging national issues and developments, and includes a number of challenge questions the committee may wish to consider regarding these.
5. The letter from the external auditor provides an update on the increasing regulatory focus facing audit suppliers and details the impact that the increasing focus will have on the scope of the Grant Thornton's work for the 2019/20 audit.
6. It should also be noted that the 2019/20 scale fee for the statutory accounts audit remains unchanged at £37,943. However, an additional fee of £7,500 will be charged due to the additional audit work required as a result of the increasing regulatory focus. The total fee for the 2019/20 statutory audit will be £45,443.

Financial Implications

7. The additional audit fee of £7,500 for 2020/21 has been added to the medium term financial plan going forward to be finally agreed as part of budget setting in February 2020.

Background Papers

None

Audit Progress Report and Sector Update

South Somerset District Council
Year ending 31 March 2020
January 2020



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Introduction



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This paper provides the Audit, Governance and Standards Committee with a report on progress in delivering our responsibilities as your external auditors.

The paper also includes:

- a summary of emerging national issues and developments that may be relevant to you as a local authority; and
- includes a number of challenge questions in respect of these emerging issues which the Committee may wish to consider (these are a tool to use, if helpful, rather than formal questions requiring responses for audit purposes)

Members of the Audit, Governance and Standards Committee can find further useful material on our website, where we have a section dedicated to our work in the public sector. Here you can download copies of our publications www.grantthornton.co.uk

If you would like further information on any items in this briefing, or would like to register with Grant Thornton to receive regular email updates on issues that are of interest to you, please contact either your Engagement Lead or Engagement Manager.

Progress at January 2020

Audit related progress

Certification of claims and returns

We certify the Council's annual Housing Benefit Subsidy claim in accordance with procedures agreed with the Department for Work and Pensions. The certification work for the 2018/19 claims for South Somerset District Council was completed on 28 November, in advance of the 30 November deadline. We have reported our findings to the Audit Committee further on in this report on Page 5.

Meetings

We met with Finance Officers in December as part of our quarterly liaison meetings and continue to be in discussions with finance staff regarding emerging developments and to ensure the audit process is smooth and effective. We also met with your Chief Executive in December to discuss the Council's strategic priorities and plans.

Events

We provide a range of workshops, along with network events for members and publications to support the Council. Your officers have been invited to our Financial Reporting Workshop in February, which will help to ensure that members of your Finance Team are up to date with the latest financial reporting requirements for local authority accounts.

Further details of the publications that may be of interest to the Council are set out in our Sector Update section of this report.

Audit Fees

During 2017, PSAA awarded contracts for audit for a five year period beginning on 1 April 2018. 2019/20 is the second year of that contract. Since that time, there have been a number of developments within the accounting and audit profession. Across all sectors and firms, the Financial Reporting Council (FRC) has set out its expectation of improved financial reporting from organisations and the need for auditors to demonstrate increased scepticism and challenge and to undertake additional and more robust testing.

Our work in the Local Government sector in 2018/19 has highlighted areas where financial reporting, in particular, property, plant and equipment and pensions, needs to improve. There is also an increase in the complexity of Local Government financial transactions and financial reporting. This combined with the FRC requirement that all Local Government audits are at or above the "few improvements needed" (2A) rating means that additional audit work is required.

We have reviewed the impact of these changes on both the cost and timing of audits. We have written to your interim S151 Officer outlining our proposed variations to the Scale Fee set by PSAA Limited. A copy of this letter has been included in the committee papers.

Our proposed scale fee for the statutory accounts audit for 2019/20 is £37,943 plus VAT plus a variation of £7,500 plus VAT, giving a total fee of £45,443 plus VAT.

Certification of claims and returns

We completed the certification of Housing Benefit claims for South Somerset District Council on 28 November 2019. Our findings are set out below

The claim was qualified, and the following errors were noted in our report:

- Rent allowances – An error was identified in our initial testing in relation to the application of tax credits. This error was also identified in prior years and a sample of 40 extra cases was chosen and the testing undertaken by the Council. We tested a sample of the population to ensure testing had been completed accurately. Testing of 40 extra cases identified two further error which led to an extrapolation of £16,233.
- Rent allowances – An error was identified in the prior year in relation to the incorrect calculation of earned income. A sample of 40 cases was tested by the Council from which a sample were reviewed to ensure the accuracy of this testing. Testing of 40 extra cases identified four errors which led to an extrapolation of £8,218.
- Rent allowances - An error was identified in the prior year in relation to the incorrect calculation of self employed earned income. A sample of 40 cases was tested by the Council from which a sample were reviewed to ensure the accuracy of this testing. Testing of 40 extra cases identified four errors which led to an extrapolation of £141.
- Rent allowances - An error was identified in the prior year in relation to the incorrect application of pension credit savings credits. A sample of 40 cases was tested by the Council from which a sample were reviewed to ensure the accuracy of this testing. Testing of 40 extra cases identified three errors, all of which are underpayments and had no impact on subsidy.
- Rent allowances - An error was identified in the prior year in relation to the incorrect classification of overpayments. A sample of 40 cases was tested by the Council from which a sample were reviewed to ensure the accuracy of this testing. Testing of 40 extra cases identified four errors which led to an extrapolation of £5,541.
- Modified Schemes – An error was identified in the prior year in relation to the uprating of war disablement pension payments. Review of the error identified that this was a system upload error in the prior year and not a manual input error. We reviewed the process for 2018-19 and were satisfied that the uprating had been correctly calculated and input into Northgate and therefore no extrapolation was required.

The guidance provided by DWP requires that where errors were identified in previous years that could lead to an overpayment in benefit, irrespective of whether an overpayment has occurred, require 40+ testing to be undertaken in the following year. Therefore, for all errors identified above, with the exception of modified schemes, 40+ testing will be undertaken in 2019/20.

Audit Deliverables

2018/19 Deliverables	Planned Date	Status
Audit Findings Report The Audit Findings Report was reported to the July and November Audit, Governance and Standards Committee.	July 2019	Complete
Auditors Report This is the opinion on your financial statement, annual governance statement and value for money conclusion.	July 2019	Complete
Annual Audit Letter This letter communicates the key issues arising from our work.	September 2019	Complete
2019/20 Deliverables	Planned Date	Status
Fee Letter Confirming audit fee for 2019/20.	April 2019	Complete
Accounts Audit Plan We are required to issue a detailed accounts audit plan to the Audit, Governance and Standards Committee setting out our proposed approach in order to give an opinion on the Council's 2019-20 financial statements.	March 2020	Not yet due
Interim Audit Findings We will report to you the findings from our interim audit and our initial value for money risk assessment within our Progress Report.	March 2020	Not yet due
Audit Findings Report The Audit Findings Report will be reported to the Audit, Governance and Standards Committee.	July 2020	Not yet due
Auditors Report This is the opinion on your financial statement, annual governance statement and value for money conclusion.	July 2020	Not yet due
Annual Audit Letter This letter communicates the key issues arising from our work.	August 2020	Not yet due

Sector Update

Councils continue to try to achieve greater efficiency in the delivery of public services, whilst facing the challenges to address rising demand, ongoing budget pressures and social inequality.

Our sector update provides you with an up to date summary of emerging national issues and developments to support you. We cover areas which may have an impact on your organisation, the wider local government sector and the public sector as a whole. Links are provided to the detailed report/briefing to allow you to delve further and find out more.

Our public sector team at Grant Thornton also undertake research on service and technical issues. We will bring you the latest research publications in this update. We also include areas of potential interest to start conversations within the organisation and with Audit, Governance and Standards committee members, as well as any accounting and regulatory updates.

- [Grant Thornton Publications](#)
- [Insights from local government sector specialists](#)
- [Reports of interest](#)
- [Accounting and regulatory updates](#)

More information can be found on our dedicated public sector and local government sections on the Grant Thornton website by clicking on the logos below:

Public Sector

Local
government

Financial Reporting Council – Summary of key developments for 2019/20 annual reports

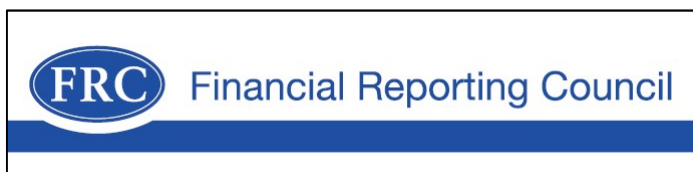
On 30 October the Financial Reporting Council (FRC) wrote an Open Letter to Company Audit Committee Chairs. Some of the points are relevant to local authorities.

The reporting environment

The FRC notes that, “In times of uncertainty, whether created by political events, general economic conditions or operational challenges, investors look for greater transparency in corporate reports to inform their decision-making. We expect companies to consider carefully the detail provided in those areas of their reports which are exposed to heightened levels of risk; for example, descriptions of how they have approached going concern considerations, the impact of Brexit and all areas of material estimation uncertainty.” These issues equally affect local authorities, and the Statement of Accounts or Annual Report should provide readers with sufficient appropriate information on these topics.

Critical judgements and estimates

The FRC wrote “More companies this year made a clear distinction between the critical judgements they make in preparing their accounts from those that involve the making of estimates and which lead to different disclosure requirements. However, some provided insufficient disclosures to explain this area of their reporting where a particular judgement had significant impact on their reporting; for example, whether a specific investment was a joint venture or a subsidiary requiring consolidation. We will continue to have a key focus on the adequacy of disclosures supporting transparent reporting of estimation uncertainties. An understanding of their sensitivity to changing assumptions is of critical value to investors, giving them clearer insight into the possible future changes in balance sheet values and which can inform their investment decisions.” Critical judgements and estimates also form a crucial part of local authority statements of account, with the distinction often blurred.



IFRS 16 Leases

The FRC letter notes “IFRS 16 is effective for periods beginning on or after 1 January 2019. We recently conducted a thematic review looking at how companies reported on their adoption of the new standard in their June 2019 interim accounts. In advance of our detailed findings which will be published shortly, I set out what we expect to see by way of disclosures in the forthcoming accounts, drawing on the results of our work.

- Clear explanation of the key judgements made in response to the new reporting requirements;
- Effective communication of the impact on profit and loss, addressing any lack of comparability with the prior year;
- Clear identification of practical expedients used on transition and accounting policy choices; and
- Well explained reconciliation, where necessary, of operating lease commitments under IAS 17, ‘Leases’, the previous standard and lease liabilities under IFRS 16.”

The implementation of IFRS is delayed until 1 April 2020 in the public sector when it will replace IAS 17 Leases and the three interpretations that supported its application. Authorities will need information and processes in place to enable them to comply with the requirements. They will need to make disclosures in the 2019/20 accounts about the impact of IFRS 16 in accordance with IAS 8/ Code 3.3.4.3 requirements for disclosure about standards which are issued but are not yet effective.

Financial Reporting



Challenge question:

Will you have the opportunity to review and comment on your authority’s statement of accounts before they are published at the end of May?

What is the future for local audit?

Paul Dossett, Head of local government at Grant Thornton, has written in the Municipal Journal “Audit has been a hot topic of debate this year and local audit is no exception. With a review into the quality of local audit now ongoing, it’s critical that part of this work looks at the overarching governance and management of the audit regime. We believe there is a strong need for new oversight arrangements if the local audit regime is to remain sustainable and effective in the future.”

Paul goes on to write “Local (local authority and NHS) audit has been a key part of the oversight regime for public services for more than a century. The National Audit Office (NAO) has exercised this role in central government for several generations and their reporting to Parliament via the Public Accounts Committee is a key part of the public spending accountability framework.

Local audit got a significant boost with the creation of the Audit Commission in 1983 which provided a coordinated, high profile focus on local government and (from 1990) NHS spending and performance at a local level. Through undertaking value for money reviews and maintaining a tight focus on the generational governance challenges, such as rate capping in the 1980s and service governance failings in the 1990s, the Commission provided a robust market management function for the local audit regime. Local audit fees, appointments, scope, quality and relevant support for auditors all fell within their ambit.

However, the Commission was ultimately deemed, among other things, to be too expensive and was abolished in 2010, as part of the Coalition Government’s austerity saving plans. While the regime was not perfect, and the sector had acknowledged that reform of the Commission was needed, complete abolition was not the answer.

Since then, there has been no body with complete oversight of the local audit regime and how it interacts with local public services. The Ministry of Housing, Communities and Local Government; Department of Health; NHS; NAO; Local Government Association (LGA); Public Sector Audit Appointments Ltd (PSAA); the Financial Reporting Council (FRC); the Chartered Institute of Public Finance & Accountancy (CIPFA), audit firms and the audited bodies themselves all have an important role to play but, sometimes, the pursuit of individual organisational objectives has resulted in sub-optimal and even conflicting outcomes for the regime overall.

These various bodies have pursued separate objectives in areas such as audit fee reduction, scope of work, compliance with commercial practice, earlier reporting deadlines and mirroring commercial accounting conventions – to name just a few.

This has resulted in a regime that no stakeholder is wholly satisfied with and one that does not ensure local audit is providing a sufficiently robust and holistic oversight of public spending.

To help provide a more cohesive and co-ordinated approach within the sector, we believe that new oversight arrangements should be introduced. These would have ultimate responsibility for ensuring the sustainability of the local audit regime and that its component parts – including the Audit Code, regulation, market management and fees – interact in an optimal way. While these arrangements do not need to be another Audit Commission, we need to have a strategic approach to addressing the financial sustainability challenges facing local government and the NHS, the benchmarking of performance and the investigation of governance failings.

There are a number of possible solutions including:

- 1) The creation of a new arm’s length agency with a specific remit for overseeing and joining up local audit. It would provide a framework to ensure the sustainability of the regime, covering fees, appointments, and audit quality. The body would also help to create a consistent voice to government and relevant public sector stakeholders on key issues arising from the regime. Such a body would need its own governance structure drawn from the public sector and wider business community; and
- 2) Extending the current remit of the NAO. Give it total oversight of the local audit regime and, in effect, establish a local audit version of the NAO, with all the attendant powers exercised in respect of local audit. In this context, there would be a need to create appropriate governance for the various sectors, similar to the Public Accounts Committee.

While the detail of the new arrangements would be up for debate, it’s clear that a new type of oversight body, with ultimate responsibility for the key elements of local audit, is needed. It would help to provide much-needed cohesion across the sector and between its core stakeholders.

The online article is available here:

<https://www.themj.co.uk/What-is-the-future-for-audit/214769>

Grant Thornton's Sustainable Growth Index Report

Grant Thornton has launched the Sustainable Growth Index (formerly the Vibrant Economy Index) – now in its third year. The Sustainable Growth Index seeks to define and measure the components that create successful places. Our aim in establishing the Index was to create a tool to help frame future discussions between all interested parties, stimulate action and drive change locally. We have undergone a process of updating the data for English Local Authorities on our online, interactive tool, and have produced an updated report on what the data means. All information is available on our online hub, where you can read the new report and our regional analyses.

The Sustainable Growth Index provides an independent, data-led scorecard for each local area that provides:

- businesses with a framework to understand their local economy and the issues that will affect investment decisions both within the business and externally, a tool to support their work with local enterprise partnerships, as well as help inform their strategic purpose and CSR plans in light of their impact on the local social and economic environment
- policy-makers and place-shapers with an overview of the strengths, opportunities and challenges of individual places as well as the dynamic between different areas
- Citizens with an accessible insight into how their place is doing, so that they can contribute to shaping local discussions about what is important to them

The Index shows the 'tip of the iceberg' of data sets and analysis our public services advisory team can provide our private sector clients who are considering future locations in the UK, or wanting to understand the external drivers behind why some locations perform better than others.

Our study looks at over 50 indicators to evaluate all the facets of a place and where they excel or need to improve.

Our index is divided into six baskets. These are:

- 1 Prosperity
- 2 Dynamism and opportunity
- 3 Inclusion and equality
- 4 Health, wellbeing and happiness
- 5 Resilience and sustainability
- 6 Community trust and belonging

This year's index confirms that cities have a consistent imbalance between high scores related to prosperity, dynamism and opportunity, and low scores for health, wellbeing, happiness inclusion and equality. Disparity between the richest and poorest in these areas represents a considerable challenge for those places.

Inclusion and equality remains a challenge for both highly urban and highly rural places and coastal areas, particularly along the east coast from the North East to Essex and Kent, face the most significant challenges in relation to these measures and generally rank below average.

Creating sustainable growth matters and to achieve this national policy makers and local authorities need to do seven things:

- 1 Ensure that decisions are made on the basis of robust local evidence.
- 2 Focus on the transformational trends as well as the local enablers
- 3 Align investment decisions to support the creation of sustainable growth
- 4 Align new funding to support the creation of sustainable growth
- 5 Provide space for innovation and new approaches
- 6 Focus on place over organisation
- 7 Take a longer-term view

The online report is available here:

<https://www.granthornton.co.uk/en/insights/sustainable-growth-index-how-does-your-place-score/>



Institute for Fiscal Studies – English local government funding: trends and challenges in 2019 and beyond

The Institute for Fiscal Studies (IFS) has found “The 2010s have been a decade of major financial change for English local government. Not only have funding levels – and hence what councils can spend on local services – fallen significantly; major reforms to the funding system have seen an increasing emphasis on using funding to provide financial incentives for development via initiatives such as the Business Rates Retention Scheme (BRRS) and the New Homes Bonus (NHB).”

The IFS goes on to report “Looking ahead, increases in council tax and additional grant funding from central government mean a boost to funding next year – but what about the longer term, especially given plans for further changes to the funding system, including an expansion of the BRRS in 2021–22?”

This report, the first of what we hope will be an annual series of reports providing an up-to-date analysis of local government, does three things in this context. First, it looks in detail at councils’ revenues and spending, focusing on the trends and choices taken over the last decade. Second, it looks at the outlook for local government funding both in the short and longer term. And third, it looks at the impact of the BRRS and NHB on different councils’ funding so far, to see whether there are lessons to guide reforms to these policies.

The report focuses on those revenue sources and spending areas over which county, district and single-tier councils exercise real control. We therefore exclude spending on police, fire and rescue, national park and education services and the revenues specifically for these services. When looking at trends over time, we also exclude spending on and revenues specifically for public health, and make some adjustments to social care spending to make figures more comparable across years. Public health was only devolved to councils in 2013–14, and the way social care spending is organised has also changed, with councils receiving a growing pot of money from the NHS to help fund services.”

The IFS reports a number of key facts and figures, including

- 1) Cuts to funding from central government have led to a 17% fall in councils’ spending on local public services since 2009–10 – equal to 23% or nearly £300 per person.
- 2) Local government has become increasingly reliant on local taxes for revenues.
- 3) Councils’ spending is increasingly focused on social care services – now 57% of all service budgets.

The IFS report is available on their website below:

<https://www.ifs.org.uk/publications/14563>





Nicola Hix
Interim S151 Officer
South Somerset District Council
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10 January 2019

Grant Thornton UK LLP
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Dear Nicola

Audit scope and additional work 2019/20

In recent conversations, including at South Somerset District Council's Audit Committee, we have discussed the increased regulatory focus facing all audit suppliers and the impact this will have on the scope of our work for 2019/20 and beyond. You will have also recently received a letter via email from Tony Crawley of PSAA explaining the changing regulatory landscape. In his letter, Mr Crawley highlights: *"significantly greater pressure on firms to deliver higher quality audits by requiring auditors to demonstrate greater professional scepticism when carrying out their work across all sectors – and this includes local audit. This has resulted in auditors needing to exercise greater challenge to the areas where management makes judgements or relies upon advisers, for example, in relation to estimates and related assumptions within the accounts. As a result, audit firms have updated their work programmes and reinforced their internal processes and will continue to do so to enable them to meet the current expectations."*

I promised I would set out in more detail the likely impact of this on our audit, and I am pleased to do so in this letter. Should further matters arise during the course of the audit they could also have fee and timetable implications that we would need to address at that point.

Across all suppliers and sectors (public and private), the Financial Reporting Council (FRC) has set out its expectation of improved financial reporting from organisations and the need for auditors to demonstrate increased scepticism and challenge, as well as to undertake additional and more robust testing. There is a general 'raising of the quality bar' following a number of recent, high-profile company failures that have also been attributed to audit performance. Alongside the FRC, other key stakeholders including the Department for Business, Energy and Industrial Strategy (BEIS) have expressed concern about the quality of audit work and the need for improvement. The FRC has been clear to us that it expects audit quality in local audit to meet the same standards as in the corporate world and the current level of financial risk within local audit bodies supports this position.

As a firm, we are absolutely committed to meeting the expectations of the FRC and other key stakeholders with regard to audit quality and public sector financial reporting. To ensure the increased regulatory focus and expectations are fully met, we anticipate that, as first seen in 2018/19, we will need to commit more time in discharging our statutory responsibilities, which will necessitate an increase in costs. I set out below the implications of this for your Council's audit.

Increased challenge and depth of work – raising the quality bar

The FRC has raised the threshold of what it assesses as a good quality audit. The FRC currently uses a four-point scale to describe the quality of the files it reviews, as follows:

Score	Description
1 or 2a	Acceptable with Limited Improvements Required
2b	Improvements required
3	Significant Improvements Required

Historically, the FRC's definition for 2b was 'acceptable but with improvements required' and, as such, both the Audit Commission and PSAA considered a '2b' to represent an acceptance level of audit quality for contract delivery purposes. The FRC has now set a 100% target for all audits (including local audits) to achieve a '2a'. Its threshold for achieving a '2a' is challenging and failure to achieve this level is reputationally damaging for individual engagement leads and their firm. Non-achievement of the standard can result in enforcement action, including fines and disqualification, by the FRC. Inevitably, we need to increase the managerial oversight to manage this risk. In addition, you should expect the audit team to exercise even greater challenge of management in areas that are complex, significant or highly judgmental. We will be required to undertake additional work in the following areas, amongst others:

- use of specialists
- information provided by the entity (IPE)
- journals
- management review of controls
- revenue
- accounting estimates
- financial resilience and going concern
- related parties and similar areas.

As part of our planning, we have also reflected on the level of materiality which is appropriate for your audit. As outlined above, the profile of local audit has increased considerably over the past year. The reviews led by Sir John Kingman, Sir Donald Brydon and Sir Tony Redmond are focusing attention on the work of auditors everywhere. Parliament, through the work of its Scrutiny Committees, has made clear its expectations that auditors will increase the quality of their work.

As a result, you may find the audit process for 2019/20 and beyond even more challenging than previous audits. This mirrors the changes we are seeing in the commercial sectors.

Property, plant and equipment (PPE or 'Fixed Assets')

The FRC has highlighted that auditors need to improve the quality of audit challenge on Property, Plant and Equipment (PPE) valuations across the sector. We will therefore increase the volume and scope of our audit work to ensure an adequate level of audit scrutiny and challenge over the assumptions that underpin PPE valuations.

Pensions (IAS 19)

The FRC has highlighted that the quality of work by audit firms in respect of IAS 19 needs to improve across local government audits. Specifically, for the following areas, we will increase the granularity, depth and scope of coverage, with increased levels of sampling, additional levels of challenge and explanation sought, and heightened levels of documentation and reporting. Our planned additional procedures include:

- verification of the accuracy and completeness of the data provided to the actuary by both the admitted body and the administering authority.
- checking the value of the Pension Fund Assets at 31 March per the Council's financial statements against the share of assets in the Pension Fund statements
- review and assess whether the significant assumptions applied by the actuary are reasonable and are followed up on areas identified by either our review or PwC as outliers.

- ensuring that the instructions from the audit team to the Pension Fund auditor include enquiries in respect of service organisation reports as well as testing in respect of material level 3 pension assets (please note that this is outside the scope of PSAA's fee variation process).

Complex accounting issues and new accounting standards

You are required to respond effectively to new accounting standards and we must ensure our audit work in these new areas is robust. This year we will both be responding to the introduction of IFRS16. IFRS16 requires a leased asset, previously accounted for as an operating lease off balance sheet, to be recognised as a 'right of use' asset with a corresponding liability on the balance sheet from 1 April 2020. There is a requirement, under IAS8, to disclose the expected impact of this change in accounting treatment in the 2019/20 financial statements.

We know the Council has appreciated our responsiveness in the past and we would wish to continue to be able to do this in the future.

Impact on the audit and associated costs

You will note we did not raise additional fees across the sector as a whole in 2018/19 in respect of the additional work required in response to the implementation of IFRS9 and IFRS15. This was a goodwill decision we took in support of the strong relationship we have with the sector. However, the volume of additional work now being required, as set out above, means we are no longer able to sustain that position. This is an issue not just across public services but also in the private sector where fees are being increased by all of the major suppliers by more than 20%.

We benefit from effective and constructive working relationships which we have established during our engagement with you to date. This allows us to absorb some of the impact of these changes. Using our strong working knowledge of you and efficiencies that we are continuously seeking to implement as part of our focus on continued collaborative working with you, we have sought to contain the impact as much as possible to below the market average.

We have assessed the impact of the above as follows for 2019/20, with the comparative position for the two previous years shown. Please note these are subject to approval by PSAA in line with PSAA's normal process. Should other risks arise during the course of the audit which we have not envisaged, we may need to make a further adjustment to the fee.

Area	Cost £		
	2019/20	2018/19	2017/18
Scale Fee	£37,943	£37,943	£49,276
Increased challenge and depth of work	£2,500	-	-
PPE	£1,750	£1,500	-
Pensions	£1,750	£3,000	-
New standards/ developments	£1,500		-
Total	£45,443	£42,443	£49,276

This would give a scale fee for the statutory accounts audit for 2019/20 of £37,943 plus VAT plus a variation of £7,500 plus VAT, giving a total fee of £45,443 plus VAT.

Please note that PSAA's arrangements require a separation of fees and remuneration, which means that Grant Thornton does not receive 100% of the current fees charged.

The additional work we are now planning across the whole of our portfolio will inevitably have an impact on the audit timetable and whether or not your audit can be delivered to appropriate quality standards by the 31 July 2020. Grant Thornton remains the largest trainer of CIPFA qualified accountants in the UK and is committed to continue to resource its local audits with suitably specialised and experienced staff

but the pool of such staff is relatively finite in the short-term. I will be happy to explain the impact of the further work we are planning to undertake on our delivery timetable for your audit, which at this stage is planned to be delivered by 31 July 2019.

Future changes to audit scope

As I have previously mentioned in meetings and at the audit and risk committee, the National Audit Office is currently consulting on revisions to the Code of Audit Practice and has also indicated its intention to consult on the accompanying Auditor Guidance Notes. This defines the scope of audit work in the public sector. The most significant change is in relation to the Value for Money arrangements. Rather than require auditors to focus on delivering an overall, binary, conclusion about whether or not proper arrangements were in place during the previous financial year, the draft Code requires auditors to issue a commentary on each of the criteria. This will allow auditors to tailor their commentaries to local circumstances. The Code proposes three specific criteria:

- a) Financial sustainability: how the body plans and manages its resources to ensure it can continue to deliver its services;
- b) Governance: how the body ensures that it makes informed decisions and properly manages its risks; and
- c) Improving economy, efficiency and effectiveness: how the body uses information about its costs and performance to improve the way it manages and delivers its services.

Under each of these criteria, statutory guidance will set out the procedures that auditors will need to undertake. An initial review of arrangements will consist of mandatory procedures to be undertaken at every local public body plus any local risk-based work. The consultation closed on 22 November 2019. A new Code will be laid before Parliament in April 2020 and will apply from audits of local bodies' 2020/21 financial statements onwards.

Until the consultation is finalised and more details emerge of what is expected of auditors, it is difficult to cost the impact. However, as soon as the requirements are finalised and it is clear exactly what the expectations will be, I will share with you further thoughts on the potential impact on the audit and associated costs.

I hope this is helpful and allows you to plan accordingly for the 2019/20 audit. Should you wish to discuss this further, please do not hesitate to contact me. We will be sharing our detailed Audit Plan with you in due course. We look forward to working with you again this year,

Yours sincerely



Engagement Lead and Key Audit Partner

For and on behalf of Grant Thornton UK LLP



Agenda Item 7

Certification of Claims Report

Director: Netta Meadows *Strategy and Support Services*
Lead Officers: Nicola Hix, *Interim S151 Officer*
Catherine Hood, *Specialist (Finance)*
Contact Details: Nicola.hix@southsomerset.gov.uk or (01935) 462612
Catherine.hood@southsomerset.gov.uk or (01935) 462157

Purpose of the report

1. This report introduces the annual report from our external auditors Grant Thornton on their findings from the signing off of the Housing Benefit Subsidy Claim for 2018/19.

Recommendations

2. The Audit Committee is asked to note the contents of the Certification of Claim Report for 2018/19.

Introduction

3. The Certification of Claims Report is included within the remit of the Audit Committee under its terms of reference as follows:

“To consider the effectiveness of the Council’s risk management arrangements, the control environment and associated anti-fraud and corruption arrangements and seek assurance from management that action has been taken”

“To consider the reports of external audit and inspection agencies and seek assurance from management that action has been taken”

Subsidy Claim

4. The external auditors certify the subsidy claim for the Housing Benefit Scheme. The report from Grant Thornton is attached at Appendix A. The total claim was £32,445,880 and as a result of the findings through the audit process, an amendment to the claim is required to the value of £89,041. This sum is due to be paid to the Department for Works and Pensions (DWP).
5. In accordance with the Housing Benefit Assurance Process (HBAP) modules an initial sample of cases was completed for all general expenditure on the subsidy claim. Given the nature of the population and the errors found in the previous claim, an additional sample of 40 cases were tested.
6. The areas where errors were found were: -
 - a. Earned income
 - b. Self-employed income
 - c. Tax credits
 - d. Pension credit savings
 - e. Classification of overpayment

7. Where errors were found and it was possible to identify and check all the claims which may be affected by the same error, all claims were checked and the claim was amended to take into the result of the checking.
8. Where 100% checking was not possible due to the number of claims that needed to be checked, extrapolation then takes effect. Extrapolation is where a % error rate found, when testing a sample of 40 claims for that error, is applied to the total amount which may be affected by the error.
9. The errors found, where 100% checking couldn't be carried out, totalled £595 and the total sample value was £524,545. As explained above, this % error rate has to be extrapolated, resulting in an overall impact on SSDC of £89,041.
10. An example of how extrapolation works is shown in the table below:

Sample	Movement / brief note of error	Sub population total (CT)	Sample error (SE)	Sample value (SV)	Percentage error rate (SE/SV)	Cell adjustment (SE/SV x CT)
Combined sample – 60 cases	Incorrect application of tax credits	£32,466,497	£109	£219,458	0.050%	£16,233

11. So, in the example above when testing tax credits, errors totalling £109 were found, which is 0.050% of the total value of benefits in the sample. The error rate i.e. the 0.050% has then been extrapolated against the sub population value of £31.46 million and the resulting £16,233 is the amount the claim has to be adjusted for in respect of the error.

Financial Implications

12. The final outcome of the claim was an additional payment of £89,041 due to the Department of Works and Pensions (DWP).
13. Whilst we owe the DWP £89,041, we have £129,025 in reserves. The DWP provide an incentive to Local Authorities (LA) whereby depending on the amount of the LA overpayments on the final subsidy claim when compared to the 100% expenditure on the final claim form we receive either nil, 40% or a 100% of the LA overpayments. This sum is put into a reserve account pending the outcome of the audit.
14. The indicative scale fee set by PSAA for the Council for 2018/19 was £9,898. Work undertaken is subject to a fee variation due to extra work being carried out. The fee for certifying the Housing Benefit return and 2018/19 audit is £14,000.

Background Papers

Housing Benefit Subsidy Claim

Our ref:
Your ref:

Housing Benefit Unit
Housing Delivery Division
DWP Business Finance & Housing Delivery Directorate
Room B120D
Warbeck House
Blackpool
Lancashire
FY2 0UZ

Section 151 officer South Somerset District Council

28 November 2019

Dear Sirs

Housing Benefit (Subsidy) Assurance Process 2019 Module 6 DWP Reporting Framework Instruction (Applicable to England only) Reporting accountants' report for the Housing Benefit Subsidy claim form MPF720A, year ended 31 March 2019

This report is produced in accordance with the terms of our engagement letter with South Somerset District Council dated 8th March 2019 and the standardised engagement terms in Appendix 2 of HBAP Module 1 2018/19 issued by the Department for Work and Pensions (DWP) for the purpose of reporting to the Section 151 Officer of South Somerset District Council and the DWP.

Our report is prepared solely for the confidential use of the Local Authority and the DWP and solely for the purpose of facilitating the claim for Housing Benefit Subsidy on form MPF720A dated 30 April 2019.

This report should not be copied, referred to or disclosed, in whole or in part (save as otherwise permitted by the standardised engagement terms), without our prior written consent. Without assuming or accepting any responsibility or liability in respect of this report to any party other than the local authority and the DWP, we acknowledge that the local authority and/or the DWP may be required to disclose this report to parties demonstrating a statutory right to see it.

This report is designed to meet the agreed requirements of Local Authority and the DWP as described in the DWP HBAP reporting framework instruction 2019.

This report should not therefore be regarded as suitable to be used or relied by any other party for any purpose or in any context. Any party other than the Local Authority and the DWP which obtains access to this report or a copy and chooses to rely on this report (or any part of it) will do so entirely at its own risk. To the fullest extent permitted by law, we accept no responsibility or liability in respect of our work or this report to any other party and shall not be liable for any loss, damage or expense of whatsoever nature which is caused by the reliance of anyone other than the addressees on our work or this report.

Respective responsibilities of the Local Authority and the reporting accountant

We conducted our engagement in accordance with HBAP Modules 1 and 6 2018/19 issued by the DWP, which highlight the terms under which DWP has agreed to engage with reporting accountants.

The Section 151 Officer of the Local Authority has responsibilities under the Income-related Benefits (Subsidy to Authorities) Order 1998. The section 151 Officer is also responsible for ensuring that the Local Authority maintains accounting records which disclose with reasonable accuracy, at any time, the financial position of the

Local Authority. It is also the Section 151 Officer's responsibility to extract relevant financial information from the Local Authority's accounting records, obtain relevant information held by any officer of the Local Authority and complete the attached form MPF720A in accordance with the relevant framework set out by the DWP.

Our approach

For the purpose of the HBAP engagement we have been provided with a signed copy of form MPF720A 2018/19 dated 30 April 2019 by the Section 151 Officer. The Section 151 Officer remains solely responsible for the completion of the MPF720A and is the signatory on the local authority's certificate on claim form MPF720A.

Our engagement was carried out in accordance with the DWP reporting framework instruction which has been prepared in accordance with the *International Standard on Related (ISRS) 4400, Engagement to perform agreed-upon-procedures regarding financial information*. The purpose of the engagement is to perform the specific test requirements determined by the DWP on the defined sample basis as set out in HBAP Modules of the HBAP reporting framework instruction on the Local Authority's form MPF720A dated 30 April 2019, and to report the results of those procedures to the Local Authority and the DWP.

The results of these are reported on in appendices A and B

Inherent limitations

The procedures specified in DWP's HBAP Reporting framework instruction does not constitute an examination made in accordance with generally accepted auditing standards, the objective of which would be the expression of assurance on the contents of the local authority's claim for Housing Benefit subsidy on form MPF720A. Accordingly, we do not express such assurance. Had we performed additional procedures or had we performed an audit or review of the local authority's claim for Housing Benefit subsidy on form MPF720A in accordance with generally accepted auditing or review standards, other matters might have come to our attention that would have been reported to you. This report relates only to the Local Authority's form MPF720A and does not extend to any financial statements of the Local Authority, taken as a whole.

This engagement will not be treated as having any effect on our separate duties and responsibilities as the external auditor of the Local Authority's financial statements. Our audit work on the financial statements of the Local Authority is carried out in accordance with our statutory obligations and is subject to separate terms and conditions. Our audit report on the Local Authority's financial statements is made solely to the Local Authority's members, as a body, in accordance with Part 5 of the Local Audit and Accountability Act 2014. Our audit work was undertaken so that we might state to the Local Authority's members those matters we are required to state to them in an auditor's report and for no other purpose. To the fullest extent permitted by law, we do not accept or assume responsibility to anyone other than the Local Authority and the Local Authority's members, as a body, for our audit work, for our audit reports, or for the opinions we have formed in respect of that audit.

Summary of HBAP report

Summary of Initial Testing

In accordance with HBAP modules an initial sample of cases was completed for all general expenditure cells. We have re-performed a sample of the Local Authority's testing and confirm the tests we have carried out concur with the Local Authority's results:

- Cell 011 Non HRA Rent Rebate
 - No claims were found to be in error
- Cell 094 Rent Allowance – Application of tax credits
 - 1 claim had incorrectly applied tax credits as part of the benefit subsidy calculation. As it was not possible to correctly establish the error for amendment additional testing of 40 cases was completed for the error

Completion of Modules

- Completion of Module 2
 - We have completed the uprating checklist as required for module 2 of the certification work and have confirmed that all parameters have been appropriately implemented. No issues have been identified
- Completion of module 5

- We have completed the questionnaire for the appropriate software supplier and no issues were identified.

Summary of testing arising from Cumulative Assurance Knowledge and Experience

In line with the requirements of HBAP Modules we have undertaken CAKE testing based upon the preceding Qualification Letter. Where appropriate the Authority has completed testing of the sub populations for:

- Rent allowances cell 94 overpaid benefit earned income calculation error
- Rent allowances cell 94 overpaid benefit earned income self-employed calculation error
- Rent allowances cell 94 overpaid benefit due to incorrect application of tax credits
- Rent allowances cell 94 overpaid benefit due to incorrect application of pension credit savings credits
- Rent allowances cell 114 Claimant error overpayment classification
- Modified Schemes cell 225 Incorrect application of uprated war disablement pension payments

We have re-performed a sample of the Authority's testing and confirm the tests we have carried out concur with the Authority's results. These results are outlined in the appropriate appendix.

The following CAKE tests have returned no errors and are considered as closed:

- Modified schemes cell 225 Incorrect application of uprated war disablement pension payments

Summary paragraph/ending of letter

For the form MPF720A dated 30 April for the year ended 31 March 2019 we have completed the specific test requirements detailed in the DWP reporting framework instruction HBAP and have identified the following results set out in Appendices A and B.

Firm of accountants – Grant Thornton UK LLP

Office – 2 Glass Wharf, Bristol, BS2 0EL

Contact details (person, phone and email) – Barrie Morris 0117 3057708 barrie.morris@uk.gt.com

Signature / stamp.....

Date

28/11/19.

Appendix A Exceptions/errors found

Cell 094 Rent Allowances – Total Expenditure (Benefit Granted)

Cell Total £32,466,497

Cell Population 8,004

Cell Sub-total £4,616,777 – sub population of claims with earned income

Cell Sub-population 1,467 – sub population of claims with earned income

Headline Cell £32,466,497

In 2016/17 and 2017/18 it was identified that the Local Authority has incorrectly calculated earned income resulting in an overpayment of benefit. During our initial testing, 5 cases (value £10,899) where the assessment was based on earned income were tested and no errors were identified.

However, given the nature of the population and the errors found in the previous claim, an additional sample of 40 cases where an assessment in the subsidy period was based upon earned income was tested. This additional testing identified:

- 3 cases which resulted in an overpayment of housing benefit to a total of £271 in 2018/19 due to miscalculating the claimants earned income. The errors ranged from £56.56 to £174.77.
- 1 case resulted in an underpayment of housing benefit to a total of £74.40 in 2018/19 due to miscalculating the claimants earned income. As there is no eligibility to subsidy for benefit which has not been paid, the underpayment (or nil impact) identified does not affect and has not, therefore, been classified as errors for subsidy extrapolation purposes.

Sample	Movement / brief note of error:	Original cell total: sub population (claims with earning)	Sample error:	Sample value:	Percentage error rate (to two decimal places):	Cell adjustment:
		[CT]	[SE]	SV]	[SE/SV]	[SE/SV times CT]
Initial sample - 5 cases	Incorrect Earned Income Calculation - Cell 094	£4,616,777	£0	£10,899		
Additional testing sample - 40 cases	Incorrect Earned Income Calculation - Cell 094	£4,616,777	£271	£141,291		
Combined sample - 45 cases	Incorrect Earned Income Calculation - Cell 094	£4,616,777	£271	£152,190	0.18%	£8,218
Corresponding adjustment:	Combined sample - Cell 102 is overstated	£4,616,777	£271	£152,190	0.18%	£(8,218)
Total corresponding adjustment	Combined sample - Cell 113 is understated					£8,218

Cell 094 Rent Allowances – Total Expenditure (Benefit Granted)

Cell Total £32,466,497 –

Cell Population 8,004

Cell Sub-total £1,566,582 – sub population of claims with self-employed earned income

Cell Sub-population 393 – sub population of claims with self-employed earned income

Headline Cell £32,466,497

In 2016/17 and 2017/18 it was identified that the Local Authority has incorrectly calculated self-employed earned income resulting in an overpayment of benefit. No cases were identified in our initial testing, where the assessment was based on earned income were tested and no errors were identified.

However, given the nature of the population and the errors found in the previous claim, an additional sample of 40 cases where an assessment in the subsidy period was based upon self-employed earned income was tested. This additional testing identified:

- 3 cases which resulted in an overpayment of housing benefit to a total of £12 in 2018/19 due to miscalculating the claimants self-employed earned income. The errors ranged from £0.51 to £6.93.
- 1 case resulted in an underpayment of housing benefit to a total of £0.14 in 2018/19 due to miscalculating the claimants earned income and 5 cases resulted in no impact on the subsidy calculation. As there is no eligibility to subsidy for benefit which has not been paid, the underpayment (or nil impact) identified does not affect and has not, therefore, been classified as errors for subsidy extrapolation purposes.

The results of our testing are set out below:

Sample	Movement / brief note of error:	Original cell total: sub population (claims with self-employed earning)	Sample error:	Sample value:	Percentage error rate (to two decimal places):	Cell adjustment:
		[CT]	[SE]	[SV]	[SE/SV]	[SE/SV times CT]
Initial sample	Incorrect Self-employed Earned Income Calculation – Cell 094	£1,566,582	£0	£0		
Additional testing sample – 40 cases	Incorrect Self-employed Earned Income Calculation – Cell 094	£1,566,582	£12	£137,587		
Combined sample - 40 cases	Incorrect Self-employed Earned Income Calculation – Cell 094	£1,566,582	£12	£137,587	0.009%	£141
Corresponding adjustment:	Combined sample - Cell 103 is overstated	£1,566,582	£12	£137,587	0.009%	£(141)
Total corresponding adjustment	Combined sample - Cell 113 is understated					£141

Cell 114 Rent Allowances – Eligible Overpayments (Current Year)

Cell Total £32,466,497

Cell Population 8,004

Cell Sub-total £417,905 – sub population of claims with overpayments

Cell Sub-population 1,535 – sub population of claims with overpayments

Headline Cell £32,466,497

It was identified in the 2016/17 and 2017/18 claims and reported in the qualification letter for those year that Cell 114 included overpayments that should properly have been classified as Cell 113 LA error and administrative delay eligible overpayments. Testing within the initial testing for 2018/19 included 2 cases within Cell 114 eligible overpayments support and in all cases the overpayments were classified appropriately. Additional 40+ testing was undertaken of Cell 114 overpayments.

Additional Testing

Testing of an additional random sample of 40 cases identified 2 cases (total value £12) where the dates have been incorrectly applied and part of the overpayment should have been classified in cell 113 (LA error overpavments) not cell 114. Testing also identified 2 case (total value £191) where dates have been incorrectly applied and part of the overpayment should have been classified in cell 102. Consequently, cell 114 is overstated and cells 102 and 113 are correspondingly understated there is no effect on cell 094.

Values ranged in value from £5.52 to £129.24

The results of our testing are set out below:

Sample	Movement / brief note of error:	Original cell total: sub population (claims with over payments)	Sample error:	Sample value:	Percentage error rate (to two decimal places):	Cell adjustment:
		[CT]	[SE]	SV	[SE/SV]	[SE/SV times CT]
Initial sample - 2 cases	Misclassification of overpayments - cell 114	£417,905	£0	£1,042		
Additional testing sample - 40 cases	Misclassification of overpayments - cell 114	£417,905	£203	£14,268		
Combined sample - 42 cases	Misclassification of overpayments - cell 114	£417,905	£203	£15,310	1.33%	£5,541
90	Combined sample - Cell 113 is understated	£417,905	£12	£15,310	0.08%	£326
32	Combined sample - Cell 102 is understated	£417,905	£191	£15,310	1.25%	£5,215
Total corresponding adjustment	Total amendment of Cell 102, 113 and 114					£(5,541)

Cell 094 Rent Allowances – Total Expenditure (Benefit Granted)
Cell Total £32,466,497 – sub population
Cell Population 8,004

In 2016/17 and 2017/18 it was identified that the Local Authority has incorrectly calculated tax credits resulting in an overpayment of benefit. 1 case (total value £105) was identified in our initial testing, where tax credits had been incorrectly applied leading to an error and an overpayment of subsidy.

Given the nature of the population and the errors found in the previous claim, an additional sample of 40 cases where an assessment in the subsidy period was based upon tax credits was tested. The Authority are unable to provide a sub population of those cases where tax credits have been applied and therefore, the extra sample has been taken from the headline cell. This additional testing identified:

- 1 case which resulted in an overpayment of housing benefit to a total of £4 in 2018/19 due to misapplication of the claimant's tax credits.
- 1 case resulted in an underpayment of housing benefit to a total of £30.61 in 2018/19 due to misapplication of the claimant's tax credits. As there is no eligibility to subsidy for benefit which has not been paid, the underpayment (or nil impact) identified does not affect and has not, therefore, been classified as errors for subsidy extrapolation purposes.

The results of our testing are set out below:

Sample	Movement / brief note of error:	Original cell total: sub population (claims with tax credits)	Sample error:	Sample value:	Percentage error rate (to two decimal places):	Cell adjustment:
		[CT]	[SE]	SV	[SE/SV]	[SE/SV times CT]
Initial sample - 20 cases	Incorrect application of tax credits - cell 94	£32,466,497	£105	£75,884		
Additional testing sample - 40 cases	Incorrect application of tax credits - cell 94	£32,466,497	£4	£143,574		
Combined sample - 60 cases	Incorrect application of tax credits - cell 94	£32,466,497	£109	£219,458	0.050%	£16,233
Corresponding adjustment:	Combined sample - Cell 103 is overstated	£32,466,497	£4	£219,458	0.001%	£(974)
	Combined sample - Cell 102 is overstated	£32,466,497	£105	£219,458	0.049%	£(15,259)
Total corresponding adjustment	Total amendment of Cell 102, 103 and 113					£(16,233)

Cell 094 Rent Allowances – Total Expenditure (Benefit Granted)

Cell Total £32,466,497 – sub population

Cell Population 8,004

Cell Sub-total £1,613,939 – sub population of claims with Pension Credit Savings

Cell Sub-population 377 – sub population of claims with Pension Credit Savings

Headline Cell £32,466,497

In 2016/17 and 2017/18 it was identified that the Local Authority has misapplied the claimants pension savings credit savings resulting in an overpayment of benefit. During our initial testing, 3 cases (value £9,663), where the assessment was based on pension savings credit savings, were tested and no errors were identified.

However, given the nature of the population and the errors found in the previous claim, an additional sample of 40 cases where an assessment in the subsidy period was based upon pensions savings credit savings was tested. This additional testing identified:

- o 3 cases resulting in an underpayment of housing benefit to a total of £9 74 in 2018/19 due to misapplication of the claimant's pensions credit savings credit. As there is no eligibility to subsidy for benefit which has not been paid, the underpayment (or nil impact) identified does not affect and has not, therefore, been classified as errors for subsidy extrapolation purposes.

Appendix B Observations

There are no observations to report.

Agenda Item 8

Internal Audit Annual Activity Report 2019/20

Head of Service: Dave Hill, Chief Executive - SWAP
Lead Officer: Alastair Woodland - Assistant Director
Contact Details: Alastair.Woodland@swapaudit.co.uk

Purpose of the Report

To update members on the Internal Audit Plan 2019-20 progress and bring to their attention any significant findings identified through our work. The report aims to provide assurance to the Audit Committee regarding the effectiveness of the control environment operated by and on behalf of the council and highlight any significant matters to be addressed by management.

Recommendation

Members are asked to note progress made in delivery of the 2019/20 internal audit plan since the previous update in October 2019.

Background

The Internal Audit function plays a central role in corporate governance by providing assurance to the Audit Committee over the effectiveness of internal controls, governance and risk management. The 2019-20 Annual Audit Plan was approved by the Audit Committee at its March 2019 meeting and is to provide independent and objective assurance on SSDC's Internal Control Environment and this work will support the Annual Governance Statement.

Financial Implications

There are no financial implications associated with these recommendations.

Background Papers: None



South Somerset District Council

Report of Internal Audit Activity

Plan Progress 2019/20 as at January 2020

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Contents

The contacts at SWAP in connection with this report are:

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Our audit activity is split between:

- Operational Audit
- Governance Audit
- Key Control Audit
- IT Audit
- Grants
- Other Reviews



Role of Internal Audit

The Internal Audit service for the South Somerset District Council is provided by South West Audit Partnership Limited (SWAP). SWAP is a Local Authority controlled Company. SWAP has adopted and works to the Standards of the Institute of Internal Auditors, further guided by interpretation provided by the Public Sector Internal Audit Standards (PSIAS), and also follows the CIPFA Code of Practice for Internal Audit. The Partnership is also guided by the Internal Audit Charter approved by the Audit and Governance Committee at its meeting in March 2019.

Internal Audit provides an independent and objective opinion on the Authority's control environment by evaluating its effectiveness. Primarily the work includes:

- Operational Audit Reviews
- Cross Cutting Governance Audits
- Annual Review of Key Financial System Controls
- IT Audits
- Grants
- Other Special or Unplanned Review

Internal Audit work is largely driven by an Annual Audit Plan. This is approved by the Section 151 Officer, following consultation with the Senior Management Team. This year's Audit Plan was reported to and approved by this Committee at its meeting in March 2019. Audit assignments are undertaken in accordance with this Plan to assess current levels of governance, control and risk.



Outturn to Date:

We rank our recommendations on a scale of 1 to 3, with 1 being a fundamental concern to the services/area being reviewed and 3 being a minor concern that requires management attention.



Internal Audit Work Programme

The schedule provided at **Appendix B** contains a list of all audits as agreed in the Annual Audit Plan 2019/20. It is important that Members are aware of the status of all audits and that this information helps them place reliance on the work of Internal Audit and its ability to complete the plan as agreed.

Each completed assignment includes its respective “assurance opinion” rating together with the number and relative ranking of recommendations that have been raised with management. In such cases, the Committee can take assurance that improvement actions have been agreed with management to address these. The assurance opinion ratings have been determined in accordance with the Internal Audit “Audit Framework Definitions” as detailed on **Appendix A** of this document.

The following table summarised Audits finalised during 2019/20:

Audit Area	Quarter	Status	Opinion
Civil Contingencies	1	Final	Reasonable
Creating New Companies	2	Final	Reasonable
Benefit Realisation Position Statement	3	Final	Advisory
Financial Resilience/Contract Monitoring Follow Up	3	Final	Follow Up

Partial Assurance / No Assurance Audits

As agreed with this Committee where a review has a status of ‘Final’ and has been assessed as ‘Partial’ or ‘No Assurance’, I will provide further detail to inform Members of the key issues identified. Since the October 2019 update there are no ‘Partial Assurance’ reviews I need to bring to your attention.

To provide assurance to members on recommendation progress of previously identified areas of weakness we have included detail in **Appendix C** in relation to Financial Resilience/Contract Monitoring Arrangements.

Outturn to Date:

We rank our recommendations on a scale of 1 to 3, with 1 being a fundamental concern to the services/area being reviewed and 3 being a minor concern that requires management attention.



Internal Audit Work Programme Contd.

'High' Corporate Risk

Our audits examine the controls that are in place to manage the risks that are related to the area being audited. We assess the risk at an inherent level i.e. how significant is the risk(s) at a corporate level on a scale of High, Medium or Low. Once we have tested the controls in place we re-evaluate the risk based on how effective the controls are operating to govern that risk (Residual Risk). Where the controls are found to be ineffective and the inherent and residual risk is assessed as 'High', I will bring this to your attention.

Since the October 2019 update there are no new 'High' risks that I need to bring to your attention from our work.

The Assistant Director for SWAP reports performance on a regular basis to the SWAP Management and Partnership Boards.



Plan Progress Performance

SWAP now provides the Internal Audit service for 24 public sector bodies. SWAP performance is subject to regular monitoring review by both the Board and the Member Meetings. The respective outturn performance results for South Somerset District Council for the 2019/20 (as at 7 January 2020) were as follows:

Performance Target	Target Year end	Average Performance
<p><u>Audit Plan – Percentage Progress</u> Final, Draft and Discussion In progress Not Started</p>	>90%	57% 26% 17%
<p><u>Quality of Audit Work</u> Overall Client Satisfaction <i>(did our audit work meet or exceed expectations, when looking at our Communication, Auditor Professionalism and Competence, and Value to the Organisation)</i></p>	>95%	100%
<p><u>Outcomes from Audit Work</u> Value to the Organisation <i>(client view of whether our audit work met or exceeded expectations, in terms of value to their area)</i></p>	>95%	Reported Year end

We keep our audit plans under regular review so as to ensure that we are auditing the right things at the right time.



Approved Changes to the Audit Plan 2019-20

The audit plan for 2019/20 is detailed in **Appendix B**. Inevitably changes to the plan will be required during the year to reflect changing risks and ensure the audit plan remains relevant to South Somerset District Council. Members will note that where necessary any changes to the plan throughout the year will have been subject to agreement with the appropriate Service Manager and the Section 151 Officer.

No further changes to the plan have been made since our previous update in October 2019.



At the conclusion of audit assignment work each review is awarded a “Control Assurance Definition”;



Audit Framework Definitions

Control Assurance Definitions

- Substantial
- Reasonable
- Partial
- None
- Non-Opinion/Advisory

Substantial	▲ ★ ★ ★	I am able to offer substantial assurance as the areas reviewed were found to be adequately controlled. Internal controls are in place and operating effectively and risks against the achievement of objectives are well managed.
Reasonable	▲ ★ ★ ☆	I am able to offer reasonable assurance as most of the areas reviewed were found to be adequately controlled. Generally, risks are well managed, but some systems require the introduction or improvement of internal controls to ensure the achievement of objectives.
Partial	▲ ★ ☆ ☆	I am able to offer Partial assurance in relation to the areas reviewed and the controls found to be in place. Some key risks are not well managed, and systems require the introduction or improvement of internal controls to ensure the achievement of objectives.
None	▲ ☆ ☆ ☆	I am not able to offer any assurance. The areas reviewed were found to be inadequately controlled. Risks are not well managed, and systems require the introduction or improvement of internal controls to ensure the achievement of objectives.

Non-Opinion/Advisory – In addition to our opinion-based work we will provide consultancy services. The “advice” offered by Internal Audit in its consultancy role may include risk analysis and evaluation, developing potential solutions to problems and providing controls assurance. Consultancy services from Internal Audit offer management the added benefit of being delivered by people with a good understanding of the overall risk, control and governance concerns and priorities of the organisation.

We keep our audit plans under regular review, so as to ensure we are auditing the right things at the right time. Recommendation are prioritised from 1 to 3 on how important they are to the service/area audited. These are not necessarily how important they are to the organisation at a corporate level.



Audit Framework Definitions

Categorisation of Recommendations

When making recommendations to Management it is important that they know how important the recommendation is to their service. There should be a clear distinction between how we evaluate the risks identified for the service but scored at a corporate level and the priority assigned to the recommendation. No timeframes have been applied to each Priority as implementation will depend on several factors; however, the definitions imply the importance.

- Priority 1: Findings that are fundamental to the integrity of the service’s business processes and require the immediate attention of management.
- Priority 2: Important findings that need to be resolved by management.
- Priority 3: Finding that requires attention.

Definitions of Risk

Risk	Reporting Implications
Low	Issues of a minor nature or best practice where some improvement can be made.
Medium	Issues which should be addressed by management in their areas of responsibility.
High	Issues that we consider need to be brought to the attention of both senior management and the Audit Committee.

Each audit covers key risks. For each audit a risk assessment is undertaken whereby with management risks for the review are assessed at the Corporate inherent level (the risk of exposure with no controls in place) and then once the audit is complete the Auditors assessment of the risk exposure at Corporate level after the control environment has been tested. All assessments are made against the risk appetite agreed by the SWAP Management Board.

Audit Type	Audit Area	Quarter	Status	Opinion	No of Rec	1 = Major	↔	3 = Minor	Comments
						Recommendation			
						1	2	3	
FINAL									
Annual Accounts Certification	Boden Mill	1	Final	Advisory	0	0	0	0	
Annual Accounts Certification	Yeovil Cemetery & Crematorium Accounts	1	Final	Advisory	0	0	0	0	
Grant/Certification	Growth Deal Capital Expenditure (YIC Phase 2)	1	Final	Advisory	0	0	0	0	
IT Audit	Data Centre - Physical and Environmental Controls	1	Final	Reasonable	9	0	0	9	
Operational	Affordable Housing Programme	2	Final	Reasonable	2	0	0	2	
Follow Up	Lone Working Arrangements	2	Final	Advisory	5	0	4	1	
Governance, Fraud and Corruption	SSDC Opium Power	2	Final	Advisory	4	0	4	0	
Operational	Civil Contingencies	1	Final	Reasonable	5	0	1	4	
Governance, Fraud and Corruption	Creating New Companies	2	Final	Reasonable	4	0	0	4	
Follow Up	Financial Resilience/Contract Monitoring	3	Final	Follow Up	0	0	0	0	See Appendix C
Operational	Benefits Realisation Position Statement	2	Final	Advisory	-	-	-	-	



Audit Type	Audit Area	Quarter	Status	Opinion	No of Rec	1 = Major	↔	3 = Minor	Comments
						Recommendation			
						1	2	3	
DRAFT									
Key Financial Controls	Payroll	2	Draft						
Key Financial Controls	Treasury Management and Bank Reconciliations	3	Draft						
IN PROGRESS									
Key Financial Controls	Council Tax & NNDR	3	In Progress						
Key Financial Controls	Housing Benefits	3	In Progress						
Key Financial Controls	Creditors	3	In Progress						
Key Financial Controls	Debtors	3	In Progress						
Key Financial Controls	Main Accounting	3	In Progress						
Cross cutting, Governance, Fraud and Corruption	Information Governance - GDPR	3	In Progress						
NOT STARTED									
Governance, Fraud and Corruption	Risk Strategy & TEN Risk Management	4							
Operational	Benefits Realisation	4							



Audit Type	Audit Area	Quarter	Status	Opinion	No of Rec	1 = Major	↔	3 = Minor	Comments
						Recommendation			
						1	2	3	
Operational	Performance Indicators Data Quality	4							
IT Audit	Wide Area Network (WAN)	4							
DROPPED/DEFERRED									
Transformation	Income Generation - service improvements	4				Move to quarter 1 of the 2020-21 Audit Plan to accommodate the work undertaken on SSDC Opium Power Ltd.			

2018-19 Outstanding Reviews

Audit Type	Audit Area	Quarter	Status	Opinion	No of Rec	1 = Major	↔	3 = Minor	Comments
						Recommendation			
						1	2	3	
IT Audit	Disaster Recovery	4	Draft	Reasonable					

Audit Assignments completed since the October 2019 update:

These are actions that we have identified as being high priority and that we believe should be brought to the attention of the Corporate Governance Committee.

Summary of Audit Findings and High Priority Service Findings

The following information provides a brief summary of each audit review finalised since the last Committee update in October 2019 where we deem it necessary to share findings. Each audit review is displayed under the relevant audit type, i.e. Operational; Key Control; Governance; Fraud & Corruption; ICT and Special Review.

Follow Up

Follow up reviews are undertaken where a previous audit has returned a 'Partial Assurance' or 'No Assurance'. This is to provide assurance to the Corporate Governance Committee that areas of weakness have been addressed. Follow up reviews will only focus on the areas of weakness identified in the original review and are usually undertaken 6 months after the original review to allow time for recommendations to be implemented.

Financial Resilience/Contract Monitoring Follow Up

In the Financial Resilience/Contract Monitoring audit completed January 2019 we offered partial assurance. Three recommendations were raised; one was given a priority-one, one priority-two and one priority-three.

Assessments of supplier financial resilience is important to ensure that supplier failure is not going to have a detrimental impact on the Council's ability to deliver services. Partial assurance was awarded due to weaknesses identified in identifying key suppliers and having plans in place to mitigate potential supplier failure. This included an inconsistent approach to monitoring suppliers, a lack of business continuity or supplier failure plans and contract managers not having access to guidance on how to manage the contracts.

Whilst carrying out this follow-up audit in November 2019, the progress made against each recommendation is summarised below in table 1:

Audit Assignments completed since the October 2019 update:

These are actions that we have identified as being high priority and that we believe should be brought to the attention of the Corporate Governance Committee.

Follow Up Continued

Progress Summary				
Priority score	Complete	In Progress	Not Started	Total
Priority 1	1	0	0	1
Priority 2	0	1	0	1
Priority 3	1	0	0	1
Total	2	1	0	3

As the table above demonstrates, two of the three recommendations have been fully implemented and action has been taken to move the other along. A Revised date for completion is the end of March 2020.

Detailed explanation against the outstanding recommendation can be viewed below.

No	Weaknesses Found	Recommendation	Revised Date for Completion	Manager's Update
Financial Resilience/Contract Monitoring				
1	Business Continuity Plans do not include provisions on dealing with suppliers who have gone into administration and can no longer deliver their contracted goods or services.	We recommend that the Lead Specialist – Strategic Planning ensures that supplier failure plans are developed for critical suppliers and the Business Continuity Plans are updated to include reference these.	31 March 2020	The Commodity and Supplier Risk Model identifies if the council has seen the supplier's business continuity plans so they know how they will manage to meet the contract should anything occur. It also identified how easy it would be to replace the supplier and the level or reliance the Council have on any one supplier for a certain commodity or service area. They do not yet have sight of all the required BCP's and these are being requested as part of the retendering process for the key critical suppliers. They will also be working on supplier failure plans alongside this process as the BCP will help identify what the Council may need to do should they fail.

Agenda Item 9

Capital, Investment and Treasury Strategies 2020/21 to 2022/23

Director Netta Meadow, Strategy and Support Services
Lead Officers: Nicola Hix, Interim S151 Officer
Paul Matravers, Specialist - Finance
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Purpose of Report

1. The purpose of this report is to inform members of the recommended strategy in relation to capital expenditure and financing, investments and treasury management activities.

Previously separate strategies have been presented, however this report provides a holistic view of the Council's capital, investment and borrowing requirements meeting the requirements of statutory guidance issued by government in January 2018.

Recommendations

2. Audit Committee are requested to review and comment on the draft Treasury Management Strategy, and recommend for approval to the District Executive.
3. To note the Minimum Revenue Provision statement (This is to go to full council for approval. The figures within the report are provisional dependant on the report going to District Executive in Feb 2020 so it is anticipated that these will change).
4. Audit Committee are requested to provide feedback on the full report including any suggestions for improvement.

Introduction and Background

5. In line with regulatory guidance, the Council is required to produce a Capital Strategy, and Investment Strategy and a Treasury Management Strategy. These are intrinsically linked so, whilst in the past these have been presented to Members as separate reports, they have been pulled together into a draft consolidated document this year. It is recognised this is a large document, but is helpful on this occasion to provide a holistic review of the relevant data and information together with supporting narrative.
6. The report is also expanded to include a number of graphs and charts to make some of this information more accessible to a wider audience. The Interim S151 Officer proposes to explore future iterations of this report to condense into a single, shorter strategy document. This will be discussed with our external auditor to ensure compliance to the relevant regulations is not compromised.
7. The Audit Committee is requested specifically to review and comment on the draft Treasury Management Strategy section of the report (Page 33-49). However, feedback and comments are invited on the whole draft report.
8. The 2020/21 Minimum Revenue Provision Statement is set out on pages 55-57. These are included in draft at this stage, and will potentially be amended for the report to Executive to reflect final budget proposals for 2020/21.

Treasury Strategy Statement 2020/21 - Key Information

9. The Treasury Management Strategy Statement is split into the following main areas:
- **External Context** (Appendix A) – Summary commentary on the wider economic picture provided by Arlingclose (Treasury Advisor)
 - **Local Context** – Current position on borrowing and investments
 - **Borrowing Strategy** – Proposed borrowing strategy 2020/21
 - **Treasury Investment Strategy** – Proposed investment strategy 2020/21
 - **Treasury Management Indicators** – Proposed indicators to be used to measure and manage exposure to treasury management risk
 - **Other Items** - Related matters
 - **Financial Implications** - Budget for investment income and debt interest
 - **Other Options Considered** - Alternative strategies, with their financial and risk management implications
10. There are no changes proposed to the 2020/21 treasury management strategy for the key areas detailed below:
- Approved counterparties and the limits applicable to each counterparty (Table 24)
 - Investment limits and the cash limits applicable (Table 25)

Minimum Revenue Provision Statement 2020/21 - Key Information

11. The 2020/21 MRP statement includes a new section on voluntary overpayments of MRP. Voluntary overpayments can be made in a financial year with the impact of the overpayment being a reduction in the charge to revenue in future years.
12. The statement provides information on the process of determining if an MRP overpayment can be made in a particular year.

Financial Implications

13. There are no additional financial implications in reviewing the attached treasury management strategy.

Background Papers: *CIPFA Treasury Management Code of Practice*
CIPFA Prudential Code
Treasury Management Practices



South Somerset
District Council

Capital, Investment and Treasury Strategies
2019/20 to 2022/23

Capital Strategy

1 Introduction

- 1.1 This Strategy sets out South Somerset District Council's approach to capital investment and sets out the long-term context in which both capital expenditure and investment decisions are made and gives due consideration to both risk and reward and impact on the achievement of priority outcomes.
- 1.2 It provides an overview of how the associated risk is managed, the implications for future financial sustainability and information on how stewardship, value for money, prudence, sustainability and affordability will be secured.
- 1.3 The investment and treasury management strategies are fundamentally linked to the capital strategy and are therefore included here to provide a holistic view of capital, investment and borrowing requirements.
- 1.4 The flowchart below provides information on the requirements and the contents of the various strategies that are required on an annual basis, and how the strategies are inter-related.

CAPITAL STRATEGY: A short overview, accessible to non-financial specialist members, covering:

CAPITAL EXPENDITURE

PFI & LEASING

BORROWING

INVESTMENTS

GUARANTEES & LIABILITIES

KNOWLEDGE & SKILLS

MRP

PRUDENTIAL INDICATORS

Treasury

Service & Commercial

CAPITAL PROGRAMME

Capital expenditure
Capital financing
Capital receipts

Prudence
Affordability
Sustainability

TREASURY STRATEGY

Interest rate forecast
Cash flow forecast
Borrowing strategy
Investment strategy
TM indicators

Risk management

INVESTMENT STRATEGY

Contribution
Security
Liquidity
Investment indicators
Capacity and skills

Proportionality

MRP STATEMENT

Prudent provision
Calculation method
Overpayments

Prudence
Aligned cost:benefit

TM POLICY STATEMENT

TREASURY MANAGEMENT PRACTICES

NON-TREASURY INVESTMENT MANAGEMENT PRACTICES

2 Capital Expenditure

Capital Expenditure Estimates

- 1.5 Capital expenditure is incurred where the Council spends money on constructing or acquiring assets such as land and buildings, vehicles, plant and equipment, which will be used for more than one year, as well as larger scale maintenance works that maintain or enhance the Councils existing assets. In local government capital expenditure can also include spending on assets owned by other bodies, and loans and grants to other bodies enabling them to buy assets. The Council has some limited discretion on what counts as capital expenditure. For example, assets costing below £10,000 are not capitalised and are charged as revenue expenditure in the year. This discretion is reflected in the Council's accounting policies which are set out within the Statement of Accounts each year.
- 1.6 In 2020/21, the Council is planning capital expenditure of £57.6m as summarised below:

Table 1: Prudential Indicator: Actual and Estimates of Capital Expenditure

	2018/19 Actual £k	2019/20 Budget £k	2020/21 Estimate £k	2021/22 Estimate £k	2022/23 Estimate £k
General Fund services	17,222	6,561	5,018	2,736	1,571
Capital investments	11,192	66,886	52,550	51,200	17,700
TOTAL	28,414	73,447	57,568	53,936	19,271

- 1.7 The Council's capital investment focusses on the following main areas:
- Investment in new and existing operational assets and issuing capital grants to support the delivery of its services and strategic priorities. This includes schemes such as regeneration and infrastructure projects, grants for accessibility adaptations and equipment to support independent living.

- Investment to grow and balance the Council's commercial investment income portfolio, as set out in the investment strategy. This may include direct property freehold or long-leasehold acquisition, as well as shareholdings and loans to third parties and subsidiaries.

Capital Programme

- 1.8 The Capital Programme represents the Council's commitment to continue to invest in its operational asset portfolio and wider investment to support housing, economy and place-shaping priorities. It is reviewed annually and approved through the budget setting process, taking into account the availability of capital resources and the financing cost implications on the revenue budget.
- 1.9 New capital schemes and projects are usually added to the Programme as part of the annual process, however the Council's governance arrangements allow for new schemes and projects to be added or removed from the programme during the year subject to appropriate approvals.
- 1.10 Service managers have submitted bids to include projects in the Council's capital programme. Bids are collated by Finance who calculate the financing cost (which can be nil if the project is fully externally financed). The Strategic Leadership Team appraises all bids based on a comparison of service priorities against financing costs and makes recommendations to District Executive. The proposed capital programme is then presented to District Executive in January and to Council in February each year.
- 1.11 The proposed capital programme includes investment of £52.6m in 2020/21, with indicative further investment of £68.9m in the subsequent two years to 2022/23. The details of this investment is included in the General Fund 2020/21 Budget Estimates reports.

Asset Management

- 1.12 To ensure that capital assets continue to be of long-term use, the Council has an asset management plan, which is incorporated in the Council's Commercial Strategy and an Asset Disposal and Community Asset Transfer Policy.

- 1.13 This Asset Disposal and Community Asset Transfer Policy provides a transparent, robust and strategic framework to enable Asset Disposal and Community Asset Transfer decisions to be made, together with a clear process for both SSDC and community organisations to progress with transfers/disposals, with long term sustainable benefits both to the Council and the community.
- 1.14 The Disposals element of the policy refers to Council owned assets that are sold on the open market for a financial consideration or otherwise transferred out of Council ownership. The aim is to enable SSDC to retain only sound assets that support the effective and efficient delivery of services, achieve corporate priorities or produce a healthy financial return each year in accordance with the Commercial Land and Property Strategy.
- 1.15 When a capital asset is identified as surplus to requirements or an enabler for others to deliver council priorities, it may be sold so that the proceeds, known as capital receipts, can be spent on new assets or to repay debt. The Council is currently also permitted to spend capital receipts on service transformation projects until 2021/22. Repayments of capital grants, loans and investments also generate capital receipts. The Council estimates it will receive £2.67 million of capital receipts in the 2020/21 financial year.

Table 2: Capital receipts in £ millions

	2018/19 Actual £k	2019/20 Budget £k	2020/21 Estimate £k	2021/22 Estimate £k	2022/23 Estimate £k
Asset sales	333	62	255	15	430
Loans repaid	224	2,318	2,414	2,427	2,439
TOTAL	557	2,380	2,669	2,442	2,869

3 Capital Financing

- 1.16 The Council's capital investment falls within the scope of the CIPFA Prudential Code for Capital Finance in Local Authorities (the 'Prudential Code'), to which the Council must give due regard. The Code was last updated in 2017. Under the Prudential Code the Council has discretion over the funding of capital expenditure and the freedom to determine the level of borrowing it undertakes to deliver the Capital Programme.

1.17 All capital expenditure must be financed, and there are range of potential funding sources the Council may use including its own resources or externally:

- Capital receipts from asset disposals and loan repayments
- Capital grants e.g. from Government or other local authorities
- Contributions from others e.g. Section 106 (S106) and Community Infrastructure Levy (CIL)
- Revenue Contributions to Capital e.g. from the Revenue Budget or Revenue Reserves
- Debt financing e.g. borrowing, capital market bonds, leasing

Capital Financing Plan

1.18 The planned financing of the capital expenditure in Table 1 above is as follows:

Table 3: Capital Financing Plan

	2018/19 Actual £k	2019/20 Budget £k	2020/21 Estimate £k	2021/22 Estimate £k	2022/23 Estimate £k	Totals 2019/20- 2022/23 £k
External Sources:						
Grants and general contributions	1,261	1,307	231	112	1	1,651
S106	264	888	0	0	0	888
CIL	0	0	0	0	0	0
Sub-total – External	1,525	2,195	231	112	1	2,539
Own Resources:						
Capital receipts & Reserves	4,735	16,728	9,739	3,857	2,038	32,362
Sub-total - Own	4,735	16,728	9,739	3,857	2,038	32,362
Debt:						
Loans (Internal & External)	22,154	54,524	47,598	49,967	17,232	169,321
Leases						
Sub-total - Debt	22,154	54,524	47,598	49,967	17,232	169,321
Total	28,414	73,447	57,568	53,936	19,271	204,222

- 1.19 The allocation of resources may vary over time, for example, where additional income is achieved through asset sales or obtaining external funding. The plan is therefore dynamic, and is overseen by the Council's S151 Officer to optimise financing arrangements on an ongoing basis. The estimates will not commit the Council to particular methods of financing. The S151 Officer will determine the actual financing of capital expenditure incurred at the end of the financial year.
- 1.20 The implications of financing capital expenditure from borrowing is that the expenditure is not funded immediately but charged to the revenue budget over a number of years. The Council may defer the timing of external borrowing on a short to medium term by using temporary cash resources held in reserves and balances. This practice, which is referred to as 'internal borrowing', does not reduce the magnitude of borrowing required or the level of funds held in reserves and balances; the funds are merely being utilised in the short term until they are required for their intended purpose. The timing of external borrowing and the balance of external / internal borrowing is determined by market conditions and the Council's cash flow position. Officers manage this position on a day to day basis in line with the overall Treasury Management Strategy.
- 1.21 Debt is only a temporary source of finance, since loans and leases must be repaid and this is, therefore, replaced over time by other financing, usually from revenue which is known as minimum revenue provision (MRP). Alternatively, capital receipts may be used to replace debt finance.

Capital Financing Requirement

- 1.22 The Council's cumulative amount of debt finance is measured by the Capital Financing Requirement (CFR). This increases with new debt-financed capital expenditure and reduces with MRP repayments and capital receipts used to replace debt. Based on the above figures for expenditure and financing the Council's estimated CFR is as follows:

Table 4: Prudential Indicator – Actual and Estimated Capital Financing Requirement

	2018/19 Actual £k	2019/20 Estimate £k	2020/21 Estimate £k	2021/22 Estimate £k	2022/23 Estimate £k
CFR Balance b/f	17,438	39,320	93,844	141,442	191,409
Expenditure financed by debt	28,414	73,447	57,568	53,936	19,271
MRP	-221	-491	-747	-765	-842
Capital receipts used to replace debt	-4,786	-16,237	-8,992	-3,092	-2,038
Grants & Contributions	-1,525	-2,195	-231	-112	-1
Total CFR	39,320	93,844	141,442	191,409	207,799

- 1.23 The capital financing requirement for 2020/21 and subsequent years includes a £14.5m increase due to a change in the accounting for leases.
- 1.24 The chart shows that the Council's proposed capital strategy and capital investment plans are expected to increase the overall indebtedness position of the next 5 years. It is important to ensure such plans are affordable and the Council can meet the costs of this debt over the short and long term.

Grants and Contributions

- 1.25 The Council will seek to access external funding towards its capital investment plans where funds are available and our schemes are within scope. Examples of grants may include Government schemes such Housing Infrastructure Fund, Future High Streets Fund and so on. We also receive contributions from other bodies such as developers in the form of S106 planning obligations contributions and Community Infrastructure Levy (see below). It is often the case that the Council will need to put some of its own resources towards a scheme in order to attract the external funding. However, this can be effective in leveraging in funds to enable larger infrastructure investments to progress and mitigate marginal viability schemes.

S106 Contributions

- 1.26 S106 contributions are received in respect of certain obligations that have been agreed through planning approvals. Contributions that are in respect of district council services within SSDC are paid to the Council, there are usually restrictions on the nature of costs that S106 monies can fund. Expenditure on items such as public art, play areas and equipment and affordable housing provision are examples service expenditure that S106 contributions can fund. S106 contributions can be used to fund both revenue and capital expenditure and are allocated to the relevant capital and revenue budget accordingly.
- 1.27 All S106 funds over £10,000 will be included if appropriate in the capital programme once received and included within a quarterly monitoring statement for reporting to District Executive.

Community Infrastructure Levy (CIL)

- 1.28 The Council operates an approved CIL policy, with the levy payable on development in certain areas within the District. CIL is recognised as capital income and therefore provides resources to contribute to eligible infrastructure investment such as transport/roads, education, town centre regeneration and flood alleviation schemes. 15% (or 25% with an adopted Neighbourhood Plan) of CIL income is passed to town or parish councils, and 5% is allocated to fund administration costs.
- 1.29 Table 5: Estimated CIL Retained Income (Net of town/parish share and administration costs)

	2018/19 Actual £k	2019/20 Estimate £k	2020/21 Estimate £k	2021/22 Estimate £k	2022/23 Estimate £k

	2018/19 Actual £k	2019/20 Estimate £k	2020/21 Estimate £k	2021/22 Estimate £k	2022/23 Estimate £k
Net CIL Income	59	267	347	451	587

Capital Receipts

- 1.30 When a capital asset is no longer needed, it may be sold so that the proceeds, known as capital receipts, can be spent on new assets or to repay debt. Repayments of capital grants, loans and investments also generate capital receipts income.
- 1.31 The balance of capital receipts reserves at 1 April 2019 was £22.80m, £13.13m is committed to financing the current approved Capital Programme. The Council estimates it will receive £7.98m of capital receipts in the coming financial years as set out below.

Table 6: Capital Receipts Income Estimates

	2018/19 Actual £k	2019/20 Estimate £k	2020/21 Estimate £k	2021/22 Estimate £k	2022/23 Estimate £k
Asset Disposals	333	62	255	15	430
Loans and Grants Repaid	224	2,318	2,414	2,427	2,439
Total Receipts	557	2,380	2,669	2,442	2,869

Flexible Use of Capital Receipts

- 1.32 In the Spending Review 2015, the Chancellor of the Exchequer announced that to support local authorities to deliver more efficient and sustainable services, the government will allow local authorities to spend up to 100% of their capital receipts from the sale of non-housing assets on revenue costs incurred to generate ongoing revenue savings, to reduce costs and / or transform service delivery in a way that reduces costs or demand for services in future years. This flexibility relates to expenditure which is properly incurred for the financial years 2016/17 to 2021/22.

- 1.33 Local authorities are only able to use capital receipts in the years in which this flexibility is offered. In using the flexibility, the Council will have due regard to the requirements of the Prudential Code, the CIPFA Local Authority Accounting Code of Practice and the current edition of the Treasury Management in Public Services Code of Practice.

Table 7: Flexible Use of Capital Receipts

	2016/17- 2018/19 £k	2019/20 Estimate £k	2020/21 Estimate £k	2021/22 Estimate £k	2022/23 Estimate £k
General Fund Flexible Use of Capital Receipts	500	0	300	0	0

2. Treasury Management and Borrowing Strategy

- 2.1 Treasury management is concerned with keeping sufficient but not excessive cash available to meet the Council's spending needs, while managing the risks involved. Surplus cash is invested until required, while a shortage of cash will be met by borrowing, to avoid excessive credit balances or overdrafts in the bank current account. The Council is typically cash rich in the short-term as revenue income is received before it is spent, but cash poor in the long-term as capital expenditure is incurred before being financed. The revenue cash surpluses are offset against capital cash shortfalls to reduce overall borrowing.
- 2.2 The Council held £19.50m of external borrowing on 1 April 2019 and treasury investments totalling £30.73m.
- 2.3 The Council's main objectives when borrowing are to achieve a low but certain cost of finance while retaining flexibility should plans change in the future. These objectives are often conflicting and the Council, therefore, seeks to strike a balance between cheaper short-term loans (currently available at around 0.75%-1%) and long term fixed rate loans where the future cost is known but higher (currently 2%-3.3%).
- 2.4 Council's do not borrow for specific assets and cannot use local authority assets as security. Borrowing is undertaken to meet the capital financing requirement (less any short term use of temporary cash balances).

Public Works Loans Board (PWLB)

- 2.5 A common source of borrowing for local authorities is the Treasury, through the Debt Management Office, which took over the responsibilities of the previous Public Works Loans Board (although the term PWLB is still commonly used). There are a number of advantages to using the PWLB as a source of borrowing, such as
- Funds can be accessed quickly – usually within 2-3 days of notice
 - It is simple to arrange with limited time and effort required
 - The Council does not require a credit rating
 - Borrowing is not linked to any specific asset, but can provide the resources need to meet the overall capital financing requirement.
- 2.6 The PWLB currently offers a discounted ‘certainty rate’ at 0.2% below its standard rates, triggered by the Council completing an annual return to Government. It also offers a discounted ‘infrastructure rate’ which is 0.4% below its standard rate, which is subject to a competitive bidding process.
- 2.7 In October, in response to the Treasury’s concern about growing total debt balances for local government, the PWLB standard and certainty rates were increased by 1% without notice. As a consequence, the Council is working on identifying alternative sources of long term finance such as issuing bonds to the capital markets (typically pension funds and insurance companies).

Total Debt Position

- 2.8 Projected levels of the Council’s total outstanding debt are shown below, compared with the CFR (as detailed above). Statutory guidance is that actual debt should remain below the CFR, except in the short-term. As can be seen from the table the Council expects to comply with this in the medium term.

Table 8: Prudential Indicator – Gross Debt and the CFR

	2018/19 Actual £k	2019/20 Budget £k	2020/21 Estimate £k	2021/22 Estimate £k	2022/23 Estimate £k
Debt	19,500	79,097	126,197	177,397	195,097
CFR	39,320	93,844	141,442	191,409	207,799

Liability Benchmark

- 2.9 To compare the Council's actual borrowing against an alternative strategy, a liability benchmark has been calculated showing the lowest risk level of borrowing. This assumes that cash and investment balances are kept to a minimum level of £30m at each year-end. This benchmark is estimated to be £75.1m and is forecast to rise to £191.1m over the next five years.

Table 9: Actual Borrowing and the Liability Benchmark

	2018/19 Actual £k	2019/20 Budget £k	2020/21 Estimate £k	2021/22 Estimate £k	2022/23 Estimate £k
Outstanding borrowing	19,500	79,097	126,197	177,397	195,097
Liability Benchmark	19,420	75,144	124,442	174,709	191,149

3. Affordable Borrowing Limit

- 3.1 The Council is legally obliged to set an affordable borrowing limit (also termed the authorised limit for external debt) each year and to keep it under review. In line with statutory guidance, a lower "operational boundary" is also set as a warning level should debt approach this limit. The Operational Boundary has been calculated based on the forecast CFR plus a tolerance for variations in spending plans during the year and possible volatility in availability of internal and external resources.

Table 10: Prudential Indicators – Authorised Limit and Operational Boundary for external debt

	2018/19 Actual £k	2019/20 Budget £k	2020/21 Estimate £k	2021/22 Estimate £k	2022/23 Estimate £k
Operational Boundary:					
Borrowing	19,500	100,000	120,000	170,000	190,000
Leases	82	1,000	15,000	20,000	20,000
Total Operational Boundary	19,582	101,000	135,000	190,000	210,000
Authorised Limit:					
Borrowing	124,000	124,000	140,000	180,000	210,000
Leases	1,000	1,000	20,000	25,000	25,000
Total Authorised Limit	125,000	125,000	165,000	205,000	235,000

3.2 Further details of existing borrowing can be found in the Treasury Management Strategy Statement.

4. Treasury Investment Strategy

4.1 Treasury investments arise from receiving cash before it is paid out again. Investments made for service reasons or for pure financial gain are not generally considered to be part of treasury management.

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

4.3 As part of the Council's financial strategy, the aim is to grow the balance within the investment portfolio to improve the net income available through treasury management to fund services, whilst maintaining a prudent balance between security, liquidity and yield. Subject to long term cash flow forecasts, it is anticipated that funds held in longer term investments will be maintained at current levels.

- 4.4 Longer term investments may expose a proportion of funds to a higher risk of capital value volatility, this volatility is mitigated by holding a risk-assessed minimum balance of funds in a Treasury Risk Reserve. The balance of funds in this specific reserve is reviewed annually and a decision taken by the S151 Officer on the required transfer to or from the reserve made based on the current and projected performance of the longer term investments. The assessment of adequate general reserves also incorporates an element of risk to investment income assumptions.

Table 11: Treasury Management Investments

	2018/19 Actual £k	2019/20 Budget £k	2020/21 Estimate £k	2021/22 Estimate £k	2022/23 Estimate £k
Near-term investments		3,000	3,000	2,000	2,000
Long-term investments		30,000	30,000	30,000	30,000
Total		33,000	33,000	32,000	32,000

- 4.5 Further details of existing treasury investments can be found in the Treasury Management Strategy below.
- 4.6 The effective management and control of risk are prime objectives of the Council's treasury management activities. The treasury management strategy therefore sets out various indicators and limits to constrain the risk of unexpected losses and details the extent to which financial derivatives may be used to manage treasury risks.
- 4.7 Decisions on treasury management and borrowing are made daily and are, therefore, delegated to the S151 Officer and his staff who must act in line with the Treasury Management Strategy approved by Full Council. Reports on treasury management activities are presented to the Audit Committee at mid-year and at year-end.

5. Investment for Service Purposes

- 5.1 The Council can make service investments; service investments can be in the form of a loan to an organisation or the purchase of shares in organisations. The purpose of service investments is to support local public services and to stimulate local economic growth.

- 5.2 In light of the public service objective, the Council is willing to take more risk than with treasury investments, however it still plans for such investments to break even after all costs.
- 5.3 Decisions on service investments are presented to Strategic Leadership Team, which includes the Section 151 Officer. Investments must meet the criteria and limits laid down in the investment strategy. Most loans and shares are capital expenditure and purchases will therefore also be approved as part of the capital programme.
- 5.4 Further details on service investments are contained in the Investment Strategy.

6. Commercial Investment Activities

- 6.1 The commercial property investment portfolio is an integral part of the Council's medium term financial plan and contributes towards the overall income generation target that is needed to mitigate the significant reduction in government funding, enable the Council to maintain and improve services and service standards, and meet our priorities and objectives. The Commercial Strategy details the Council's approach to commercialisation. One of the aims of the strategy is to align with and support the Council Plan and ensure that the Council is the partner of choice for the community and commercial sectors by demonstrating its commercial awareness and effective delivery of services.
- 6.2 The value of the property held for investment purposes was £26.1m as at 31 March 2019 and is anticipated to be £85.7m at 31 March 2020, the forecast rate of return net of financing costs is anticipated to be in the region of 3.98%.
- 6.3 With financial return being the main objective, and as with investments for service purposes, the Council accepts a higher risk on commercial investment than with treasury investments. It has a robust risk assessment process in place which includes assessing the risk of loss before entering into and whilst holding service investments.
- 6.4 This increased risk is balanced with an efficient and proportional regard to governance, policy, management, processes and systems to ensure robust decision-making, performance and success of new commercial enterprises, contracts and partnerships. All of which will continue to evolve and be refined over time to ensure that the Council adheres to its statutory responsibilities and that public money continues to be appropriately invested, used and accounted for.
- 6.5 In considering investment opportunities, a predetermined set of assessment criteria for each proposed investment is used and a business case is completed to ensure transparency, due diligence, governance and consistency to aid achievement of the investment objectives.

- 6.6 In order that commercial investments remain proportionate to the size of the authority, these are subject to an overall maximum investment limit of £150m.
- 6.7 If the returns on investments are not maintained at the required levels contingency plans to continue to provide services are in place. The contingency plan includes holding adequate general reserves and a specific investment risk reserves such as the Treasury Risk Reserve and the Investment Property Risk Reserve.
- 6.8 Decisions on commercial investments are made in line with the criteria and limits approved by council in the 2020/21 investment strategy. Property and most other commercial investments are also capital expenditure and purchases will therefore also be approved as part of the capital programme.
- 6.9 Further details on commercial investments and limits are included in the investment strategy.

7. Liabilities

- 7.1 In addition to capital debt as detailed above the Council is committed to making future payments to cover its pension deficit, which was valued at £73.83m on 1 April 2019. This balance is due to be paid over a 20 year period, and the deficit and annual contributions are revalued every three years. It has also set aside funds to cover provisions for probable costs. The Council is also at risk of having to pay for contingent liabilities but has not put aside any money because payment is contingent on, as yet, unknown events occurring which may crystallise possible amounts due.
- 7.2 Decisions on incurring new discretionary liabilities are taken by senior managers and service managers in consultation with the S151 Officer. The risk of liabilities crystallising and requiring payment is monitored by the finance team and reported to the S151 officer.
- 7.3 Further details on liabilities and guarantees can be found in the 2018/19 Statements of Accounts.

8. Revenue Budget Implications

- 8.1 Although capital expenditure is not charged directly to the revenue budget, interest payable on loans/leases and capital debt repayment provisions are charged to revenue, offset by any investment income receivable. The net annual charge is known as financing costs; this is compared to the net revenue stream i.e. the amount funded from Council Tax, business rates and general government grants.

Table 12: Prudential Indicator – Proportion of financing costs to net revenue stream

	2018/19 Actual	2019/20 Estimate	2020/21 Estimate	2021/22 Estimate	2022/23 Estimate
Financing Costs (£m)	(0.939)	(0.781)	(0.77)	245	497
Proportion of net revenue stream	(5.65%)	(4.82%)	(0.51%)	1.66%	3.39%

- 8.2 Financing costs for 2020/21 and subsequent years includes an increase due to a change in the accounting for leases.
- 8.3 Due to the very long-term nature of capital expenditure and financing, the revenue budget implications of expenditure incurred in the next few years will extend for up to 50 years into the future. The S151 Officer is satisfied that the proposed capital programme is prudent, affordable and sustainable.
- 8.4 All capital investment must be sustainable in the long term through revenue support by the Council or its partners. All capital investment decisions consider the revenue implications both in terms of servicing the finance and running costs of the new assets. The impact of the revenue implications is a significant factor in determining approval of projects. The use of capital resources has been fully taken into account in the production of the Council’s Medium Term Financial Plan.

9. Knowledge and Skills

- 9.1 The Council employs professionally qualified and experienced staff in senior positions with responsibility for making capital expenditure, borrowing and investment decisions. For example, the S151 Officer is a qualified accountant, and the Director of Commercial Services and Income Generation is highly experienced in the commercial property field. There are several other professionally qualified Finance Specialists within the Council’s finance function and the Council pays for staff to study towards relevant professional qualifications including CIPFA. All officers involved in the treasury and investment management function have access to relevant technical guidance and training to enable them to acquire and maintain the appropriate level of expertise, knowledge and skills to undertake the duties and responsibilities allocated to them.
- 9.2 Where Council staff do not have the knowledge and skills required, use is made of external advisers and consultants that are specialists in their field. The Council currently employs Arlingclose Limited as treasury management advisers, and utilises services of property consultants who provide a diligent assessment of the market and assists in preparing a bid, acting as the

sounding board for the in house Investment Surveyor. This approach is more cost effective than employing such staff directly, and ensures that the Council has access to knowledge and skills commensurate with its risk appetite.

- 9.3 Those charged with governance (Members of the Audit Governance and the District Executive) recognise their individual responsibility to ensure that they have the necessary skills to complete their role effectively. The S151 Officer will ensure that elected members tasked with treasury management responsibilities, including those responsible for scrutiny, have access to training relevant to their needs and responsibilities.

Investment Strategy

1 Introduction

1.1 The Council invests funds that it holds for three broad purposes:

- i) because it has surplus cash as a result of its day-to-day activities, for example when income is received in advance of expenditure (known as **treasury management investments**),
- ii) to support local public services by lending to or buying shares in other organisations (**service investments**), and
- iii) to earn investment income (known as **commercial investments** where this is the main purpose)

1.2 This investment strategy meets the requirements of statutory guidance issued by the government in January 2018, and focuses on the second and third of these categories.

2 Treasury Management Investments

2.1 The Council typically receives its income in cash (e.g. from taxes and grants) before it pays for its expenditure in cash (e.g. through payroll and invoices). It also holds reserves for future expenditure and collects local taxes on behalf of other local authorities and central government. These activities, plus the timing of borrowing decisions, lead to a cash surplus which is invested in accordance with guidance from the Chartered Institute of Public Finance and Accountancy (CIPFA). The balance of treasury management investments is expected to fluctuate between £30m and £60m during the 2020/21 financial year.

2.2 The contribution that these investments make to the objectives of the Council is to support effective treasury management activities.

2.3 Full details of the Council's policies and its plan for 2020/21 for treasury management investments are covered in the treasury management strategy later in this document.

3 Service Investments – Loans

- 3.1 The Council lends money to local businesses, local charities, other local authority partnerships, and local residents to support local public services and priorities, and stimulate local economic growth. Currently the Council has loans invested with:
- Hinton St George shop
 - Somerset Waste Partnership – for waste vehicles, with added benefit of keeping waste contract costs down
 - Opium Power Limited
- 3.2 The Council has also included provision in its Capital Programme to provide further loan finance to the Somerset Waste Partnership for new vehicles, depot works and bins / boxes to deliver Recycle More under the new waste contract.
- 3.3 The main risk when making service loans is that the borrower will be unable to repay the principal lent and/or the interest due. In order to minimise this risk and ensure that total exposure to service loans remains proportionate to the size of the Council, upper limits on the outstanding loans to each category of borrower have been set as follows:

Table 13: Loans for Service Purposes

Category of borrower	Actual as at 31/03/2019			2020/21 Approved Limit £k
	Balance Owing £k	Loss Allowance £k	Net Figure In Accounts £k	
Local Businesses	157	0	157	200
Local authorities	1,017	0	1,017	10,000
Joint Operations	11,192	0	11,192	15,000
Community (Small) Loans	0	0	0	1,000
Employees	26	0	26	100
Total	12,392	0	12,392	26,300

- 3.4 Accounting standards require the Council to set aside a loss allowance for loans, reflecting the likelihood of non-payment. The figures for loans in the Councils statement of accounts will be shown net of this loss allowance. However, the Council makes

every reasonable effort to collect the full sum lent and has appropriate credit control arrangements in place to recover overdue repayments.

- 3.5 No loss allowance is set aside for the current loans made for service purposes. In the case of the loan to the local business and the loan to the joint operation, the Council has a charge over the asset. The asset values are currently higher than the value of the balance owing on the respective loans, therefore no loss allowance is currently required. Assets are revalued in line with the accounting policies and the loss allowance will be revised if asset value reduces to a level below the balance outstanding on the loan.
- 3.6 The Council assesses the risk of loss before entering into and whilst holding service loans by working up a robust business case and applying due diligence to all requests for service loans, and proportionate monitoring of credit risk of borrowers. For example, with loans to key businesses the Council's finance specialist team (qualified accountants) will review financial statements and service officers will maintain communication with the borrower in order that emerging risks are identified promptly. The Council will use credit rating information where available, and will use external specialist advisors if appropriate.

4 Service Investments – Shares

- 4.1 The Council does not currently hold any direct investment in the shares of subsidiaries, its suppliers or local businesses. As part of the Council's commercialisation agenda, the Council may explore opportunities to establish wholly-owned or partly-owned trading companies. In any such case, appropriate business cases, due diligence, risk assessment and governance proposals will be developed for consideration of Full Council. In addition, relevant provisions would be added to the Investment Strategy including the expected contribution to the Council's strategies and priorities, and the security and liquidity of investments.

5 Commercial Investments – Property

- 5.1 The Council invests in a diverse investment property portfolio both locally and nationally with the intention of generating surplus income that will be spent on local public services delivered within the district. This is an essential response to significant reductions in government funding over recent years, in order to meet service delivery objectives and the place making role of the Council, and avoid service cuts. The council plans to increase its investment by up to £85m over the next 2-3 years.

5.2 The Council holds a number of assets that were initially acquired for service purposes such as benefitting the local economy but have since been reclassified as investment properties. These are now established and the main purpose for holding the assets is for rental income. The following table summarises the investment properties as at 1 April 2019.

Table 14: Property held for investment purposes

Sector	Actual Purchase cost £k	31 st March 2019 (Actual)		31 st March 2020 (Expected)	
		Valuation Gains or (-) losses £k	Value in accounts £k	Valuation Gains or (-) losses £k	Value in accounts £k
Offices	11,761	-901	10,860	TBC	TBC
Retail	11,300	-1,200	10,100		
Industrial	3,361	-261	3,100		
Small Business Units	1,153	-53	1,100		
Historic Buildings	419	-39	380		
Nursery	284	-44	240		
Commercial	187	33	220		
Garages	65	-6	59		
Warehouse	38	-3	35		
Totals	28,568	-2,474	26,094		

- 5.3 The Council has purchased a number of properties held for investment purposes since the 1 April 2019, the purchase cost of the properties is detailed in table 15.

Table 15: Properties purchased 2019/20

Sector	Actual Purchase cost £k
Industrial	20,624
Offices	13,316
Industrial	3,361
Alternative	6,765
Retail	4,674
Total	48,740

- 5.4 The total value of property held for investment purposes as at 31 December 2019 is £74.8m. The valuation gains and losses and the value in the accounts in respect of these purchases, and the properties held at 1 April 2019, is not known at the stage as the gains and losses on properties are undertaken as part of the closure of accounts.
- 5.5 In accordance with government guidance, the Council considers a property investment to be secure if its accounting valuation is at or higher than its purchase cost including taxes and transaction costs. The Council also recognises that asset values may increase and decrease over time due to market volatility, and takes a long term perspective with the assumption that capital values are likely to hold or grow over the life of the asset.
- 5.6 *Where value in accounts is at or above purchase cost:* A fair value assessment of the Council's investment property portfolio has been made within the past twelve months, and the underlying assets provide security for capital investment. Should the 2019/20 year end accounts preparation and audit process value these properties below their purchase cost, then an updated investment strategy will be presented to full council detailing the impact of the loss on the security of investments and any revenue consequences arising therefrom.

or

- 5.7 *Where value in accounts is below purchase cost:* The fair value of the Council's investment property portfolio is no longer sufficient to provide security against loss, and the Council is therefore taking mitigating actions to protect the capital invested. These actions include: planning to hold the assets for the long term; maintaining assets to appropriate quality; mitigating risk of realised losses through maintaining adequate funds in an Investment Risk Reserve, and reducing capital borrowing through its MRP policy.
- 5.8 The Council assesses the risk of loss before entering into and whilst holding property investments by undertaking appropriate due diligence including full valuation surveys and operating an asset management plan. The Council also considers strength of local market conditions to give confidence on future re-letting and also considers possible alternative uses if appropriate, and actively monitors the portfolio to ensure tenant obligations for maintaining assets are fulfilled.
- 5.9 Compared with other investment types, property is relatively difficult to sell and convert to cash at short notice, and can take a considerable period to sell in certain market conditions. To ensure that the invested funds can be accessed when they are needed, for example to repay capital borrowed, the Council actively manages cash flow through its treasury management arrangements and plans to under-borrow against its CFR so that it can temporarily borrow at short notice if required.
- 5.10 The Council's asset disposal policy includes the approved process for asset disposal and performance indicators (property management indicators) which provide the information on the performance of each property. The performance indicators provide information on assets which are not yielding the level of return required by the Commercial Strategy.
- 5.11 The Council uses industry standard software, to track the performance of its investment portfolio. The software is capable of monitoring running yields asset by asset and across the portfolio, and adopting multiple scenarios. By continually reviewing the market, the tenant covenant and unexpired lease term of each property, the Council is able to find the optimum time to dispose of assets.

6 Other Categories of Investment

- 6.1 Special Purpose Vehicles - The Council has setup a special purpose vehicle (SSDC Opium Power Ltd) which will to deliver a renewable energy project. This is the Council's first step into ownership and development of renewable energy which will provide essential support to the National Grid for balancing power demand and storing renewable energy. The company is 50:50 owned between the Council and Opium Power Limited, with the Council providing a secured term loan facility to the

SPV. The agreed rate of interest on the loan is 5% per annum. A repayment schedule has been agreed with the SPV as part of the loan conditions.

- 6.2 Renewable energy investments – This type of investment not only assist with the Council's income generation needs and contributes towards the objectives of the commercial strategy, they also meet the Council Plan commitment to promote the use of green technology. Renewable energy measures and investments are continually sought to ensure that the Council's existing and future energy costs and requirements on our own operational property are considered.
- 6.3 Community Benefit - Other investments that do not meet the internal rate of return target, but do provide some financial return and also bring collective benefit to the community in accordance with the wider Corporate Plan objectives are considered with a different form of assessment criteria but similar decision making process. The primary objective may not be to generate income but to deliver a service of community benefit i.e. economic development, jobs, health, welfare, leisure, housing need etc.
- 6.4 Regeneration Schemes - Major investment in Regeneration Schemes are planned or are in progress, such as the Chard Regeneration Scheme and the Yeovil Refresh, and these are projects with their own strategies and plans for delivery, but they link to the Commercial Strategy objectives in the longer term and the same principles apply in executing these projects.
- 6.5 Therefore, the council will progress, consider and assess Regeneration proposals, using an investment based approach that seeks to create viable regeneration schemes that not only pay for themselves but generate a return on the investment over the longer term where possible. Regeneration delivers both tangible commercial and community objectives resulting in income generation for the wider district in the medium to long-term, as well as directly to the Council through business rates or council tax, for example.

7 Financial Guarantees

- 7.1 Although not strictly counted as investments, since no money has exchanged hands yet, financial guarantees carry similar risks to the Council and are included here for completeness.
- 7.2 The Council had the following guarantees on 1 April 2019, as reported in the Council's Statement of Accounts for 2018/19:
 - Environmental risk in the Birchfield Park - £311k

- Somerset Waste Partnership (SWP) pension liability - £275k
- South West Audit Partnership Limited Pension Liability - £149k
- Mama Bears Nursery Pension Liability - £36k

8 Proportionality

- 8.1 The Council currently has a low dependency on investment property income, but with increased investment the Council plans to become dependent on income generating investment activity to achieve a balanced revenue budget. Table 15 below shows the extent to which the expenditure planned to meet the service delivery objectives and place making role of the Council is dependent on achieving the expected net income from investments over the lifecycle of the Medium Term Financial Plan.
- 8.2 Should it fail to achieve the expected net income, the Council's contingency plans for continuing to provide these services including holding adequate funds in an earmarked Investment Risk Reserve as well as carrying adequate General Reserves. Budget estimates are also set using prudent assumptions about net income from the portfolio including an allowance for voids / non-collection.

Table 16: Proportionality of Investments

	2018/19 Actual	2019/20 Estimate	2020/21 Estimate	2021/22 Estimate	2022/23 Estimate
Gross Service Expenditure	71,886,232	68,481,530	64,721,510	63,155,350	62,805,750
Investment Income					
- Treasury Investments	1,426,361	1,648,920	1,393,120	1,445,560	1,484,250
- Commercial Investments	1,030,192	1,160,630	5,024,594	7,218,464	10,103,214
Total Investment Income	2,456,553	2,809,550	6,417,714	8,664,024	11,587,464
Proportion	3.42%	4.10%	9.92%	13.72%	18.45%

- 8.3 Investment income shown in the above table is the gross income included in the budget estimates, disregarding asset management and capital financing costs.

9 Borrowing In Advance of Need

- 9.1 Government guidance is that local authorities must not borrow more than or in advance of their needs purely in order to profit from the investment of the extra sums borrowed. The Council has chosen not to follow this guidance and plans to borrow for this purpose because generating investment income is now essential to respond to the large scale reductions in grant funding from Government. The Council (and its predecessors) has already sought to mitigate this reduction through service cost reductions, combining into a single workforce followed by the creation of the single new council entity, and driving further efficiency by transforming how we work and effectively managing demand for services. Increasing income is also part of the strategy to mitigate the significant funding reductions.

10 Capacity, Skills and Culture

- 10.1 The Council have enterprising staff, partners and members, their skills and ideas need to be clearly and effectively communicated and harnessed to help achieve our Commercial Strategy. The Council have invested in staff training to enhance staff and member skills and raise the level of commercial expertise across the Council. Staff training is a continuing priority in this area with continuing professional development being an integral part of this.
- 10.2 The Council has recruited a highly experienced commercial director and qualified property specialists, which ensures that the necessary skills and knowledge are in place to achieve the aims of the Commercial Strategy and ensures that the risks involved in commercial investments are fully understood.
- 10.3 Officers involved in the investment making decision process are governed by internal procedures and processes and external statutory guidance in the form of the CIPFA Treasury Management Code and MHCLG Investment guidance. Internally limits are set in the annual Treasury Management Strategy Statement and the overriding Treasury Management Practices. The Council team dealing with investment assessments and management are professionally qualified and experienced in their field of property, finance and legal, with access to training as required. Specialist advice will also be bought in for non-traditional property investments as required.
- 10.4 Members on the Investment Assessment Group will have access to relevant commercial property training for example as provided by the LGA or CIPFA as well as being advised by professional specialists.
- 10.5 Reporting to members on a regular basis on the performance on current investments, and on potential new investments is an integral part of the Commercial Strategy, the continual reporting ensures that elected members have the information needed to assess the risks and rewards that are associated in this area.

- 10.6 In considering investment opportunities, a predetermined set of assessment criteria for each proposed investment is used and a business case is completed to ensure transparency, due diligence, governance and consistency to aid achievement of the investment objectives.
- 10.7 Officers who are tasked with negotiating commercial deals have been provided with the necessary training and information and are aware of the core principles of the prudential framework and of the regulatory regime within which local authorities operate.
- Briefings and guidance provided to, and discussed with the senior leadership team and officers involved in commercial deals.
 - There is a requirement for continuing professional development for qualified professionals who are part of the decision making process for commercial deals.
- 10.8 The Council has robust governance arrangements in place, the Commercial Strategy (2017-2021) sets out the arrangements which:
- Sets out the approved budget for the financial years that the strategy covers, the authority to manage the budget of either borrowings or reserves is delegated to the S151 officer in consultation with the Investment Assessment Group.
 - An Investment Assessment Group established who undertake due diligence, report on performance and recommend investments to acquire, or assets to dispose of, to the CEO that meet required criteria set out in the Commercial Strategy
 - The IAG comprises of the Property, Land and Development Manager, Director of Commercial Services & Income Generation, S151 Officer, Monitoring Officer, and Portfolio Holder.
 - Delegation of individual investment / acquisition approvals up to a value of £10 Million for any single transaction to the Chief Executive Officer in consultation with the Leader.
 - In considering opportunities, a predetermined set of assessment criteria for each proposed investment project is used.
 - A business case is completed in each case to ensure transparency, due diligence, governance and consistency to aid achievement of the Commercial Strategy and the Corporate Plan objectives.
 - Where the criteria are met, there is a schedule of delegation agreed that enables positive decisions to be made that respect market requirements for swift action and confidentiality.
 - If a unanimous recommendation to proceed is made by the IAG, the proposal will be recommended to the Chief Executive Officer for a final decision in consultation with the Council Leader.

- There is regular performance monitoring to demonstrate how investments are performing over time, and to enable portfolio review to take place to maximise benefit over time.

11 Investment Indicators

11.1 The Council has set the following quantitative indicators to allow elected measures and the public to assess the Council's total risk exposure as a result of its investment decisions.

Total investment exposure:

11.2 This indicator shows the Council's total exposure to potential investment losses. It includes amounts the Council is contractually committed to lend but have yet to draw down and guarantees the Council has issued.

Table 17: Total Investment Exposure

	Actual 1/4/2019 £k	Forecast 31/3/2020 £k	Forecast 31/3/2021 £k	Forecast 31/3/2022 £k
Treasury Management Investments – Strategic Funds	23,250	30,000	30,000	30,000
Treasury Management Investments – Other	7,480	3,000	2,000	2,000
Service Investments – Loans	1,174	5,021	715	1,370
Commercial Investment – Property	26,109	85,691	120,691	140,116
Other investments – SPV	11,192	12,316	11,674	9,884
Total Investments	69,205	136,028	142,715	183,370
Guarantees Issued on Pension Liabilities	460	460	185	185
Total Commitments and Guarantees	460	460	185	185
Total Exposure	69,665	136,468	142,900	183,555

How investments are funded:

- 11.3 Government guidance is that these indicators should include how investments are funded. Since the Council does not normally associate particular assets with particular liabilities, it is difficult to comply with this guidance. However, the following investments could be described as being funded by borrowing. The remainder of the Council's investments are funded by usable reserves and income received in advance of need.

Table 18: Investments funded by Borrowing

	Actual 1/4/2019 £k	Forecast 31/3/2020 £k	Forecast 31/3/2021 £k	Forecast 31/3/2022 £k
Treasury Management Investments	0	0	0	0
Service Investments – Loans	0	4,125	4,794	4,801
Commercial Investment – Property	26,109	85,691	120,691	140,116
Other investments - SPV	11,191	12,316	11,674	9,884
Total Funded by Borrowing	38,475	102,132	137,159	154,801

Rate of return received:

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

Table 19: Investment Net Rate of Return

	Actual 1/4/2019	Forecast 31/3/2020	Forecast 31/3/2021	Forecast 31/3/2022
Treasury Management Investments	3.20%	2.84%	3.10%	3.10%
Service Investments – Loans	2.49%	2.80%	2.80%	2.80%
Commercial Investment – Property	5.56%	3.98%	3.50%	3.50%

Other investments - SPV	5.00%	6.00%	6.00%	6.00%
Total All Investments	4.06%	3.91%	3.85%	3.85%

Other investment indicators:

- 11.5 The Government's investment guidance suggests authorities should consider a range of other quantitative indicators to show risks and opportunities in respect of investment and borrowing. The table below summarises indicators proposed for this Council.

Table 20: Other investment indicators

	Actual 1/4/2019	Forecast 31/3/2020	Forecast 31/3/2021	Forecast 31/3/2022
Commercial Income to Net Service Expenditure	6.30%	7.17%	32.82%	48.32%
Investment cover ratio	3.86	3.50	8.82	7.80
Loan to value ratio	40.28%	56.96%	65.14%	70.39%

- 11.6 Commercial Income to Net Service Expenditure: Indicates dependence on commercial income to deliver core services.
- 11.7 Investment cover ratio: The total net income from commercial property investment compared to the interest expense relative to investment properties funded by borrowing.
- 11.8 Loan to value ratio: The amount of debt compared to the total assets value on the Council's balance sheet.

Treasury Management Strategy

1 Introduction

- 1.1 Treasury management is the management of the Council's cash flows, borrowing and investments and the associated risks. The Council has borrowed and invested substantial sums of money and is, therefore, exposed to financial risks including the loss of invested funds and the revenue effect of changing interest rates. The successful identification, monitoring and control of financial risk are, therefore, central to the Council's prudent financial management.
- 1.2 Treasury risk management at the Council is conducted within the framework of the Chartered Institute of Public Finance and Accountancy's Treasury Management in the Public Services: Code of Practice 2017 Edition (the CIPFA Code) which requires the Council to approve a treasury management strategy before the start of each financial year. This report fulfils the Council's legal obligation under the Local Government Act 2003 to have regard to the CIPFA Code.
- 1.3 Investments held for service purposes and for commercial income generation are considered in the Investment Strategy above.

2 External Context

- 2.1 The treasury strategy appropriately considers the wider economic picture. The Council's treasury advisor – Arlingclose – has provided a summary commentary on this wider context and their own interest rate forecasts, which is provided in Appendix A.

3 Local Context

- 3.1 On 31st December 2019, the Council had external borrowing of £51.5m and £29.2m of treasury investments. These balances are summarised below.

Table 21: Existing Debt and Investment Position

	1/4/2019 Balance £k	31/12/2019 Balance £k
External Borrowing:		
Local Authorities	-11,500	-51,500
Higher Education Providers	-8,000	0
Total External Borrowing	-19,500	-51,500
Treasury Investments:		
Covered bonds (secured)	4,000	4,000
Term Deposits (Other LA's & Banks)	3,000	1,000
Money Market Funds	480	910
Property & Pooled funds	23,250	23,250
Total Treasury Investments	30,730	29,160
Net Debt(-)/Investment	11,230	-22,340

3.2 Forecast changes in these sums are shown in the balance sheet analysis in Table 22 below.

Table 22: Balance Sheet Summary and Forecast

	1/4/2019 Actual £k	31/3/2020 Estimate £k	31/3/2021 Estimate £k	31/3/2022 Estimate £k	31/3/2023 Estimate £k
Capital Financing Requirement	39,320	93,844	141,442	191,409	207,799
Less: External Borrowing	-19,500	-79,097	-111,697	-162,897	-180,597
Less: Other debt liabilities (leases)	-82	-1,000	-14,500	-14,500	-14,500
Internal Borrowing	19,738	13,747	15,245	14,012	12,702
Less: Usable reserves	-47,100	-45,900	-44,200	-43,900	-43,850
Less: Working capital surplus (-) / deficit	-2,800	-2,800	-2,800	-2,800	-2,800
Treasury Investments (-) / New Borrowing	-30,162	-34,953	-31,755	-32,688	33,948

- 3.3 The underlying need to borrow for capital purposes is measured by the Capital Financing Requirement (CFR), while usable reserves and working capital are the underlying resources available for investments. The Council's current strategy is to maintain borrowing and investments below their underlying levels, sometimes known as internal borrowing.
- 3.4 The Council has an increasing CFR due to the planned spending within the capital programme including expected investment property acquisitions and significant expenditure on regeneration schemes. The trend of increased expenditure indicates it will be required to borrow up to £181m over the forecast period.
- 3.5 The financing approach agreed in the governance for the regeneration programmes is quite elastic meaning the CFR could grow further in line with supported business cases, however a 'worst case' position in terms of potential up front borrowing has been taken into account in setting the required borrowing limit.
- 3.6 CIPFA's Prudential Code for Capital Finance in Local Authorities recommends that the Council's total debt should be lower than its highest forecast CFR over the next three years. Table 21 shows that the Council expects to comply with this recommendation over the medium term.

Liability benchmark:

- 3.7 To compare the Council's actual borrowing against an alternative strategy, a liability benchmark has been calculated showing the lowest risk level of borrowing. This assumes the same forecasts as table 21 above, but that cash and investment balances are kept to a minimum level of £30m at each year-end to maintain sufficient liquidity but minimise credit risk.

Table 23: Liability benchmark

	1/4/2019 Actual £k	31/3/2020 Estimate £k	31/3/2021 Estimate £k	31/3/2022 Estimate £k	31/3/2023 Estimate £k
Total CFR	39,320	93,844	141,442	191,409	207,799
Less: Usable reserves	-47,100	-45,900	-44,200	-43,900	-43,850
Less: Working capital	-2,800	-2,800	-2,800	-2,800	-2,800
Plus: Minimum investments	30,000	30,000	30,000	30,000	30,000
Liability benchmark	19,420	75,144	124,442	174,709	191,149

Borrowing Strategy

- 3.8 The Council currently holds £51.50m of loans (as at 31 December 2019), compared to £19.50m on 1 April 2019, as part of its strategy for funding previous years' capital programmes. The balance sheet forecast in table 20 shows that the Council expects to borrow up to £120m in 2020/21. The Council may also borrow additional sums to pre-fund future years' requirements, providing this does not exceed the authorised limit for borrowing of £165m.
- 3.9 The Council's chief objective when borrowing money is to strike an appropriately low risk balance between securing low interest costs and achieving certainty of those costs over the period for which funds are required. The flexibility to renegotiate loans should the Council's long-term plans change is a secondary objective.
- 3.10 Given the significant cuts to public expenditure and in particular local government funding, the Council's borrowing strategy continues to address the key issue of affordability without compromising the longer-term stability of the debt portfolio. With short-term interest rates currently much lower than long-term rates, it is likely to be more cost effective in the short term to either use internal resources, or to borrow short term loans instead.

- 3.11 By doing so, the Council is able to reduce net borrowing costs (despite foregone investment income) and reduce overall treasury risk. The benefits of internal and short-term borrowing will be monitored regularly against the potential for incurring additional costs by deferring borrowing into future years when long-term borrowing rates are forecast to rise modestly. Arlingclose will assist the Council with this 'cost of carry' and breakeven analysis. Its output may determine whether the Council borrows additional sums at long-term fixed rates in 2020/21 with a view to keeping future interest costs low, even if this causes additional cost in the short-term.
- 3.12 Alternatively, the Council may arrange forward starting loans, where the interest rate is fixed in advance, but the cash is received in later years. This would enable certainty of cost to be achieved without suffering a cost of carry in the intervening period (although forward loan interest rates will usually factor in an allowance for interest rate risk during the intervening period).
- 3.13 Additionally, the Council may borrow further short term loans to cover unplanned cash flow shortages.
- 3.14 The approved sources of long-term and short-term borrowing are:
- Public Works Loan Board (PWLB) and any successor body
 - Any institution approved for investments (see below)
 - Any other bank or building society authorised to operate in the UK
 - Any other UK public sector body
 - UK public and private pension funds (except Somerset County Pension Fund)
 - Capital market bond investors
 - UK Municipal Bonds Agency plc and other special purpose companies created to enable local authority bond issues
- 3.15 Other sources of debt finance: In addition, capital finance may be raised by the following methods that are not borrowing, but may be classed as other debt liabilities:
- Leasing
 - Hire purchase
 - Private finance initiative
 - Sale and leaseback

- 3.16 Municipal Bonds Agency: UK Municipal Bonds Agency plc was established in 2014 by the Local Government Association as an alternative to the PWLB. It plans to issue bonds on the capital markets and lend the proceeds to local authorities. This will be a more complicated source of finance than the PWLB for two reasons: borrowing authorities will be required to provide bond investors with a guarantee to refund their investment in the event that the agency is unable to for any reason; and there will be a lead time of several months between committing to borrow and knowing the interest rate payable. Any decision to borrow from the Agency will therefore be the subject of a separate report to full Council.
- 3.17 Short-term and variable rate loans: These loans leave the Authority exposed to the risk of short-term interest rate rises and are therefore subject to the interest rate exposure limits in the treasury management indicators below. Financial derivatives may be used to manage this interest rate risk (see section below).
- 3.18 Debt rescheduling: The PWLB allows authorities to repay loans before maturity and either pay a premium or receive a discount according to a set formula based on current interest rates. Other lenders may also be prepared to negotiate premature redemption terms. The Council may take advantage of this and replace some loans with new loans, or repay loans without replacement, where this is expected to lead to an overall cost saving or a reduction in risk.

4 Treasury Investment Strategy

- 4.1 The Council holds significant invested funds, representing income received in advance of expenditure plus balances and reserves held. In the past 12 months, the Council's investment balance has ranged between £29m and £46m, and similar levels are expected to be maintained in the forthcoming year.
- 4.2 The CIPFA Code requires the Council to invest its funds prudently, and to have regard to the security and liquidity of its investments before seeking the highest rate of return, or yield. The Council's objective when investing money is to strike an appropriate balance between risk and return, minimising the risk of incurring losses from defaults and the risk of receiving unsuitably low investment income. Where balances are expected to be invested for more than one year, the Council will aim to achieve a total return that is equal or higher than the prevailing rate of inflation, in order to maintain the spending power of the sum invested.
- 4.3 If the UK enters into a recession in 2020/21, there is a small chance that the Bank of England could set its Bank Rate at or below zero, which is likely to feed through to negative interest rates on all low risk, short-term investment options. This situation

already exists in many other European countries. In this event, security will be measured as receiving the contractually agreed amount at maturity, even though this may be less than the amount originally invested.

- 4.4 Given the increasing risk and very low returns from short-term unsecured bank investments, the Council aims to further diversify into more secure and/or higher yielding asset classes during 2020/21. The Council has increased its strategic (long-term) investments from £23.25m at the start of the financial year to an estimated £27.50m by the 31 March 2020. This diversification will represent a continuation of the strategy adopted in earlier years.
- 4.5 A proportion of the Council's surplus cash is currently invested in short-term unsecured bank deposits, money market funds and other local authorities.
- 4.6 Under the new IFRS 9 standard, the accounting for certain investments depends on the Council's 'business model' for managing them. The Council aims to achieve value for money from its internally managed treasury investments by a business model of collecting the contractual cash flows and, therefore, where other criteria are also met, these investments will continue to be accounted for at amortised cost.

Approved Counterparties

- 4.7 The Council may invest its surplus funds with any of the counterparty types in table 24 below, subject to the cash limits (per counterparty) and the time limits shown.

Table 24: Approved investment counterparties and limits

Credit rating	Banks unsecured	Banks secured	Government	Corporates	Registered Providers
UK Govt	n/a	n/a	£ Unlimited 50 years	n/a	n/a
AAA	£3 m 5 years	£6 m 20 years	£6 m 50 years	£3 m 20 years	£3 m 20 years
AA+	£3 m 5 years	£6 m 10 years	£6 m 25 years	£3 m 10 years	£3 m 10 years
AA	£3 m 4 years	£6 m 5 years	£6 m 15 years	£3 m 5 years	£3 m 10 years
AA-	£3 m 3 years	£6 m 4 years	£6 m 10 years	£3 m 4 years	£3 m 10 years
A+	£3 m 2 years	£6 m 3 years	£3 m 5 years	£3 m 3 years	£3 m 5 years
A	£3 m 13 months	£6 m 2 years	£3 m 5 years	£3m 2 years	£3 m 5 years
A-	£3 m 6 months	£6 m 13 months	£3 m 5 years	£3 m 13 months	£3 m 5 years
None	n/a	n/a	£6 m 25 years*	n/a	£3 m 5 years
Pooled funds and real estate investment trusts		£10m (nominal value) per fund or trust			

This table must be read in conjunction with the notes below

- 4.8 **Credit rating:** Investment limits are set by reference to the lowest published long-term credit rating from a selection of external rating agencies. Where available, the credit rating relevant to the specific investment or class of investment is used, otherwise the counterparty credit rating is used. However, investment decisions are never made solely based on credit ratings, and all other relevant factors including external advice will be taken into account.
- 4.9 **Banks unsecured:** Accounts, deposits, certificates of deposit and senior unsecured bonds with banks and building societies, other than multilateral development banks. These investments are subject to the risk of credit loss via a bail-in should the regulator determine that the bank is failing or likely to fail. See below for arrangements relating to operational bank accounts.
- 4.10 **Government:** Loans, bonds and bills issued or guaranteed by national governments, regional and local authorities and multilateral development banks. These investments are not subject to bail-in, and there is generally a lower risk of insolvency, although they are not zero risk. Investments with the UK Central Government may be made in unlimited amounts for up to 50 years.
- 4.11 **Corporates:** Loans, bonds and commercial paper issued by companies other than banks and registered providers. These investments are not subject to bail-in, but are exposed to the risk of the company going insolvent. Loans to unrated companies will only be made either following an external credit assessment or to a maximum of £2m per company as part of a diversified pool in order to spread the risk widely.
- 4.12 **Registered providers:** Loans and bonds issued by, guaranteed by or secured on the assets of registered providers of social housing and registered social landlords, formerly known as housing associations. These bodies are tightly regulated by the Regulator of Social Housing (in England), the Scottish Housing Regulator, the Welsh Government and the Department for Communities (in Northern Ireland). As providers of public services, they retain the likelihood of receiving government support if needed.
- 4.13 **Pooled funds:** Shares or units in diversified investment vehicles consisting of the any of the above investment types, plus equity shares and property. These funds have the advantage of providing wide diversification of investment risks, coupled with the services of a professional fund manager in return for a fee. Short-term Money Market Funds that offer same-day liquidity and very low or no volatility will be used as an alternative to instant access bank accounts, while pooled funds whose value changes with market prices and/or have a notice period will be used for longer investment periods.
- 4.14 Bond, equity and property funds offer enhanced returns over the longer term, but are more volatile in the short term. These allow the Council to diversify into asset classes other than cash without the need to own and manage the underlying

investments. Because these funds have no defined maturity date, but are available for withdrawal after a notice period, their performance and continued suitability in meeting the Council's investment objectives will be monitored regularly.

- 4.15 **Real estate investment trusts:** Shares in companies that invest mainly in real estate and pay the majority of their rental income to investors in a similar manner to pooled property funds. As with property funds, REITs offer enhanced returns over the longer term, but are more volatile especially as the share price reflects changing demand for the shares as well as changes in the value of the underlying properties. Investments in REIT shares cannot be withdrawn but can be sold on the stock market to another investor.
- 4.16 **Operational bank accounts:** The Council may incur operational exposures, for example through current accounts, collection accounts and merchant acquiring services, to any UK bank with credit ratings no lower than BBB- and with assets greater than £25 billion. These are not classed as investments, but are still subject to the risk of a bank bail-in, and balances will therefore be kept below £200,000 per bank. The Bank of England has stated that in the event of failure, banks with assets greater than £25 billion are more likely to be bailed-in than made insolvent, increasing the chance of the Council maintaining operational continuity.
- 4.17 **Risk assessment and credit ratings:** Credit ratings are obtained and monitored by the Council's treasury advisers, who will notify changes in ratings as they occur. Where an entity has its credit rating downgraded so that it fails to meet the approved investment criteria then:
- no new investments will be made
 - any existing investments that can be recalled or sold at no cost will be, and
 - full consideration will be given to the recall or sale of all other existing investments with the affected counterparty
- 4.18 Where a credit rating agency announces that a credit rating is on review for possible downgrade (also known as "rating watch negative" or "credit watch negative") so that it may fall below the approved rating criteria, then only investments that can be withdrawn on the next working day will be made with that organisation until the outcome of the review is announced. This policy will not apply to negative outlooks, which indicate a long-term direction of travel rather than an imminent change of rating.
- 4.19 **Other information on the security of investments:** The Council understands that credit ratings are good, but not perfect, predictors of investment default. Full regard will therefore be given to other available information on the credit quality of the

organisations in which it invests, including credit default swap prices, financial statements, information on potential government support, reports in the quality financial press and analysis and advice from the Council's treasury management adviser. No investments will be made with an organisation if there are substantive doubts about its credit quality, even though it may otherwise meet the above criteria.

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

Investment Limits

- 4.21 The Council's revenue reserves available to cover investment losses are forecast to be £3m on 31 March 2020. In order that no more than 20% of available reserves will be put at risk in the case of a single default, the maximum that will be lent to any one organisation (other than the UK Government) will be £10m. A group of banks under the same ownership will be treated as a single organisation for limit purposes. Limits will also be placed on fund managers, investments in brokers' nominee accounts, foreign countries and industry sectors as below. Investments in pooled funds and multilateral development banks do not count against the limit for any single foreign country, since the risk is diversified over many countries.

Table 25: Investment limits

	Cash limit
Any single organisation, except the UK Central Government	£10m each
UK Central Government	unlimited
Any group of organisations under the same ownership	£20m per group
Any group of pooled funds under the same management	£20m per manager
Negotiable instruments held in a broker's nominee account	£30m per broker
Foreign countries	£12m per country
Registered providers and registered social landlords	£8m in total
Unsecured investments with building societies	£8m in total
Loans to unrated corporates	£4m in total
Money market funds	£20m in total
Real estate investment trusts	£10m in total

4.22 **Liquidity management:** The Council uses an in-house spreadsheet based cash flow forecasting model to determine the maximum period for which funds may prudently be committed. The forecast is compiled on a prudent basis to minimise the risk of the Council being forced to borrow on unfavourable terms to meet its financial commitments. Limits on long-term investments are set by reference to the Council's medium-term financial plan and cash flow forecast.

5 Treasury Management Indicators

5.1 The Council measures and manages its exposures to treasury management risks using the following indicators.

Security

- 5.2 The Council has adopted a voluntary measure of its exposure to credit risk by monitoring the value-weighted average credit rating of its investment portfolio. This is calculated by applying a score to each investment (AAA=1, AA+=2, etc.) and taking the arithmetic average, weighted by the size of each investment. Unrated investments are assigned a score based on their perceived risk.

Credit risk indicator	Target
Portfolio average credit rating	5.0

Liquidity

- 5.3 The Council has adopted a voluntary measure of its exposure to liquidity risk by monitoring the amount of cash available to meet unexpected payments within a rolling three month period, without additional borrowing.

Liquidity risk indicator	Target
Total cash available within 3 months	£10m

Interest Rate Exposures

- 5.4 This indicator is set to control the Council's exposure to interest rate risk. The impact of a change in interest rates is calculated on the assumption that maturing loans and investments will be replaced at current rates. The upper limits on the one-year revenue impact of a 1% rise or fall in interest rates will be:

Interest rate risk indicator	Limit
Upper limit on one-year revenue impact of a 1% rise in interest rates	£200,000
Upper limit on one-year revenue impact of a 1% fall in interest rates	£150,000

Maturity Structure of Borrowing

- 5.5 This indicator is set to control the Council's exposure to refinancing risk. The limits set for each category within this indicator is wide since the indicator is only to cover the risk of replacement loans being unavailable, not interest rate risk. Time periods start on the first day of each financial year. The maturity date of borrowing is the earliest date on which the lender can demand repayment. The upper and lower limits on the maturity structure of borrowing will be:

Refinancing rate risk indicator	Upper limit	Lower limit
Under 12 months	100%	100%
12 months and within 24 months	100%	100%
24 months and within 5 years	100%	100%
5 years and within 10 years	100%	100%
10 years and above	100%	100%

Principal Sums Invested For Periods Longer Than a Year

- 5.6 The purpose of this indicator is to control the Council's exposure to the risk of incurring losses by seeking early repayment of its investments. The limits on the long-term principal sum invested to final maturities beyond the period end will be:

Price risk indicator	2020/21	2021/22	2022/23
Limit on principal invested beyond year end	£30m	£25m	£25m

6 Related Matters

- 6.1 **Financial Derivatives:** Local authorities have previously made use of financial derivatives embedded into loans and investments both to reduce interest rate risk (e.g. interest rate collars and forward deals) and to reduce costs or increase

income at the expense of greater risk (e.g. LOBO loans and callable deposits). The general power of competence in Section 1 of the Localism Act 2011 removes much of the uncertainty over local authorities' use of standalone financial derivatives (i.e. those that are not embedded into a loan or investment).

- 6.2 The Council will only use standalone financial derivatives (such as swaps, forwards, futures and options) where they can be clearly demonstrated to reduce the overall level of the financial risks that the Council is exposed to. Additional risks presented, such as credit exposure to derivative counterparties, will be taken into account when determining the overall level of risk. Embedded derivatives, including those present in pooled funds and forward starting transactions, will not be subject to this policy, although the risks they present will be managed in line with the overall treasury risk management strategy.
- 6.3 Financial derivative transactions may be arranged with any organisation that meets the approved investment criteria. The current value of any amount due from a derivative counterparty will count against the counterparty credit limit and the relevant foreign country limit.
- 6.4 In line with the CIPFA Code, the Council will seek external advice and will consider that advice before entering into financial derivatives to ensure that it fully understands the implications.
- 6.5 Markets in Financial Instruments Directive: The Council has opted up to professional client status with its providers of financial services, including advisers, banks, brokers and fund managers, allowing it access to a greater range of services but without the greater regulatory protections afforded to individuals and small companies. Given the size and range of the Council's treasury management activities, the S151 Officer believes this to be the most appropriate status.

Financial Implications

6.6 The budget for investment income and debt interest in 2020/21 is summarised as follows:

Table 26: Interest Income and Costs Budget Estimates

	2020/21 Investment Income £k	2020/21 Average Interest Rate %	2020/21 Interest Costs £k	2020/21 Average Interest Rate %	2020/21 Net Income or Costs £k
Total	-1,393	3.10%	570	1.00%	-823

6.7 If actual levels of investments and borrowing, or actual interest rates differ from those forecast, performance against budget will be correspondingly different. Significant variances will be identified in budget monitoring reports to the Senior Leadership Team and the District Executive.

7 Other Options Considered

7.1 The CIPFA Code does not prescribe any particular treasury management strategy for local authorities to adopt. The S151 Officer, having consulted the Portfolio Holder for Finance believes that the above strategy represents an appropriate balance between risk management and cost effectiveness. Some alternative strategies, with their financial and risk management implications, are listed below.

Alternative	Impact on income and expenditure	Impact on risk management
Invest in a narrower range of counterparties and/or for shorter times	Interest income will be lower	Lower chance of losses from credit related defaults, but any such losses may be greater

Alternative	Impact on income and expenditure	Impact on risk management
Invest in a wider range of counterparties and/or for longer times	Interest income will be higher	Increased risk of losses from credit related defaults, but any such losses may be smaller
Borrow additional sums at long-term fixed interest rates	Debt interest costs will rise; this is unlikely to be offset by higher investment income	Higher investment balance leading to a higher impact in the event of a default; however long-term interest costs may be more certain
Borrow short-term or variable loans instead of long-term fixed rates	Debt interest costs will initially be lower	Increases in debt interest costs will be broadly offset by rising investment income in the medium term, but long-term costs may be less certain
Reduce level of borrowing	Saving on debt interest is likely to exceed lost investment income	Reduced investment balance leading to a lower impact in the event of a default; however long-term interest costs may be less certain

External Context – Commentary by Arlingclose (November 2019)

Economic background: The UK's progress negotiating its exit from the European Union, together with its future trading arrangements, will continue to be a major influence on the Authority's treasury management strategy for 2020/21.

UK Consumer Price Inflation (CPI) for September registered 1.7% year on year, unchanged from the previous month. Core inflation, which excludes the more volatile components, rose to 1.7% from 1.5% in August. The most recent labour market data for the three months to August 2019 showed the unemployment rate ticked back up to 3.9% while the employment rate was 75.9%, just below recent record-breaking highs. The headline 3-month average annual growth rate for pay was 3.8% in August as wages continue to rise steadily. In real terms, after adjusting for inflation, pay growth increased 1.9%.

GDP growth rose by 0.3% in the third quarter of 2019 from -0.2% in the previous three months with the annual rate falling further below its trend rate to 1.0% from 1.2%. Services and construction added positively to growth, by 0.6% and 0.4% respectively, while production was flat and agriculture recorded a fall of 0.2%. Looking ahead, the Bank of England's Monetary Policy Report (formerly the Quarterly Inflation Report) forecasts economic growth to pick up during 2020 as Brexit-related uncertainties dissipate and provide a boost to business investment helping GDP reach 1.6% in Q4 2020, 1.8% in Q4 2021 and 2.1% in Q4 2022.

The Bank of England maintained Bank Rate to 0.75% in November following a 7-2 vote by the Monetary Policy Committee. Despite keeping rates on hold, MPC members did confirm that if Brexit uncertainty drags on or global growth fails to recover, they are prepared to cut interest rates as required. Moreover, the downward revisions to some of the growth projections in the Monetary Policy Report suggest the Committee may now be less convinced of the need to increase rates even if there is a Brexit deal.

Growth in Europe remains soft, driven by a weakening German economy which saw GDP fall -0.1% in Q2 and is expected to slip into a technical recession in Q3. Euro zone inflation was 0.8% year on year in September, well below the European Central Bank's target of 'below, but close to 2%' and leading to the central bank holding its main interest rate at 0% while cutting the deposit facility rate to -0.5%. In addition to maintaining interest rates at ultra-low levels, the ECB announced it would recommence its quantitative easing programme from November.

In the US, the Federal Reserve began easing monetary policy again in 2019 as a pre-emptive strike against slowing global and US economic growth on the back on of the ongoing trade war with China. At its last meeting the Fed cut rates to the range of 1.50-1.75% and financial markets expect further loosening of monetary policy in 2020. US GDP growth slowed to 1.9% annualised in Q3 from 2.0% in Q2.

Credit outlook: Credit conditions for larger UK banks have remained relatively benign over the past year. The UK's departure from the European Union was delayed three times in 2019 and while there remains some concern over a global economic slowdown, this has yet to manifest in any credit issues for banks. Meanwhile, the post financial crisis banking reform is now largely complete, with the new ringfenced banks embedded in the market.

Challenger banks hit the news headlines in 2019 with Metro Bank and TSB Bank both suffering adverse publicity and falling customer numbers.

Looking forward, the potential for a "no-deal" Brexit and/or a global recession remain the major risks facing banks and building societies in 2020/21 and a cautious approach to bank deposits remains advisable.

Interest rate forecast: The Authority's treasury management adviser Arlingclose is forecasting that Bank Rate will remain at 0.75% until the end of 2022. The risks to this forecast are deemed to be significantly weighted to the downside, particularly given the upcoming general election, the need for greater clarity on Brexit and the continuing global economic slowdown. The Bank of England, having previously indicated interest rates may need to rise if a Brexit agreement was reached, stated in its November Monetary Policy Report and its Bank Rate decision (7-2 vote to hold rates) that the MPC now believe this is less likely even in the event of a deal.

Gilt yields have risen but remain at low levels and only some very modest upward movement from current levels are expected based on Arlingclose's interest rate projections. The central case is for 10-year and 20-year gilt yields to rise to around 1.00% and 1.40% respectively over the time horizon, with broadly balanced risks to both the upside and downside. However, short-term volatility arising from both economic and political events over the period is a near certainty.

Arlingclose Economic & Interest Rate Forecast November 2019

Underlying assumptions:

- The global economy is entering a period of slower growth in response to political issues, primarily the trade policy stance of the US. The UK economy has displayed a marked slowdown in growth due to both Brexit uncertainty and the downturn in global activity. In response, global and UK interest rate expectations have eased.
- Some positivity on the trade negotiations between China and the US has prompted worst case economic scenarios to be pared back. However, information is limited, and upbeat expectations have been wrong before.
- Brexit has been delayed until 31 January 2020. While the General Election has maintained economic and political uncertainty, the opinion polls suggest the Conservative position in parliament may be strengthened, which reduces the chance of Brexit being further frustrated. A key concern is the limited transitional period following a January 2020 exit date, which will maintain and create additional uncertainty over the next few years.
- UK economic growth has stalled despite Q3 2019 GDP of 0.3%. Monthly figures indicate growth waned as the quarter progressed and survey data suggest falling household and business confidence. Both main political parties have promised substantial fiscal easing, which should help support growth.
- While the potential for divergent paths for UK monetary policy remain in the event of the General Election result, the weaker external environment severely limits potential upside movement in Bank Rate, while the slowing UK economy will place pressure on the MPC to loosen monetary policy. Indeed, two MPC members voted for an immediate cut in November 2019.
- Inflation is running below target at 1.7%. While the tight labour market risks medium-term domestically-driven inflationary pressure, slower global growth should reduce the prospect of externally driven pressure, although political turmoil could push up oil prices.
- Central bank actions and geopolitical risks will continue to produce significant volatility in financial markets, including bond markets.

Forecast:

- Although we have maintained our Bank Rate forecast at 0.75% for the foreseeable future, there are substantial risks to this forecast, dependant on General Election outcomes and the evolution of the global economy.
- Arlingclose judges that the risks are weighted to the downside.
- Gilt yields have risen but remain low due to the soft UK and global economic outlooks. US monetary policy and UK government spending will be key influences alongside UK monetary policy.
- We expect gilt yields to remain at relatively low levels for the foreseeable future and judge the risks to be broadly balanced.

A summary of the forecast rates is included on the next page. Note:

- PWLB Certainty Rate (Maturity Loans) = Gilt yield + 1.80%
- PWLB Local Infrastructure Rate (Maturity Loans) = Gilt yield + 0.60%

	Dec-19	Mar-20	Jun-20	Sep-20	Dec-20	Mar-21	Jun-21	Sep-21	Dec-21	Mar-22	Jun-22	Sep-22	Dec-22	Average
Official Bank Rate														
Upside risk	0.00	0.00	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.21
Arlingclose Central Case	0.75	0.75	0.75	0.75	0.75	0.75	0.75	0.75	0.75	0.75	0.75	0.75	0.75	0.75
Downside risk	-0.50	-0.75	-0.75	-0.75	-0.75	-0.75	-0.75	-0.75	-0.75	-0.75	-0.75	-0.75	-0.75	-0.73
3-month money market rate														
Upside risk	0.10	0.10	0.25	0.25	0.25	0.25	0.25	0.25	0.30	0.30	0.30	0.30	0.30	0.25
Arlingclose Central Case	0.75	0.75	0.75	0.75	0.75	0.75	0.75	0.75	0.75	0.75	0.75	0.75	0.75	0.75
Downside risk	-0.50	-0.75	-0.75	-0.75	-0.75	-0.75	-0.75	-0.75	-0.75	-0.75	-0.75	-0.75	-0.75	-0.73
1yr money market rate														
Upside risk	0.10	0.20	0.20	0.20	0.20	0.20	0.20	0.25	0.30	0.30	0.30	0.30	0.30	0.23
Arlingclose Central Case	0.85	0.85	0.85	0.85	0.85	0.85	0.85	0.85	0.85	0.85	0.85	0.85	0.85	0.85
Downside risk	-0.30	-0.50	-0.55	-0.65	-0.65	-0.65	-0.65	-0.65	-0.65	-0.65	-0.65	-0.65	-0.65	-0.60
5yr gilt yield														
Upside risk	0.30	0.35	0.35	0.35	0.35	0.35	0.35	0.35	0.35	0.40	0.45	0.45	0.45	0.37
Arlingclose Central Case	0.50	0.50	0.50	0.55	0.60	0.60	0.60	0.60	0.60	0.60	0.60	0.60	0.60	0.57
Downside risk	-0.35	-0.50	-0.50	-0.55	-0.60	-0.60	-0.60	-0.60	-0.60	-0.60	-0.60	-0.60	-0.60	-0.56
10yr gilt yield														
Upside risk	0.30	0.30	0.35	0.35	0.35	0.35	0.35	0.35	0.35	0.40	0.40	0.45	0.45	0.37
Arlingclose Central Case	0.75	0.75	0.80	0.80	0.85	0.85	0.90	0.90	0.95	0.95	1.00	1.00	1.00	0.88
Downside risk	-0.40	-0.40	-0.40	-0.40	-0.45	-0.45	-0.45	-0.45	-0.50	-0.50	-0.50	-0.50	-0.50	-0.45
20yr gilt yield														
Upside risk	0.30	0.30	0.35	0.35	0.35	0.35	0.35	0.35	0.35	0.40	0.40	0.45	0.45	0.37
Arlingclose Central Case	1.20	1.20	1.25	1.25	1.25	1.30	1.30	1.30	1.35	1.35	1.35	1.40	1.40	1.30
Downside risk	-0.40	-0.40	-0.45	-0.45	-0.45	-0.45	-0.45	-0.45	-0.45	-0.45	-0.45	-0.50	-0.50	-0.45
50yr gilt yield														
Upside risk	0.30	0.30	0.35	0.35	0.35	0.35	0.35	0.35	0.35	0.40	0.40	0.45	0.45	0.37
Arlingclose Central Case	1.20	1.20	1.25	1.25	1.25	1.30	1.30	1.30	1.35	1.35	1.35	1.40	1.40	1.30
Downside risk	-0.40	-0.40	-0.45	-0.45	-0.45	-0.45	-0.45	-0.45	-0.45	-0.45	-0.45	-0.50	-0.50	-0.45

Minimum Revenue Provision (MRP) Statement

1 Policy Statement

- 1.1 Where the Council finances capital expenditure by debt, it must put aside resources to repay that debt in later years. The amount charged to the revenue budget for the repayment of debt is known as Minimum Revenue Provision (MRP), although there has been no statutory minimum since 2008. The Local Government Act 2003 requires the Council to have regard to the Ministry of Housing, Communities and Local Government's Guidance on Minimum Revenue Provision (the MHCLG Guidance) most recently issued in 2018.
- 1.2 The broad aim of the MHCLG Guidance is to ensure that capital expenditure is financed over a period that is either reasonably commensurate with that over which the capital expenditure provides benefits, or, in the case of borrowing supported by Government Revenue Support Grant, reasonably commensurate with the period implicit in the determination of that grant.
- 1.3 The MHCLG Guidance requires the Council to approve an Annual MRP Statement each year and recommends a number of options for calculating a prudent amount of MRP. The following statement incorporates options recommended in the Guidance as well as locally determined prudent methods.
- 1.4 For capital expenditure incurred before 1st April 2008, MRP will be determined in accordance with the former regulations that applied on 31st March 2008, incorporating an "Adjustment A" of £9,113k.
- 1.5 For capital expenditure on operational assets incurred after 31st March 2008, MRP will be determined by charging the expenditure over the expected useful life of the relevant asset by either of the following methods:
 - a) In equal instalments
 - b) Using an annuity basis
- 1.6 For freehold land, MRP will be applied over 50 years, except where there is a structure on the land which the Council considers to have a life of more than 50 years where in such cases the longer life may also be applied to the land.

- 1.7 For capital expenditure not related to council assets but which has been capitalised by regulation or direction (e.g. capital grants to third parties) will be charged in equal instalments over a period of up to 25 years.
- 1.8 For assets acquired by leases, MRP will be determined as being equal to the element of the rent or charge that goes to write down the balance sheet liability.
- 1.9 For capital expenditure loans to third parties that are repaid in annual or more frequent instalments of principal, the Council will make nil MRP, but will instead apply the capital receipts arising from principal repayments to reduce the capital financing requirement instead. In years where there is no principal repayment, MRP will be charged in accordance with the MRP policy for the assets funded by the loan, including where appropriate, delaying MRP until the year after the assets become operational. While this is not one of the options in the MHCLG Guidance, it is thought to be a prudent approach since it ensures that the capital expenditure incurred in the loan is fully funded over the life of the assets.
- 1.10 For investment properties, MRP will be calculated over a period of no more than 50 years, and MRP may be calculated by either of the following methods:
 - a) In equal instalments
 - b) Using an annuity basis
 - c) Weighted to reflect projected net income cash flows over the expected life of investment (up to 50 years)
- 1.11 MRP will be charged from the start of the financial year after the expenditure is incurred, meaning capital expenditure incurred during 2020/21 will not be subject to a MRP charge until 2021/22.

2 Capital Financing Requirement and MRP Estimates

- 2.1 Based on the Council's latest estimate of its capital financing requirement (CFR) on 31 March 2020, the budget estimate for MRP has been set as follows:

Capital Financing Requirement and MRP	31/03/2020 Estimated CFR £k	2020/21 Estimated MRP £k
Capital Expenditure before 1 April 2008	9,113	0
Unsupported Capital Expenditure since 31 March 2008	84,731	747
Voluntary overpayment or use of prior year overpayments	0	0
Total	93,844	747

3 MRP Overpayments

- 3.1 Overpayments: In earlier years, the Council has made no voluntary overpayments of MRP that are available to reduce the revenue charges in later years. It is not planned to make an overpayment in 2020/21, however the S151 Officer may determine such an overpayment during the year and report this through the Outturn Report.

MRP Overpayments	£k
Actual balance 1 April 2019	0
Approved overpayment 2019/20	0
Expected balance 31 March 2020	0
Planned overpayment 2020/21	0
Forecast Overpayments Balance 31 March 2021	0

Agenda Item 10

Audit Committee Forward Plan

Lead Officer: *Becky Sanders, Case Officer*
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Purpose of the Report

This report informs Members of the agreed Audit Committee Forward Plan.

Recommendation

Members are asked to comment upon and note the proposed Audit Committee Forward Plan as attached.

Audit Committee Forward Plan

The forward plan sets out items and issues to be discussed over the coming few months and is reviewed annually.

Items marked in italics are not yet confirmed.

Background Papers: *None*

Audit Committee Forward Plan

Meeting Date	Item	Responsible Officer
26 Mar '20	Internal Audit Plan 2020/21 and Internal Audit Charter – to approve 2020/21 plan	Alastair Woodland (SWAP)
	External Audit Plan for 2019/20 Accounts	Finance Specialist (GT)
	External Audit Progress Report 2019/20	Finance Specialist (GT)
	Annual Fraud Programme Update	TBC
	Health and Safety Update Report	Director (Strategy & Support Services)
	Civil Contingency update	Director (Strategy & Support Services)
	Whistleblowing update	Director (Strategy & Support Services)
28 May '20	<i>Review of Internal Audit</i>	<i>S151 Officer</i>
	<i>Internal Audit Plan Progress Report – 2019/20 Q4</i>	<i>Alastair Woodland (SWAP)</i>
	<i>Internal Audit Annual Report and Opinion 2019/20</i>	<i>Alastair Woodland (SWAP)</i>
	<i>Annual Treasury Management Activity Report 2019/20 (to go on to Council)</i>	<i>Finance Specialist</i>
30 July '20 (week later than normal)	<i>Annual Governance Statement</i>	<i>S151 Officer</i>
	<i>External Audit – Audit Findings Report</i>	<i>S151 Officer (GT)</i>
	<i>Internal Audit Plan Progress Report 2020/21 - Q1</i>	<i>Alastair Woodland (SWAP)</i>
	<i>Approve Annual Statement of Accounts</i>	<i>Finance Specialist</i>
	<i>Approve Summary of Accounts</i>	<i>Finance Specialist</i>
22 Oct '20	<i>Internal Audit Plan Progress Report 2020/21 – Q2</i>	<i>Alastair Woodland (SWAP)</i>
	<i>Treasury Management Practices</i>	<i>Finance Specialist</i>
	<i>Treasury Management Mid-Year Performance and Strategy Update (to go on to Council)</i>	<i>Finance Specialist</i>
	<i>External Audit – Annual Audit Letter</i>	<i>Finance Specialist (GT)</i>
28 Jan '21	<i>External Audit – Certification of Housing benefit Subsidy Claim</i>	<i>Finance Specialist (GT)</i>
	<i>Internal Audit Plan Progress Report 2020/21 – Q3</i>	<i>Alastair Woodland (SWAP)</i>
	<i>Treasury Management Strategy Statement 2021/22 (to go on to Council)</i>	<i>Finance Specialist</i>