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Audit Advisory Board

Thursday 27 January 2022
10.00 am Virtual meeting

SOMERSET County Council

To: The Members of the Audit Advisory Board

Cllr M Lewis (Chair), Cllr M Caswell (Vice-Chair), Cllr H Davies, Cllr B Filmer, Cllr P Ham, Cllr L Leyshon, Cllr G Noel and Cllr M Rigby

All Somerset County Council Members are invited to attend.

Issued By Scott Wooldridge, Strategic Manager - Governance and Democratic Services - 19 January 2022

For further information about the meeting, please contact Neil Milne at NDmilne@somerset.gov.uk or 01823 357628 or Andrew Randell at arandell@somerset.gov.uk or 01823 357628

Guidance about procedures at the meeting follows the printed agenda.

This Advisory Board will be open to the public and press.

This agenda and the attached reports and background papers are available on the councils website.

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AGENDA

Item Audit Committee - 10.00 am Thursday 27 January 2022

*** Public Guidance notes contained in agenda annexe ***

1 **Apologies for absence**

2 **Declarations of Interest**

Details of all Members' interests in District, Town and Parish Councils can be viewed on the Council Website at
County Councillors membership of Town, City, Parish or District Councils and this will be displayed in the meeting room (Where relevant).

The Statutory Register of Member's Interests can be inspected via request to the Democratic Service Team.

3 **Minutes from the meeting held on 30 November 2021** (Pages 7 - 14)

The Advisory Board is asked to confirm the minutes are accurate**.**

4 **Public Question Time**

The Chair will allow members of the public to present a petition on any matter within the Advisory Board remit. Questions or statements about any matter on the agenda for this meeting will be taken at the time when each matter is considered.

5 **Medium Term Financial Plan Reports** (Pages 15 - 72)

To consider the report.

6 **External Audit Progress Report and Sector Update** (Pages 73 - 96)

7 **Internal Audit Update Report** (Pages 97 - 114)

To consider the report.

8 **Risk Management Update** (Pages 115 - 124)

To consider the report.

9 **Future Workplan** (Pages 125 - 126)

To consider this report

10 **Any other urgent items of business**

Item Audit Advisory Board - 10.00 am Thursday 27 January 2022

The Chair may raise any items of urgent business.

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General Guidance notes for Somerset County Council advisory virtual meetings

1. **Advisory Virtual Council Public Meetings**

Please be advised that this an Advisory Board meeting and as a consultative meeting without any decisions to be made. It is not a meeting as defined under the Local Government Act 1972 or Local Government Act 2000 and therefore can take place virtually.

2. **Inspection of Papers**

Any person wishing to inspect minutes, reports, or the background papers for any item on the agenda should contact Democratic Services at democraticservices@somerset.gov.uk or telephone 01823 357628.

They can also be accessed via the council's website on www.somerset.gov.uk/agendasandpapers.

3. **Members' Code of Conduct requirements**

When considering the declaration of interests and their actions as a councillor, Members are reminded of the requirements of the Members' Code of Conduct and the underpinning Principles of Public Life: Honesty; Integrity; Selflessness; Objectivity; Accountability; Openness; Leadership. The Code of Conduct can be viewed on the council website at Code of Conduct.

4. **Minutes of the Meeting**

Details of the issues discussed, and recommendations made at the meeting will be set out in the minutes, which the Advisory Board will be asked to approve as a correct record at its next meeting.

5. **Public Question Time**

If you wish to speak, please contact Democratic Services by 5pm 3 clear working days before the meeting. Email democraticservices@somerset.gov.uk or telephone 01823 357628.

A slot for Public Question Time is set aside near the beginning of the meeting, after the minutes of the previous meeting have been agreed. However, questions or statements about any matter on the agenda for this meeting may be taken at the time when each matter is considered.

At the Chair's invitation you may ask questions and/or make statements or comments about any matter on the Board's agenda – providing you have given the required notice. You may also present a petition on any matter within the Board's remit. The length of public question time will be no more than 20 minutes in total.

You must direct your questions and comments through the Chair. You may not take a direct part in the debate. The Chair will decide when public participation is to finish.

If there are many people present at the meeting for one particular item, the Chair may adjourn the meeting to allow views to be expressed more freely. If an item on the agenda is contentious, with a large number of people attending the meeting, a representative should be nominated to present the views of a group.

An issue will not be deferred just because you cannot be present for the meeting. Remember that the amount of time you speak will be restricted to three minutes only.

In line with the council's procedural rules, if any member of the public interrupts a meeting the Chair will warn them accordingly. If that person continues to interrupt or disrupt proceedings the Chair can ask the Democratic Services Officer to remove them as a participant from the meeting.

6. **Meeting Etiquette**

- Mute your microphone when you are not talking.
- Switch off video if you are not speaking.
- Only speak when invited to do so by the Chair.
- Speak clearly (if you are not using video then please state your name)
- If you're referring to a specific page, mention the page number.
- Switch off your video and microphone after you have spoken.
- There is a facility in Microsoft Teams under the ellipsis button called turn on live captions which provides subtitles on the screen.

7. **Recording of meetings**

The Council supports the principles of openness and transparency. It allows filming, recording and taking photographs at its meetings that are open to the public - providing this is done in a non-disruptive manner. Members of the public may use Facebook and Twitter or other forms of social media to report on proceedings. No filming or recording may take place when the press and public are excluded for that part of the meeting. As a matter of courtesy to the public, anyone wishing to film or record proceedings is asked to provide reasonable notice to the Meeting Administrator so that the relevant Chair can inform those present at the start of the meeting.

We would ask that, as far as possible, members of the public aren't filmed unless they are playing an active role such as speaking within a meeting and there may be occasions when speaking members of the public request not to be filmed.

Advisory Board meetings are not recorded by the Council as they are not formal meetings.

8. Operating Principles for Audit Advisory Board

Reports

i. The reports should be clearly and concisely written. The report template available to officers on the intranet will be used.

ii. Reports should highlight issues for Member consideration, no matter how difficult or complex, for example:

- All reports should detail current performance levels.
- All reports should identify cost implications.

iii. No report should contain a recommendation "to note" the report.

iv. Any report, which outlines clear priorities for improvement, should contain recommendations and a detailed action plan with timescales and resources.

Members

i. Members should be clear about cost and resourcing issues highlighted in clearly and concisely written reports.

ii. Members should seek to understand the impact of reports on Council performance.

iii. Members can refer reports / issues back to the Cabinet where there are constructive concerns about services and/or performance.

9. The Role of the Audit Advisory Board

(a) Recommend approval (but not direct) internal audit's strategy, plan and performance;

(b) Reviews summary internal audit reports and the main issues arising, and seeks assurance that action has been taken where necessary;

(c) Considers the reports of external audit and inspection agencies;

(d) Ensures that the Council's assurance statements, including the Annual Governance Statement, properly reflect the risk environment and any actions required to improve it;

(e) Ensures that there are effective relationships between external and internal audit,

inspection agencies and other relevant bodies, and that the value of the audit process and effective financial governance is actively promoted;

(f) Reviews the financial statements, external auditor’s opinion and reports to Members, and monitors management action in response to the issues raised by external audit;

(g) Recommend approval of the annual accounts of the Council and the Annual Governance Statement, together with considering the Matters Arising from the Accounts Audit.

AUDIT COMMITTEE

Minutes of a Meeting of the Audit Committee held in the Luttrell Room, County Hall, Taunton, on Tuesday 30 November 2021 at 12:00 pm

Present: Cllr Mike Lewis (Chair), Cllr Mike Caswell (Vice Chair), Cllr Bob Filmer, Cllr Graham Noel, Cllr Hugh Davies, Cllr Liz Leyshon, Cllr Mike Rigby (virtual attendance).

Other Members present: Cllr Mandy Chilcott, Cllr Tessa Munt, Cllr Christine Lawrence, Cllr Bill Revans.

Officers present: (JV) Director of Finance and Governance, (PG) Service Manager-Chief Accountant, (AS) Service Manager for Investments, (BB) Strategic Manager for Finance Systems and Governance, (OW) Head of Property, (LF) Assistant Director of SWAP, (BM) Key Audit Partner-Grant Thornton, (NM) Committee Manager, (TB) Committee Clerk

Apologies for absence – Agenda Item 1

Cllr Phillip Ham did not attend.

Declarations of Interest - Agenda Item 2

The Chair of the Committee noted the details of all Councillors' interests already declared in District, Town and Parish Councils and the Pension Fund.

There were no new declarations.

Minutes from the previous meeting - Agenda Item 3

The Audit Committee agreed that the minutes of the meeting held on 23 September 2021 were accurate, and the Chair signed them.

Public Question Time - Agenda Item 4

The Chair informed the meeting that no questions or statements were received by the PQT deadline of 5pm on Wednesday 24 November.

Internal Audit Update - Agenda Item 5

The Chair invited the Assistant Director of SWAP to present the progress update for November, which focused on high-risk areas, and limited assurance reporting forms an important part of that. No reports with limited assurance have been finalised, but two reasonable assurance reports had been finalised, with more reports due to be finalised by January. There was much work in progress and new work due to start in Quarter 4, but they were on track to deliver the scheduled audit plan.

As regards the reporting of implementation of agreed actions, which was introduced at the last meeting, implementation had been slowed due to the pandemic and limited resources, but agreed actions were beginning to be implemented more quickly with a 21% reduction in the number of outstanding actions.

With reference to Page 21 of the report, it was explained the first paragraph referred to meetings with DMT's and heads of service which took place in October to ensure that audit plan scheduled for the second half of the year contained key risk areas; this has led to some changes in the plan. Page 22 demonstrated the mapping of the Council's strategic risks against audit work; the only exception to the coverage of strategic risks concerned climate change, which was scheduled for later in the fourth quarter.

Page 23 provided an overview of the current status of implementation of agreed actions from the limited assurance reports, which had decreased from 113 to 89 over two months. Page 25 detailed the safeguarding in schools follow-up work (after the original audit last fiscal year in 2021), good progress had been made in implementing the recommendations, a couple were not fully complete and would require more time to implement in full as part of a larger ongoing development in relation to safeguarding. Members noted the Auditors were satisfied, however, that enough work had been done to mitigate the original risks reported, and no further follow-up work was proposed.

The Chair invited questions from the Committee, and during consideration of the reports, issues/concerns were raised, questions were asked/answered, and further information was provided:

A question was raised with respect to Page 27 regarding the whistle blowing policy review and whether the whole of the policy would be reviewed by SWAP, or whether that would be reviewed internally. In response it was noted that the Council would review the policy, while SWAP's anti-fraud lead would contribute in an advisory capacity.

The Chair thanked the Assistant Director of SWAP and stated that he looks forward to the January reports. The Audit Committee accepted the update report.

Approval of the Pension Fund Accounts 2020/2021- Agenda Item 6

The Chair invited the Key Audit Partner of Grant Thornton to present the Audit Findings Report, accounts, and Letter of Representation. It was noted that this report had already been presented to the Committee in September and that this report would provide an update highlighting changes, as there was a small amount of work still outstanding in September. He referred to Page 51, Appendix A regarding audit adjustments, which highlighted the only change which relates to testing and agreement of investments.

It was noted that the UK equities figure of just over £12.9 million had been classified as Level 1, where inputs were directly observable, which they were unable to do, so this has been changed to Level 2 with management's approval (Note 30 has been updated to reflect that change). As this was an immaterial reclassification in both the current and prior periods, it was explained no further adjustments were required. Also, with respect to additional voluntary contributions to Prudential, this was not made available by Prudential but was a trivial amount. This situation was not limited to the Somerset Pension Fund and was the case for all pension funds managed by Brunel, so management had been asked to engage more with Prudential in future, but it was reiterated that this was an amount of low triviality and did not need to go into the report, hence the verbal update only.

The Chair invited questions from the Committee, and during consideration of the reports, issues/concerns were raised, questions were asked/answered, and further information was provided:

It was questioned why certain issues are referred to as "trivial" when they involve hundreds of thousands of pounds; in response it was explained that there were strict guidelines for auditors and what would change the view of stakeholders, and Page 39 of the report, set out what the materiality was based on the gross value of the fund. As the materiality for the Pension Fund audit was set at approximately £26.1 million, the triviality level was £1.3 million. Materiality is set at 1% of the Pension Fund balance, which is over £2.5 billion, with triviality set at 5% of materiality; so a figure of £1 million would not change the overall view of the financial information included in the report or compel a change in the financial statements.

With respect to the AVC's (voluntary contributions), it was queried whether this was a matter between the purchaser and the pension provider and whether it is audited. In response Members heard that it was a requirement within the Pension Fund accounts to disclose the information provided, and it was not a comment on the performance of the Finance team that Prudential did not provide the information. It was added that the figures from Prudential were a disclosure but not included in the primary statements and were not part of the valuation of the Fund given in the net assets statement, nor were the contributions included in the Fund account.

It was asked if were possible to have an update with respect to the assets of the Pension Fund had been moved to Brunel which stood at 93%, and it was noted that the Fund was valued monthly and the value for the end of October was

£2.894 billion. Of the assets left this was principally cash and illiquid long-term investments; therefore, the amount moved will change very slowly over the next few years and will only reach a total of 97-98%, so the transition process is for all intents and purposes now complete. Cash would remain with the internal treasury team until further notice.

The Key Audit Partner then discussed the Letter of Representation, noting that it was the standard letter and no additional disclosures were being asked; there was only one unadjusted misstatement of £7.6 million which had been identified and was well below the materiality figure, so subject to the Committee's approval, the letter could be signed.

The Audit Committee considered and commented on the report and unanimously approved the audited Pension Fund accounts and Letter of Representation on behalf of Somerset County Council.

Approval of the Statement of Accounts 2020/2021 - Agenda Item 7

The Chair invited the Key Audit Partner of Grant Thornton to present the Audit Findings Report. He confirmed that the audit had been completed and, subject to the Committee's approval of the report, the accounts, and the Letter of Representation, they would be able to issue the audit opinion later today.

As set out on Page 84, materiality was reviewed as a result of the financial statements received; it was noted that the Council's expenditure increased from £12.3 million at the planning stage to £13.5 million, and although there was no additional risk, the Council's expenditure did increase and the materiality setting was based on that. Page 85, sets out the significant risks that were required for consideration; the first being the management override of controls, and the key areas looked at were journal authorisations and transactions undertaken by the Council, and management's use of estimates and judgements.

It was highlighted the Auditors were waiting for four responses from people who had posted journals to their standard confirmation requests. It had been identified that there was no formal approval process for posting journals, meaning some persons were able to approve their own journal transactions, which is an identified weakness, but a mitigating control measure is in progress. As for the extent of journals being processed at the Council there were 125 persons posting journals, more than 7500 journals, 480,000 transaction lines, and a value of £9.2 billion. The scope for error in so many journals was therefore quite high, so the Finance team were reviewing this situation, however it was noted there were no issues regarding revenue and expenditure cycles.

Page 87 set out the work on the valuation of land and buildings, which contributed in the 2019/20 audit to a significant delay to the audit opinion; the process had been improved but was still being progressed. A number of different issues had been raised with respect to property, plant and equipment; the net impact was £61,000, so it was not adjusted in the Financial Statements.

Further work had been done on the depreciated replacement costs assets, and assurance was provided that at 31 March these were not materially misstated. Page 89 discussed the Pension Fund liability from the Council's perspective (there were no issues); Pages 90-91 regard key judgements and estimates, and an assessment had been given with respect to the land and building valuation and the net pension fund liability.

On Page 92, highlighted the considerable work completed regarding the Minimum Revenue Provision (MRP) and ensuring that it was appropriate. The Auditors had confirmed they were comfortable with the Council's MRP and the way it had been calculated. Page 93 highlighted a deficiency regarding internal control around the IT review, as there were control deficiencies around the segregation of duties, as developers had access to the production environment within the financial system and some conflict within the SAP system. Management had agreed to review these processes, which have been identified as a deficiency but not a significant deficiency. There were no other matters regarding the Financial Statements, and no concerns with respect to the Council's preparation of them as a going concern.

Regarding Value for Money (VFM) and the brief commentary on Page 99, the work had not concluded, but they had given assurance that there was not a risk of significant weakness in the Council's arrangements. He confirmed their continuing independence and ethical declarations on Page 106; noting that management had responded to each of the recommendations made; pointing out the follow-up to their recommendations made in the prior year on Page 110; and in Appendix C, set out the audit adjustments that had been made as well as the impact of unadjusted misstatements.

The Chair invited questions from the Committee, and during consideration of the reports, issues/concerns were raised, questions were asked/answered, and further information was provided:

On the issue of journals, the Director of Finance and Governance, noting this had been covered at recent Member training, adding that the work from Grant Thornton on this matter had been very useful, as the Council was now looking at the number of persons with access to journals and looking at a new system to ensure training and reduce the overall number of journals. It was asked if the persons approving the journals were able to approve their own expenditure and it was explained that the journals only entail moving money within the Council finance system. Another query regarded what assurance there was regarding persons with access to journals and SAP and if they would have that access removed upon leaving the employ of the Council and it was explained that removing access was indeed part of the termination process. The Key Audit Partner explained that they had examined if anyone who had left the Council's employ was processing journals, and no such incidents had been identified. It was asked how the Council compared to others regarding journals and it was noted that although it is not the highest number amongst Councils it was on the high side and being acted upon, and reflected in the audit findings. The Service Manager-Chief Accountant noted that his team tested and reviewed the journals and that the value of the journals was less of a concern and that government regulations required that accounts were compliant with the code. On the question of long-term absences by journal users, it was agreed that access to the journals should be removed during the period of leave and that journals would have to be assigned to a role rather than a person. It was asked how the Council cross-checked that a person had changed roles or was off long term and it was noted that transfers of roles were notified to the delegations' team, and the line manager of the person in question was required to reassign the role, and he would confirm those arrangements during his review.

It was questioned whether there would be a new system to replace SAP, and if there was any information available regarding Minimum Review Process and the Councils' borrowing for investments and yield. It was explained that an examination of finance systems was part of the unitary council transition process, but given the age of SAP and its configuration, there was a possibility of change to reduce the number of journals. Regarding investments and borrowing for yield, there had recently been a consultation by CIPFA on the treasury management code and the prudential code that was closed just over a week ago; CIPFA was doing a 'soft launch' for next year's codes and then a full launch in 2023/24. Details on the codes were pending, but clearly there should not be borrowing for yield. The Key Audit Partner noted that it was a risk area for all Councils and was being tightened up; the guidance is clear where MRP has been charged on investment properties, and they were identifying any concerns at all Councils and reporting them.

With respect to VFM, it was noted that the commentary in the audit finding was positive, and sufficient assurance had been given as there were no significant weakness, but some improvements may be suggested. Due to the pandemic and more detailed requirements, this work would be completed by the end of February, and it was hoped that the report could be presented at the next Audit Committee meeting.

The Audit Committee approved the audited Statement of Accounts 2020/21, including the updated annual governance statement and the Letter of Representation.

Appointment of External Auditors - Agenda Item 8

The Chair invited the Director of Finance and Governance to present the report. He noted that there will be a process from 1 April 2023 for appointing external auditors, and all Somerset local authorities had been invited to take part in the national auditor appointment arrangements established by Public Sector Audit Appointments (PSAA). If the Audit Committee recommended acceptance, the matter would be presented to Full Council in February with a decision for approval due by 11 March 2022.

The Chair invited questions from the Committee, and during consideration of the reports, issues/concerns were raised, questions were asked/answered, and further information was provided:

It was asked if the Council and all District Councils had the same external auditors and it was noted that four out of five did, and while it would be easier if all five did, it would be the PSAA who would make the appointment. It was clarified that there was no immediate plan to change the auditors of that one Council, as the procurement would only take effect with the initiation of the new unitary Council. In response to a question about paying for the audits at that time, it was stated that the 2022/23 financial year audit would be part of the new unitary council's responsibility and will be reported to the unitary Council's Audit Committee, but will cover all five previous Councils' accounts; the cost of delivering that audit will be met by predecessor bodies, but thereafter audit work will be paid by the unitary Council.

The Audit Committee: accepted the invitation to opt into the PSAA sector-led option for the appointment of external auditors for five financial years beginning on 1 April 2023; the matter will now go to Full Council.

Independent Member for the Audit Committee- Agenda Item 9

The Chair invited the Governance Specialist-Democratic Services to present the report from the Monitoring Officer following the recommendation within the Redmond Review earlier this year relating to the appointment of at least one independent member, suitably qualified with experience in audit but not a County, District or Parish Councillor, to the Audit Committee. This appointee would act in an advisory role and would not have voting rights. Recruitment was now live and ongoing, with the closing date for applications being 20th December, and it is proposed that recruitment will be completed in such time as to enable the successful candidate to attend the next Committee meeting.

The Chair invited questions from the Committee, and during consideration of the reports, issues/concerns were raised, questions were asked/answered, and further information was provided:

It was asked who would be on the interview panel and it was explained the panel would be comprised of the Director of Finance and Governance, the Strategic Manager for Finance Systems and Governance, and the Governance Specialist-Democratic Services. With respect to the person's qualifications and how they are checked, it was noted that Pages 380-382 of the recruitment pack (within the Agenda) provided the specifications that must be met, and colleagues in HR would carry out due diligence regarding the authenticity of the qualifications and experience claimed. Regarding how long the appointment will be for, the original appointment will be until March 30, 2023, but if the person is qualified and capable, this could be extended.

The Audit Committee accepted the report.

Committee Future Work Programme – Agenda Item 10

The Audit Committee noted and accepted the work programme that listed future agenda items and reports.

Any Other Urgent Items of Business - Agenda Item 11

The Chair noted that the next Audit Committee meeting will be held on 27 January 2022 and thanked the Governance Specialist-Democratic Services for all his hard work and valuable contribution, as he would be moving on to other work commitments. He also wished everyone a happy and healthy Christmas and New Year, and after ascertaining that there were no other items of business he closed the meeting.

(The meeting ended at 13:15)

CHAIR

Treasury Management Strategy Statement 2022-23

Cabinet Member(s): Cllr Mandy Chilcott – Cabinet Member for Resources
Local Member(s) and Division: All
Lead Officer: Jason Vaughan – Director of Finance & Governance (Section 151 Officer)
Author: Alan Sanford – Principal Investment Officer
Contact Details: alsanford@somerset.gov.uk or (01823) 359585

1. Summary / Background

1.1. The Council recognises that effective treasury management underpins the achievement of its business and service objectives and is essential for maintaining a sound financial reputation. It is therefore committed to driving value from all of its treasury management activities and to employing suitable performance measurement techniques, within the context of effective risk management.

This report brings together the requirements of the Chartered Institute of Public Finance and Accountancy (CIPFA) Treasury Management in the Public Services Code of Practice Revised 2017 Edition (CIPFA TM Code), and the CIPFA Prudential Code for Capital Finance in Local Authorities: Revised 2017 Edition (CIPFA Prudential Code).

New CIPFA Treasury Management and Prudential Codes were published in December 2021, too late to be wholly incorporated into this year's written strategy. More details of their implementation are given in section 11 'Introduction and Background' below.

Whilst most of the requirements of the 2018 Ministry of Housing, Communities and Local Government (MHCLG) Investment Guidance are no longer relevant to Treasury Management Investments (it now overwhelmingly refers to non-treasury investments), it does adhere to MHCLG guidance to prioritise Security, Liquidity and Yield, in that order.

Somerset is undergoing a Local Government Reorganisation (LGR), with the new Council coming into effect on 1st April 2023. This will mean bringing together the debt and investment portfolios of the 5 current Councils. In order to do this in the most effective and efficient manner, actions may be taken during 2022-23 with the best interests of the continuing Council in mind, as well as purely those of Somerset County Council.

The Council currently holds £324.55m of debt as part of its strategy for funding previous years' capital programmes. Of this, £159.05m is Public Works Loan Board (PWLB) debt, £108m is Lender Option Borrower Option (LOBO) debt, and a further £57.5m of fixed rate bank loans. As at 31st December 2021 the average rate paid on all debt was 4.66%.

Investment balances for 2021-22 to the 31st December 2021 have ranged between £261m (6th April) to £358m (25th July), averaging £313m. The average includes just over £114m of cash held on behalf of others during the period. £114.86m was being held as at 31st December 2021 on behalf of others, including entities where the Council is the accountable/administering body. An average rate of 0.54% has been achieved, yielding income in excess of £1.27m. Within this figure £45m is invested in Pooled Funds, £15m with the Churches, Charities, Local Authorities (CCLA) Property Fund, £15m with a Royal London Investment Grade Credit Fund, and £15m with the M&G Corporate Bond Fund.

2. Recommendations

2.1. The Cabinet is asked to endorse the following and recommend approval by Council on 14th February 2022:

- To adopt the Treasury Borrowing Strategy (as shown in Section 2 of the report).
- To approve the Treasury Investment Strategy (as shown in Section 3 of the report) and proposed Lending Counterparty Criteria (attached at **Appendix B** to the report).
- To adopt the Prudential Treasury Indicators in section 4.

The Cabinet is recommended:

- To note the current Treasury Management Practices (TMPs) attached at **Appendix D** to the report.

3. Reasons for recommendations

3.1 Under new CIPFA guidance the Treasury Management Strategy (TMS) can be delegated to a committee of the Council under certain conditions. However, it is seen as a key element of the overall Capital Strategy and as that must be presented to the Full Council, it is regarded as appropriate that the TMS should be part of that process.

4. Other options considered

4.1. None. The adoption of the TMS is a regulatory requirement.

5. Links to County Vision, Business Plan and Medium-Term Financial Strategy

5.1. Effective Treasury Management provides support to the range of business and service level objectives that together help to deliver the Somerset County Plan.

6. Consultations and co-production

6.1. None. The adoption of the TMS is a regulatory requirement.

7. Financial and Risk Implications

7.1. The budget for investment income in 2022-23 is £1.36m, based on an average investment portfolio of £220m at an average return of 0.7% (these figures are net of balances held on behalf of external investors i.e. the Local Enterprise Partnership). The budget for debt interest paid in 2022-23 is £15.378m, based on an average debt portfolio of £364.55m at an average interest rate of 4.21%. If actual levels of investments or borrowing, or actual interest rates, differ from the forecast, performance against budget will be correspondingly different.

7.2. The TMS is the Council's document that sets out strategy and proposed activities to conduct Treasury Management activity while mitigating risks. **Appendix D**, the Treasury Management Practices document gives detailed explanation of the policies and procedures specifically used in treasury risk management.

8. Legal and HR Implications

8.1. Treasury Management must operate within specified legal and regulatory parameters as set out in the summary, and in more detail in the TMPs.

8.2. There are no HR implications.

9. Other Implications

9.1. Equalities Implications

There are no equalities implications.

9.2. Community Safety Implications

There are no community safety implications.

9.3. Sustainability Implications

There are no sustainability implications.

9.4. Health and Safety Implications

There are no health and safety implications.

9.5. Health and Wellbeing Implications

There are no health and wellbeing implications.

9.6. Social Value

Not applicable

10. Scrutiny comments / recommendations:

10.1. The Audit Committee is the body responsible for ensuring effective scrutiny of the treasury management strategy and policies.

11 Introduction and Background

Treasury management is the management of the Council's cash flows, borrowing and treasury investments, and the associated risks. The Council has significant debt and treasury investment portfolios 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.

Investments held for service purposes or for commercial profit, collectively referred to as non-treasury investments, are considered in a separate report, the Investment Strategy.

Treasury risk management at the Council is conducted within the framework of the CIPFA 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.

As noted in 1.1, new CIPFA Treasury Management and Prudential Codes were published in December 2021, too late to be wholly incorporated into this year's written strategy. However, SCC Treasury Management will operate within the letter and the spirit of the revised Codes. Given that LGR in Somerset will see the new unitary Somerset Council starting in April 2023 it is considered more appropriate to defer until 2023-24 when the overall position for the new Council can be clearly set out.

The foreword of the Prudential Code states that the new code takes immediate effect, except that Authorities may defer introducing the revised reporting requirements until the 2023/24 financial year. It particularly highlights that the requirement that local authorities must not borrow to invest primarily for financial return applies with immediate effect.

Within the new code, the new section, ‘Prudence in borrowing and investment’ is the key change in the code.”. It states “legitimate examples of prudent borrowing” as:

- Financing capital expenditure primarily related to the delivery of a local authority’s functions.
- Temporary management of cash flow within the context of a balanced budget.
- Securing affordability by removing exposure to future interest rate rises.
- Refinancing current borrowing, including adjusting levels of internal borrowing, to manage risk, reduce costs or reflect changing cash flow circumstances.
- Other treasury management activity that seeks to prudently manage treasury risks without borrowing primarily to invest for financial return.

The Prudential Code determines that certain acts or practices are not prudent activity for a local authority and incur risk to the affordability of local authority investment; therefore, in order to comply with the Prudential Code,

- An authority must not borrow to invest primarily for financial return.
- It is not prudent for local authorities to make any investment or spending decision that will increase the capital financing requirement, and so may lead to new borrowing, unless directly and primarily related to the functions of the authority; and where any financial returns are either related to the financial viability of the project in question or otherwise incidental to the primary purpose.”

Unlike the Prudential Code, there is no mention of the date of initial application in the TM Code, and the guidance notes have yet to be published; however, SCC will follow the same process as the Prudential Code, i.e. defer introducing the revised reporting requirements until the 2023/24 financial year but following the revised code (when guidance enables and clarifies) immediately.

Under Section 3 of the LGA 2003 (duty to determine affordable borrowing limit), a Local Council must have regard to the CIPFA Prudential Code. This code requires the setting of a number of Prudential Indicators, benchmarks within which Treasury and Investment Management, and Capital Financing are managed. The setting of Prudential Indicators for Treasury Management requires Authorities to recognise key implications of their borrowing and investment strategies. These relate to the affordability of overall borrowing limits, the maturity structure of borrowing, and longer-term investments.

In formulating the Treasury Management Strategy, and the setting of Prudential Indicators, Somerset County Council (SCC) adopts the Treasury Management Framework and Policy recommended by CIPFA. These can be found in **Appendix A**.

The current TMPs are attached for information as **Appendix D** to this report and set out the main categories of risk that may impact on the achievement of Treasury Management objectives. No treasury management activity is without risk. The successful identification, monitoring and control of risks are the prime criteria by which the effectiveness of its treasury management activities will be measured. The main risks to the Council's treasury activities are:

- Credit and Counterparty Risk (security of investments)
- Liquidity Risk (inadequate cash resources)
- Market or Interest Rate Risk (fluctuations in price / interest rate levels)
- Refinancing Risk (impact of debt maturing in future years)
- Legal & Regulatory Risk.

The schedules to the TMPs provide details of how these risks are actively managed.

External Context

Economic background: The ongoing impact on the UK from coronavirus, together with higher inflation, higher interest rates, and the country's trade position post-Brexit, will be major influences on the Authority's treasury management strategy for 2022/23.

The Bank of England (BoE) increased Bank Rate to 0.25% in December 2021 while maintaining its Quantitative Easing programme at £895 billion. The Monetary Policy Committee (MPC) voted 8-1 in favour of raising rates, and unanimously to maintain the asset purchase programme.

Within the announcement the MPC noted that the pace of the global recovery was broadly in line with its November Monetary Policy Report. Prior to the emergence of the Omicron coronavirus variant, the Bank also considered the UK economy to be evolving in line with expectations, however the increased uncertainty and risk to activity the new variant presents, the Bank revised down its estimates for Q4 GDP growth to 0.6% from 1.0%.

Inflation was projected to be higher than previously forecast, with CPI likely to remain above 5% throughout the winter and peak at 6% in April 2022. The labour market was generally performing better than previously forecast and the BoE now expects the unemployment rate to fall to 4% compared to 4.5% forecast previously; but notes that Omicron could weaken the demand for labour.

UK CPI for November 2021 registered 5.1% year on year, up from 4.2% in the previous month. Core inflation, which excludes the more volatile components, rose to 4.0% y/y from 3.4%. The most recent labour market data for the three months to October 2021 showed the unemployment rate fell to 4.2% while the employment rate rose to 75.5%.

In October 2021, the headline 3-month average annual growth rate for wages was 4.9% for total pay and 4.3% for regular pay. In real terms, after adjusting for inflation, total pay growth was up 1.7% while regular pay was up 1.0%. The change in pay growth has been affected by a change in composition of employee jobs, where there has been a fall in the number and proportion of lower paid jobs.

Gross domestic product (GDP) grew by 1.3% in the third calendar quarter of 2021 according to the initial estimate, compared to a gain of 5.5% q/q in the previous quarter, with the annual rate slowing to 6.6% from 23.6%. The Q3 gain was modestly below the consensus forecast of a 1.5% q/q rise. During the quarter activity measures were boosted by sectors that reopened following pandemic restrictions, suggesting that wider spending was flat. Looking ahead, while monthly GDP readings suggest there had been some increase in momentum in the latter part of Q3, Q4 growth is expected to be soft.

GDP growth in the euro zone increased by 2.2% in calendar Q3 2021 following a gain of 2.1% in the second quarter and a decline of -0.3% in the first. Headline inflation has been strong, with CPI registering 4.9% year-on-year in November, the fifth successive month of inflation. Core CPI inflation was 2.6% y/y in November, the fourth month of successive increases from July's 0.7% y/y. At these levels, inflation is above the European Central Bank's target of 'below, but close to 2%', putting some pressure on its long-term stance of holding its main interest rate of 0%.

The US economy expanded at an annualised rate of 2.1% in Q3 2021, slowing sharply from gains of 6.7% and 6.3% in the previous two quarters. In its December 2021 interest rate announcement, the Federal Reserve continue to maintain the Fed Funds rate at between 0% and 0.25% but outlined its plan to reduce its asset purchase programme earlier than previously stated and signalled they are in favour of tightening interest rates at a faster pace in 2022, with three 0.25% movements now expected.

An economic and interest rate forecast provided by Arlingclose is attached at **Appendix C.**

Internal Context
As at 31st December 2021 the external long-term debt portfolio of SCC stood at just over £324m as in **table 1** below.

Table 1 – Debt Portfolio

	Balance on 31-03-2020 £m	**Debt Matured / Repaid £m**	**New Borrowing £m**	**Balance on 31-12-2021 £m**	**Increase/ Decrease in Borrowing £m**
Short Term Borrowing	0.00	0.00	0.00	0.00	0.00
PWLB	159.05	0.00	0.00	159.05	0.00
LOBOs	108.00	0.00	0.00	108.00	0.00
Fixed Rate Loans	57.50	0.00	0.00	57.50	0.00
Total Borrowing	**324.55**	**0.00**	**0.00**	**324.55**	**0.00**

The underlying need to borrow for capital purposes is measured by the Capital Financing Requirement (CFR), while useable reserves and working capital are the underlying resources available for investment.

Statutory guidance is that debt should remain below the CFR, except in the short-term. The Council expects to comply with this in the medium term.

The investment portfolio set out in **Tables 2-4** below, at the same time stood at just under £302m, although as at 31st December 2021 just over £114m was cash held on behalf of other entities, primarily where SCC is the accountable / administering body.

Table 2 – Investments as at 31st December 2021

	Balance as at 31-03-2021 £m	Rate of Return at 31-3-2021 %	Balance as at 31-12-2021 £m	Rate of Return at 31-12-2021 %
Short-Term Balances (Variable)	75.63	0.04	79.92	0.08
Comfund (Fixed)	160.00	0.39	177.00	0.25
Pooled Funds	40.00	2.87	45.00	2.72
Total Investments	**275.63**	**0.66**	**301.92**	**0.54**

Table 3 - Investment balances by type

	31 March 2021 £m	31 December 2021 £m	Change
Money Market Funds / Call Accounts	45.63	39.92	-5.71
Notice Bank Accounts	40.00	95.00	+55.00
Time Deposits - Banks	20.00	35.00	+15.00
Time Deposits - LAs	130.00	87.00	-43.00
Pooled Funds	40.00	45.00	+5.00
Total Investments	**275.63**	**301.92**	**+26.29**

Table 4 - Breakdown of investment balances by source

	31 March 2021 £m	31 December 2021 £m	Change
ENPA / SWC	0.04	-0.19	-0.23
Organisations in the Comfund	7.22	8.05	+0.83
LEP – Growth Deal Grant	41.69	56.83	+15.14
Earmarked Revenue Reserves – Held as Accountable Body	11.55	6.57	-4.98
NHS CCG Prepayments	31.60	43.60	+12.00
Total Externals	**92.10**	**114.86**	**+22.76**
SCC	183.53	187.06	+3.53
Total	**275.63**	**301.92**	**+26.29**

In **table 5** below, as shown in the Capital Strategy, the 'Assumed debt not yet taken' row indicates that £40m of new borrowing could be needed by the end of March 2023 to finance the capital plan. Timings of actual capital expenditure linked to the capital plan are not totally predictable. By continuing the passive borrowing strategy currently pursued, and with additional funding currently being held, external borrowing will be minimised, and as in 2021-22, may not be necessary at all.

Table 5 - External Debt and the Capital Financing Requirement

	31.3.2021 actual £m	**31.3.2022 forecast £m**	**31.3.2023 budget £m**	**31.3.2024 budget £m**	**31.3.2025 budget £m**
Short term debt	7.220	10.000	10.000	10.000	10.000
Long term debt *	334.173	332.099	325.814	312.993	288.701
Assumed debt not yet taken	0.000	0.000	40.000	80.000	120.000
PFI & leases	42.533	39.872	38.669	37.350	36.031
Total external borrowing	**383.926**	**381.971**	**414.483**	**440.343**	**454.732**
Capital Financing Requirement	**458.106**	**484.976**	**519.020**	**539.949**	**537.740**

*Reduces for Minimum Revenue Provision (MRP) & debt repayment

SCC has a projected cash income in excess of £700m for 2022-23.

These factors represent significant cash flow, and debt and investment portfolio management for the Council's Officers. In the current financial and economic environment and taking into account potential influencing factors, it is imperative that the Council has strategies and policies in place to manage flows and balances effectively. The strategies and policies herein state the objectives of Treasury Management for the year and set out the framework to mitigate the risks to successfully achieve those objectives.

12 Borrowing Strategy

The Council's need to borrow for capital purposes is determined by the capital programme. Council Members are aware of the major projects identified by the 4-year capital medium-term financial plan (MTFP). The Council currently holds £324.55m of loans, as part of its strategy for funding previous years' capital programmes. The balance sheet forecast in the table above shows that the Council may have a need to borrow up to £40m by the end of 2022-23.

A continuation of the passive borrowing strategy currently pursued is deemed most prudent, primarily reducing cash balances as capital spend is actually incurred before taking any borrowing. By doing this, and with additional funding currently being held, external borrowing will be minimised, and as in 2021-22, may not be necessary at all.

In reality, not all proposed expenditure will be incurred during 2022-23, as some projects may not even get started, and others may span more than 1 year. Also, historically, there has been significant 'slippage' in the capital programme, and it is likely the COVID-19 crisis will increase the chances of this through 2022-23.

Objectives: 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.

The Council will adhere to MHCLG guidance, which states "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".

Strategy: Given the significant cuts to public expenditure and in particular to 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 to medium-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 to medium-term loans instead, i.e. from Local Authorities for 1-3 years, or from the Public Works Loan Board (PWLB) for 5-20 years.

By doing so, the Council can reduce net borrowing costs (despite foregone investment income) and reduce overall treasury risk. The benefits of internal or short to medium-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 2022-23 with a view to keeping future interest costs low, even if this causes additional cost in the short-term.

The Council has previously raised most of its long-term borrowing from the PWLB or via LOBOs with banks. Current policy is not to take further LOBO loans. PWLB loans are no longer available to local authorities planning to buy investment assets primarily for yield; the Authority intends to avoid this activity in order to retain its access to PWLB loans The Council will continue to assess alternatives to borrowing long-term loans from other sources including banks, pension funds and local authorities, and may wish to investigate the possibility of issuing bonds and similar instruments, in order to lower interest costs and reduce over-reliance on one source of funding in line with the CIPFA Code.

The Council may also 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.

The use of Call Accounts and Money Market Funds (MMFs) will continue for short-term liquidity; however, it may be appropriate and/or necessary to borrow short-term (1 week to 3 months) to cover cash flow fluctuations. Where this is deemed advantageous, short-term funds will be obtained from the money market using the services of a panel of money market brokers.

Sources of borrowing: Approved sources of borrowing are cited in the TMPs. Since PWLB rates were reduced in December 2020, commercial lenders' offerings are less attractive than previously, but this option will still be sought and considered. It is envisaged that any new borrowing will be in the short to medium-term periods (up to 25 years), as this is most compatible with the current maturity profile. Interest rates for these maturities are expected to remain low as the continued economic uncertainty necessitates low interest rates for longer. A smaller amount of longer-dated borrowing may also be deemed appropriate when considering the overall portfolio.

Variable rate loans currently mitigate the cost of carry. Shorter-dated Equal Instalment of Principal (EIP) loans are cheaper than loans paid on maturity and are repaid systematically in equal instalments over their life. Both will be actively considered, as will shorter dated loans (1-3 years) from other Local Authorities.

No new borrowing will be in the form of LOBOs. SCC will continue with the current policy not to accept any option to pay a higher rate of interest on its' LOBO loans and will exercise its own option to repay the loan should a lender exercise an option. SCC will also investigate opportunities to repay where a lender is looking to exit the LOBO by selling the loan. This would be undertaken in conjunction with our treasury advisors. SCC may utilise cash resources for repayment or may consider replacing any loan(s) by borrowing from other sources. Depending on prevailing rates and the amount to be repaid, new loans might be taken over a number of maturities. The 'Maturity Structure of Borrowing' indicators have been set to allow for this contingency strategy.

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 relative to the rate of the loan. 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. Officers continually monitor repayment rates and calculate premiums to identify opportunities to repay or reschedule PWLB loans.

13 Treasury Investment Strategy

In 2018, the MHCLG issued revised Statutory Guidance on Local Government Investments (3rd Edition). It states *"Investments made by local authorities can be classified into one of two main categories:*

- *Investments held for treasury management purposes; and*
- *Other investments.*

"Where local authorities hold treasury management investments, they should apply the principles set out in the Treasury Management Code. They should disclose that the contribution that these investments make to the objectives of the local authority is to support effective treasury management activities. The only other element of this Guidance that applies to treasury management investments is the requirement to prioritise Security, Liquidity and Yield in that order of importance".

The changes made to the 3rd edition of this Guidance reflect changes in patterns of local authority behaviour. Some local authorities have been investing in non-financial assets, with the primary aim of generating profit. Others are entering very long-term investments or providing loans to local enterprises or third sector entities as part of regeneration or economic growth projects that are in line with their wider role for regeneration and place making.

The new CIPFA codes were designed to deal with investments specifically held primarily for yield (non-Treasury investments). Previously this did not include the use of Pooled Funds, but it now seems as if they may fall into the non-Treasury investment category. SCC and our advisors Arlingclose would argue that they are very much used as a Treasury investment by SCC, matching our reserve requirements and debt liabilities. Whilst the situation at present would appear to be unclear, this strategy, (including currently held Pooled Funds) applies only to investments held for treasury purposes. Any non-treasury investments are dealt with in a separate Investment Strategy (separate agenda item).

The Council's treasury investments can be divided into two areas. Money that is invested to help smooth anticipated monthly cash flow movements, and funds which have been identified as not being immediately required (core balances), which can be invested over a longer timeframe. Total balances for 2021-22 to the end of December 2021 have ranged between £261m to £358m, averaging £313m to the 31st December 2021. These balances include just over £114m of cash held on behalf of other entities.

If a passive borrowing strategy is adopted, i.e. internal borrowing to fund capital expenditure, investment levels will decrease. If Arlingclose's 'cost of carry' and breakeven analysis determines that the Council borrows additional sums at medium-term fixed rates in 2022-23 with a view to keeping future interest costs low, investment balances could possibly be higher.

Objectives: 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.

Negative interest rates: Under current economic scenarios, there is still a possibility 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 these circumstances, security will be measured as receiving the contractually agreed amount at maturity, even though this may be less than the amount originally invested.

Strategy: The Council as at 31st December 2021 has £301.92m of investments (£187m net of external bodies), of which the £45m invested in Pooled Funds (£15m with the Churches, Charities, Local Authorities (CCLA) Property Fund, £15m with a Royal London Investment Grade Credit Fund, and £15m with the M&G Corporate Bond Fund), is for a period longer than 13 months. Given that the Council holds balances and reserves that are by their nature more strategic and longer-term, it seems appropriate to mitigate the risk of existing and forecast low (negative in real terms) interest rates, and risks posed by unsecured bank deposits, by more closely matching longer-term strategic investments to longer-term strategic balances held. The Council therefore aims to hold these more secure and/or higher yielding asset classes during 2022-23. Whilst the revised CIPFA Code may suggest that all investments held for yield should be considered for sale before any new borrowing is taken, (Pooled Funds are deemed to come under this description in the new codes), we believe it appropriate at this time to continue to hold them.

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

Implementation: The Section 151 Officer (Director of Finance & Governance) under delegated powers will undertake the most appropriate form of investments in keeping with the investment objectives, income and risk management requirements and Prudential Indicators. The Director of Finance & Governance in turn delegates responsibility for implementing policy to Treasury Management Officers. This is done by using only the agreed investment instruments, and credit criteria below and in **appendix B.** As is current procedure, the use of a new instrument or counterparty would be proposed in conjunction with the Council's Treasury Advisors, Arlingclose and specifically authorised by the Section 151 Officer (Director of Finance & Governance).

Approved Investments: The list below shows currently approved instruments, with a brief description of current and potential investment instrument characteristics underneath.

- Business Reserve Accounts and term deposits.
- Deposits with other Local Authorities.
- Low Volatility Net Asset Value (LVNAV) Money Market Funds
- The Debt Management Office (DMO)
- Variable Net Asset Value (VNAV) Money Market Funds.
- Gilts and Treasury Bills.
- Certificates of Deposit with Banks and Building Societies
- Commercial Paper
- Use of any public or private sector organisation that meets the creditworthiness criteria rather than just banks and building societies.
- Building Societies – Including unrated Societies with better creditworthiness than their credit rated peers.
- Corporate Bonds – Can offer access to high credit rated counterparties, such as utility, supermarket, and infrastructure companies.
- Covered Bonds and Reverse Repurchase Agreements (Repos) present an opportunity to invest short-term with banks on a secured basis and hence be exempt from bail-in
- Pooled Funds. These funds allow the Council to diversify into asset classes other than those above, without the need to own and manage the underlying investments. Bond, equity and property funds offer enhanced returns over the longer term but are more volatile in the short term. Their values change with market prices, so will be considered for longer investment periods. It would be the Council's intention to be invested in longer-dated Bond Funds, Equity Funds, or Property Funds for at least 3-5 years.

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.

Banks secured: Covered bonds, reverse repurchase agreements and other collateralised arrangements with banks and building societies. These investments are secured on the bank's assets, which limits the potential losses in the unlikely event of insolvency, and means that they are exempt from bail-in.

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.

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.

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.

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

Bond, equity and property funds offer enhanced returns over the longer term but are more volatile in the short term. These allow the Council to diversify into other asset classes without the need to own and manage the underlying investments.

Pooled funds would be the likely vehicles to diversify into more longer-term strategic investments but pose risks to both Security (of market value of investment), and to Liquidity of SCC investments. Because the value of pooled fund investments is subject to market fluctuations, there is a possibility that at any given time, the value of the Council's investment could be less than the original sum. However, there would be no realised loss until such time as the investment was sold. Currently there is a statutory override on accounting treatment that means nominal market losses at year-end do not need to be taken through the Income and Expenditure account if certain criteria are met. This might not always be the case in the future.

This risk is mitigated by taking a longer-term view of any investment, initially at least for 3 to 5-years. This would help to smooth any volatility in market values. Current accounting treatment (runs until 31st March 2023) may mitigate the reputational risk of reporting a loss in the I & E, as a 'Pooled Funds Adjustment Account' reserve will hold any unrealised losses (or gains) in capital value.

As Pooled Funds become a greater part of the overall portfolio, investments would be diversified among asset classes so that risks to any specific asset class would be limited.

Liquidity risk–Typically, Pooled Funds are extremely liquid, but by mitigating the risk of capital loss (by having to sell at a price lower than the initial sum invested), Investment would potentially lock away capital for 3 to 5-years plus. The Section 151 Officer will mitigate liquidity risk by determining the level of prudent investment, with reference to the level of core balances and reserves, commensurate with that timeframe.

Upside risk is that income returns are positive and significantly above today's cash investment rates. There may also be potential for capital growth.

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.

Approved counterparties – Credit Rated: SCC maintains a restricted list of financial institutions to be used as counterparties, and in accordance with the credit criteria set out in appendix B. Any proposed additions to the list must be approved by the Section 151 Officer (Director of Finance & Governance).

Approved counterparties – Non-Credit Rated: As investment decisions are never made solely based on credit ratings, and some institutions may not have ratings at all, account will be taken of any relevant credit criteria in appendix B, and any other relevant factors including advice from our treasury advisors for the approval of individual institutions. Again, this will be specifically authorised by the Section 151 Officer (Director of Finance & Governance).

Credit rating: SCC has constructed and will maintain a counterparty list based on the criteria set out in **Appendix B.** The minimum credit quality is proposed to be set at A- or equivalent. The credit standing of institutions (and issues if used) will be monitored and updated on a regular basis.

The Council will continuously monitor counterparties creditworthiness. All three credit rating agencies' websites will be visited frequently, and all ratings of proposed counterparties will be subject to verification on the day of investment (MHCLG guidance states that a credit rating agency is one of Standard & Poor's, Moody's Investor Services Ltd, and Fitch Ratings Ltd). All ratings of currently used counterparties will be reported to the regular treasury management meeting, where proposals for any new counterparties will be discussed.

New counterparties must be approved by the Section 151 Officer (Director of Finance & Governance) before they are used. Any changes to ratings that put the counterparty below the minimum acceptable credit quality whilst we have a deposit, or a marketable instrument will be brought to the attention of the Section 151 Officer (Director of Finance & Governance) immediately, and an appropriate response decided on a case-by-case basis. Sovereign credit ratings will be monitored and acted on as for financial institution ratings. Investment limits are set by reference to the lowest published long-term credit rating from the three rating agencies mentioned above. Where available, the credit rating relevant to the specific investment or class of investment is used, otherwise the counterparty credit rating is used.

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 those outlined below.

- Credit Default Swaps and Government Bond Spreads.
- GDP and Net Debt as a Percentage of GDP for sovereign countries.
- Likelihood and strength of Parental Support.
- Banking resolution mechanisms for the restructure of failing financial institutions, i.e. bail-in.
- Market information on corporate developments and market sentiment towards the counterparties and sovereigns.
- Underlying securities or collateral for 'covered instruments'.
- Other macroeconomic factors

It remains the Council's policy to suspend or remove institutions that still meet criteria, but where any of the factors above give rise to concern. Also, when it is deemed prudent, the duration of deposits placed is shortened or lengthened, depending on counterparty specific metrics, or general investment factors.

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: Investment limits are set out in **appendix B**. In setting criteria in **appendix B**, account is taken of both expected and possible balances, the availability and accessibility of the various instruments to be used, and their security, liquidity, and yield characteristics.

Liquidity management: The Council uses purpose-built cash flow forecasting software 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.

14 Treasury Management Prudential Indicators

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

The Authorised Limit and Operational Boundary are Prudential Indicators and are authorised by Full Council as part of the Capital Strategy. They are included here for information only. The 'Maturity Structure of Borrowing'', 'Principal sums invested for periods longer than a year', and 'Credit Risk' Indicators are specific Treasury Management Indicators and are to be adopted as per the recommendations set out in this paper.

Authorised limit and Operational Boundary: The Council is required to set an authorised limit and an operational boundary for external debt. The authorised limit is the maximum external debt (net of investments) that may be incurred in the specified years. The operational boundary differs from the authorised limit in that it is based on expectations of the maximum external debt according to probable, not all possible events. It is consistent with the maximum level of external debt projected in the Capital Strategy. In order that the preceding borrowing strategy can be carried out, the following Prudential Indicators have been proposed to Council in the Capital Strategy, along with Capital plans and the rationale behind the figures. They are shown again here to give the full picture. (These figures are rounded to nearest million)

	2022-23 £m	**2023-24 £m**	**2024-25 £m**
Authorised limit			
Borrowing	452	486	510
Other Long-Term Liabilities	51	50	50
Total	503	536	560
Operational boundary			
Borrowing	407	441	465
Other Long-Term Liabilities	43	42	41
Total	450	483	506

Maturity Structure of Borrowing: The Council has set for the forthcoming year, both the upper and lower limits with respect to the maturity structure of its borrowing. The calculation is the amount of projected borrowing maturing in each period, expressed as a percentage of the total projected borrowing. CIPFA Code guidance for the 'maturity structure' indicator states that the maturity of LOBO loans should be treated as if their next option date is the maturity date. The 'maturity structure of borrowing' indicators have been set with regard to this, and having given due consideration to proposed new borrowing, current interest rate expectations, and the possibility of rescheduling or prematurely repaying loans outlined in the borrowing strategy. The bands and limits remain as for 2021-22. They are: -

	Upper Limit	Lower Limit
Under 12 months	50%	15%
>12 months and within 24 months	25%	0%
>24 months and within 5 years	25%	0%
>5 years and within 10 years	20%	0%
>10 years and within 20 years	20%	5%
>20 years and within 30 years	20%	0%
>30 years and within 40 years	45%	15%
>40 years and within 50 years	15%	0%
>50 years	5%	0%

Principal sums invested for periods longer than a year: The purpose of this indicator is to control the Council's exposure to the risk of incurring losses by seeking early repayment of its investments.

The prime policy objectives of local authority investment activities are the security and liquidity of funds, and authorities should avoid exposing public funds to unnecessary or unquantified risk. Authorities should consider the return on their investments; however, this should not be at the expense of security and liquidity. It is therefore important that authorities adopt an appropriate approach to risk management with regards to their investment activities. As the strategy is looking to diversify more into pooled funds, it is the Council's intention to be invested in these for periods of 3-5 years plus. Therefore, a prudential indicator of £75m is deemed necessary for year 1, with similar levels in years 2 and 3 as the investments are to be retained.

	2022-23	**2023-24**	**2024-25**
Prudential Limit for principal sums	**£m**	**£m**	**£m**
invested for periods longer than 1 year	75	75	75

The sums indicated in this indicator do not include any investment in non-Treasury Investments covered by a separate Investment Strategy.

Credit Risk Indicator: The Council has adopted a voluntary measure of its exposure to credit risk by monitoring the value-weighted average credit rating / credit score of its in-house 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 (in conjunction with Arlingclose) and will be calculated quarterly.

Credit risk indicator	Target
Portfolio average credit rating (score)	A (6.0)

15 <u>Other Matters</u>

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

Derivative Instruments: The code requires that the Council must explicitly state whether it plans to use derivative instruments to manage risks. 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). However, the Council does not intend to use derivatives.

Should this position change, the Council may seek to develop a detailed and robust risk management framework governing the use of derivatives, but this change in strategy will require Full Council approval.

External Service Providers: The code states that external service providers should be reviewed regularly and that services provided are clearly documented, and that the quality of that service is controlled and understood.

The Council recognises, as per CIPFA guidance, that, "the overall responsibility for treasury management must always remain with the Council". So as not to place undue reliance on treasury advisors and other external services, the council has always sourced its own information, performed its own analysis of market and investment conditions, and the suitability of counterparties. It continues to do so through embedded practices, thereby maintaining the skills of the in-house team to ensure that services provided can be challenged, and that undue reliance is not placed on them.

Member Training: All public service organisations should be aware of the growing complexity of treasury management in general, and its application to the public services in particular. Modern treasury management, and particularly non-treasury investments demand appropriate skills.

The new Investment Strategy demands a greater level of understanding and involvement by members, and that document sets out the specific requirements for that purpose; However, there should still be an appropriate level of skills and understanding applied to the Treasury Management Strategy.

All Council Members receive introductory training, which includes an overview of the treasury management function. Council Officers would be able and willing to provide a more detailed level of training, if Councillors thought that there would be no conflict of interest.

Through contacts with the CIPFA Treasury Management Forum and its independent Treasury Advisors, SCC could also facilitate training via an independent third party. Officers also have contacts within a number of money market brokers and fund managers who could provide training.

As and when needed, information sheets could be prepared and made available to help keep members abreast of current developments.

Markets in Financial Instruments Directive II (MiFID II): As a result of the second Markets in Financial Instruments Directive (MiFID II), from 3rd January 2018 local authorities were automatically treated as retail clients but could "opt up" to professional client status, providing certain criteria was met. This included having an investment balance of at least £10 million and the person(s) authorised to make investment decisions on behalf of the Council have at least a year's relevant professional experience. In addition, the regulated financial services firms to whom this directive applies have had to assess that that person(s) have the expertise, experience and knowledge to make investment decisions and understand the risks involved. Each regulated Financial Services firm undertakes a separate assessment with ongoing compliance.

The Council continues to meet the conditions to opt up to professional status and has done so in order to maintain its erstwhile MiFID II status prior to January 2018. As a result, the Council will continue to have access to products including money market funds, pooled funds, treasury bills, bonds, shares and to financial advice.

16 Background papers

Local Government Act 2003 – Guidance under section 15(1)(a) 3rd Edition, effective from 1 April 2018.

The CIPFA 'Treasury Management in the Public Services' Code of Practice 2017 Edition, and The CIPFA 'Treasury Management in the Public Services' Code of Practice Revised Edition 2021.

The CIPFA Prudential Code for Capital Finance in Local Authorities: 2017 Edition, and. The CIPFA Prudential Code for Capital Finance in Local Authorities: Revised Edition 2021.

Note: For sight of individual background papers please contact the report author.

Report Sign-Off

		Signed-off
Legal Implications	Honor Clarke	
Governance	Scott Wooldridge	
Corporate Finance	Jason Vaughan	17/1/2022
Human Resources	Chris Squire	
Property	Paula Hewitt / Oliver Woodhams	
Procurement / ICT		
Senior Manager	Stephen Morton	
Commissioning Development	Sunita Mills / Ryszard Rusinek	
Renewal Board		
Local Member		
Cabinet Member	Cllr Mandy Chilcott - Cabinet Member for Resources	14/01/2022
Opposition Spokesperson	Cllr Liz Leyshon	
Scrutiny Chair	Cllr Anna Groskop - Place Scrutiny	
Audit Committee	Cllr Mike Lewis	

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Appendix A

Treasury Management Policy Statement

Introduction and Background

1.1 The Council adopts the key recommendations of CIPFA's Treasury Management in the Public Services: Code of Practice (the code), as described in Section 5 of the Code

1.2 The Council will create and maintain, as the cornerstones for effective treasury and investment management:

- A treasury management policy statement stating the policies, objectives and approach to risk management of its treasury management activities
- Suitable treasury management practices (TMPs) setting out the manner in which the organisation will seek to achieve those policies and objectives, and prescribing how it will manage and control those activities
- Investment management practices (IMPs) for investments that are not for treasury management purposes.

The content of the policy statement, TMPs and IMPs will follow the recommendations contained in Sections 6, 7 and 8 of the TM Code, subject only to amendment where necessary to reflect the particular circumstances of this organisation. Such amendments will not result in the organisation materially deviating from the TM Code's key principles.

1.3 The Council (ie Full Council) will receive reports on its treasury and investment management policies, practices and activities, including, as a minimum, an annual strategy and plan in advance of the year, a mid-year review and an annual report after its close in the form prescribed in its TMPs and IMPs.

1.4 The Council delegates responsibility for the implementation and regular monitoring of its treasury management policies and practices to Cabinet and for the execution and administration of treasury management decisions to the Section 151 Officer, who will act in accordance with the organisation's policy statement, TMPs and IMPs, and if they are a CIPFA member, CIPFA's Standard of Professional Practice on treasury management.

1.5 This organisation nominates the Audit Committee] to be responsible for ensuring effective scrutiny of the treasury management strategy and policies.

Policies and Objectives of Treasury Management Activities

2.1 The Council defines its treasury management activities as:

> "The management of the organisation's borrowing, investments and cash flows, including its banking, money market and capital market transactions, the effective control of the risks associated with those activities and the pursuit of optimum performance consistent with those risks."

2.2 This Council regards the successful identification, monitoring and control of risk to be the prime criteria by which the effectiveness of its treasury management activities will be measured. Accordingly, the analysis and reporting of treasury management activities will focus on their risk implications for the organisation, and any financial instruments entered into to manage these risks.

2.3 This Council acknowledges that effective treasury management will provide support towards the achievement of its business and service objectives. It is therefore committed to the principles of achieving value for money in treasury management, and to employing suitable performance measurement techniques, within the context of effective risk management.

2.4 The Council's borrowing will be affordable, sustainable and prudent and consideration will be given to the management of interest rate risk and refinancing risk. The source from which the borrowing is taken, and the type of borrowing should allow the Council transparency and control over its debt.

2.5 The Council's primary objective in relation to investments remains the security of capital. The liquidity or accessibility of the Council's investments followed by the yield earned on investments remain important but are secondary considerations.

Appendix B

<u>SCC Lending Counterparty Criteria 2022-23</u>

The following criteria will be used to manage counterparty risks to Somerset County Council investments for new deposits / investments from the time that the new Treasury Management Strategy is passed by Full Council at its meeting in February 2022.

Please note that the limits in this appendix apply only to Treasury Management Investments, not to those detailed in the Separate Investment Strategy.

Where deposits held were made under previous criteria, there will be no compulsion to terminate those deposits to meet new criteria, where a penalty would be incurred.

Deposits
Any Financial Institution that is authorised by the Prudential Regulation Authority to accept deposits in the UK, or is a UK Building Society can be lent to, subject to the rating criteria below at the time of the deposit.

Unrated Building Societies
Unrated Building Societies as identified by Treasury Advisors can be used, with a maximum of £1m per Society and a maximum maturity of 1 year.

Marketable Instruments – Any bank, other organisation, or security whose credit ratings satisfy the criteria below: -

Rating of Counterparty or Security
<u>Deposits or instruments of less than 13 months duration (refer to long-term ratings)</u>
Fitch A- or above
S&P A- or above
Moody's A3 or above

The maximum deposit / investment amount for any authorised counterparty or security that has as a minimum at least two ratings of the three above will be £20m. This is approximately 5.6% of maximum balance, 6.4% of average balance for the year to 31st December 2021-22. The % may be significantly less if borrowing up to the CFR is taken early in the year.

The maximum deposit / investment amount for any authorised counterparty or security that has as a minimum - Fitch AA-, S&P AA-, and Moody's Aa3, will be £25m. This is approximately 7.0% of maximum balance, 8.0% of average balance for the year to 31st December 2021-22. The % may be significantly less if borrowing up to the CFR is taken early in the year.

<u>Deposits or instruments of more than 13 months duration (refer to long-term ratings)</u>
Fitch AA- or above
S&P AA- or above
Moody's Aa3 or above

The maximum deposit / investment amount for more than 13 months for any authorised counterparty or security that has as a minimum at least two ratings of the three above will be £10m. This figure is to be included in the overall figure above.

The allowed deposit amounts above are the single maximum per counterparty at any one time, and that counterparty or security must be rated as above or better by at least two of the three agencies. Short-term ratings will be monitored and considered in relative rather than absolute terms.

It remains the Council's policy to suspend or remove institutions that still meet criteria, but where any of the other factors below give rise to concern. Also, when it is deemed prudent, the duration of deposits placed is shortened or lengthened, depending on counterparty specific metrics, or general investment factors.
Where deposits held were made under previous criteria, there will be no compulsion to terminate those deposits to meet new criteria, where a penalty would be incurred.

Operational Bank Accounts
As the Council's current bankers, Nat West are currently within the minimum criteria. If they should fall below criteria, the instant access Call Account facility may still be used for short-term liquidity requirements and business continuity arrangements. This will generally be for smaller balances where it is not viable to send to other counterparties or in the event of unexpected receipts after the daily investment process is complete. Money will be placed in the instant access Nat West call account overnight.

Public Sector Bodies
Any UK Local Authority or Public Body will have a limit of £15m and a maximum maturity of 5 years.

The UK Government, including Gilts, T-Bills, and the Debt Management Office (DMADF) will be unlimited in amount and duration.

Due to the Local Government Reorganisation, it will be appropriate to consider the potential borrowing and investment needs of the other Somerset Councils. If they needed short-term borrowing, it may be possible and appropriate for SCC to cover that need. For this reason, there will be no limit on the lending to the other 4 Somerset Councils.

The table below gives a definition and approximate comparison of various ratings by the three main agencies: -

Definitions of Rating Agency Ratings

	Fitch		Moody's		S&P	
Short-Term	F1+	Exceptionally strong	P-1	Superior	A-1+	Extremely strong
	F1	Highest quality			A-1	Strong
	F2	Good quality	P-2	Strong	A-2	Satisfactory
	F3	Fair quality	P-3	Acceptable	A-3	Adequate
	B	Speculative	NP	Questionable	B and below	Significant speculative characteristics
	C	High default risk				
	(+) or (-)		(1,2, or 3)		(+) or (-)	
Long-Term	AAA	Highest quality	Aaa	Exceptional	AAA	Extremely strong
	AA	V High quality	Aa	Excellent	AA	Very strong
	A	High quality	A	Good	A	Strong
	BBB	Good quality	Baa	Adequate	BBB	Adequate capacity
	BB	Speculative	Ba	Questionable	BB and below	Significant speculative characteristics
	B	Highly Speculative	B	Poor		
	CCC	High default risk	Caa	Extremely poor		

Financial Groups
For Financial Groups (where two or more separate counterparties are owned by the same eventual parent company) investments can be split between entities, but an overall limit equal to the highest rated constituent counterparty within the group will be used.

Country Limits
Excluding the UK, there will be a limit of £30m. This is approximately 8.4% of maximum balance, 9.6% of average balance for the year to 31st December 2021-22. The % may be significantly less if borrowing up to the CFR is taken early in the year.

Money Market Funds
With regulatory changes now effected, previously titled Constant Net Asset Value (CNAV) Money Market Funds have been converted into Low Volatility Net Asset Value (LVNAV) funds. Any LVNAV Fund used must be rated by at least two of the main three ratings agency, and must have the following, (or equivalent LVNAV) ratings.

Fitch AAAmmf	Moody's Aaa-mf	Standard & Poor's AAAm

Subject to the above, deposits can be made with the following limits: -
The lower of £15m or 0.5% of the total value for individual Funds.
No more than 50% of total deposits outstanding are to be held in LVNAV MMFs.

VNAV and other Pooled Funds
Currently, not all Variable Net Asset Value (VNAV) Funds carry a rating. Many VNAV bond funds are not rated. Equity, multi-asset and property funds are also not credit rated.

Whilst it is not currently the Council's intention to invest further in Pooled Funds during 2022-23. The decision to invest in a particular asset class or fund will be primarily based on the liability benchmark, and specifically whether the duration of debt and the necessary level of reserves supports longer-term investments. Secondly, it will consider the evaluation of the risk/reward characteristics including volatility, expected income return and potential for capital growth. Diversification of asset classes/funds and the overall level of investment will be determined by the Section 151 Officer with reference to the level of core balances and reserves. As potential investment would lock away capital for 3 to 5-years plus, the level of prudent investment would be commensurate with the level of core balances and reserves available for/during that timeframe.

Fluctuations in SCC cash balances, and particularly cash balances net of external bodies is difficult to predict over a 3 to 5-year timeframe. Furthermore, the amalgamation of the five Council's portfolios due to LGR will determine strategy in longer-term assets. The Section 151 Officer will determine a suitable level of longer-term investment with reference to the level of core balances and reserves, it may be that a % of core balances and reserves is deemed the most appropriate limit for Pooled Funds, but in any case, this will not exceed £60m in total (Including current Pooled Fund investments of £25m), or £15m in any one fund.

Other Indicators

The Council will continue to use a range of indicators, not just credit ratings. Among other indicators to be taken into account will be:

- Credit Default Swaps and Government Bond Spreads.
- GDP, and Net Debt as a Percentage of GDP for sovereign countries.
- Likelihood and strength of Parental Support.
- Banking resolution mechanisms for the restructure of failing financial institutions, i.e. bail-in.
- Share Price.
- Market information on corporate developments and market sentiment towards the counterparties and sovereigns.
- Underlying securities or collateral for covered instruments.
- Other macroeconomic factors

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Appendix C

Arlingclose Economic Outlook & Interest Rate Forecast

Interest rate forecast:
The MPC will want to build on the strong message it delivered this month by tightening policy despite Omicron uncertainty.

Arlingclose therefore expects Bank Rate to rise to 0.50% in Q1 2022, but then remain there. Risks to the forecast are initially weighted to the upside, but becoming more balanced over time. The Arlingclose central forecast remains below the market forward curve.

Gilt yields will remain broadly flat from current levels. Yields have fallen sharply at the longer end of the yield curve, but expectations of a rise in Bank Rate have maintained short term gilt yields at higher levels.

Easing expectations for Bank Rate over time could prompt the yield curve to steepen, as investors build in higher inflation expectations.

The risks around the gilt yield forecasts vary. The risk for short-and-medium-term yields is initially on the upside but shifts lower later. The risk for long-term yields is weighted to the upside.

The table below highlights the forecast for key benchmark rates

	Dec-21	Mar-22	Jun-22	Sep-22	Dec-22	Mar-23	Jun-23	Sep-23	Dec-23	Mar-24	Jun-24	Sep-24	Dec-24
Official Bank Rate													
Upside risk	0.00	0.00	0.25	0.25	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50
Arlingclose Central Case	0.25	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50
Downside risk	0.00	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25
3-month money market ra													
Upside risk	0.05	0.05	0.25	0.35	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50
Arlingclose Central Case	0.25	0.55	0.55	0.60	0.60	0.60	0.60	0.65	0.65	0.65	0.65	0.65	0.65
Downside risk	0.00	-0.25	-0.25	-0.30	-0.30	-0.30	-0.30	-0.35	-0.35	-0.35	-0.35	-0.35	-0.35
5yr gilt yield													
Upside risk	0.00	0.35	0.45	0.55	0.55	0.55	0.55	0.55	0.55	0.50	0.50	0.45	0.45
Arlingclose Central Case	0.60	0.60	0.60	0.60	0.60	0.60	0.60	0.60	0.60	0.65	0.70	0.75	0.75
Downside risk	-0.10	-0.20	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.30	-0.35	-0.40	-0.40
10yr gilt yield													
Upside risk	0.10	0.25	0.35	0.40	0.45	0.50	0.50	0.50	0.50	0.50	0.55	0.55	0.55
Arlingclose Central Case	0.80	0.85	0.85	0.85	0.85	0.85	0.85	0.85	0.85	0.90	0.90	0.95	0.95
Downside risk	-0.10	-0.25	-0.30	-0.35	-0.35	-0.35	-0.35	-0.35	-0.35	-0.40	-0.40	-0.40	-0.40
20yr gilt yield													
Upside risk	0.30	0.40	0.45	0.45	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50
Arlingclose Central Case	1.00	1.05	1.10	1.10	1.10	1.10	1.15	1.15	1.15	1.20	1.20	1.20	1.20
Downside risk	-0.15	-0.30	-0.35	-0.40	-0.40	-0.40	-0.40	-0.40	-0.40	-0.45	-0.45	-0.45	-0.45
50yr gilt yield													
Upside risk	0.25	0.30	0.40	0.45	0.45	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50
Arlingclose Central Case	0.70	0.75	0.80	0.85	0.90	0.95	1.00	1.05	1.05	1.10	1.10	1.15	1.15
Downside risk	-0.15	-0.30	-0.35	-0.40	-0.40	-0.40	-0.40	-0.40	-0.40	-0.45	-0.45	-0.45	-0.45

PWLB Standard Rate (Maturity Loans) = Gilt yield + 1.00%
PWLB Certainty Rate (Maturity Loans) = Gilt yield + 0.80%
PWLB Infrastructure Rate (Maturity Loans) = Gilt yield + 0.60%

Underlying assumptions:

- The global recovery from the pandemic has entered a more challenging phase. The resurgence in demand has led to the expected rise in inflationary pressure, but disrupted factors of supply are amplifying the effects, increasing the likelihood of lower growth rates ahead. The advent of the Omicron variant of coronavirus is affecting activity and is also a reminder of the potential downside risks.

- Despite relatively buoyant activity survey data, official GDP data indicates that growth was weakening into Q4 2021. Other data, however, suggested continued momentum, particularly for November. Retail sales volumes rose 1.4%, PMIs increased, and the labour market continued to strengthen. The end of furlough did not appear to have had a significant impact on unemployment. Wage growth is elevated.

- The CPI inflation rate rose to 5.1% for November and will rise higher in the near term. While the transitory factors affecting inflation are expected to unwind over time, policymakers' concern is persistent medium term price pressure.

- These factors prompted the MPC to raise Bank Rate to 0.25% at the December meeting. Short term interest rate expectations remain elevated.

- The outlook, however, appears weaker. Household spending faces pressures from a combination of higher prices and tax rises. In the immediate term, the Omicron variant has already affected growth – Q4 and Q1 activity could be weak at best.

- Longer-term government bond yields remain relatively low despite the more hawkish signals from the BoE and the Federal Reserve. Investors are concerned that significant policy tightening in the near term will slow growth and prompt the need for looser policy later. Geo-political and coronavirus risks are also driving safe haven buying. The result is a much flatter yield curve, as short-term yields rise even as long-term yields fall.

- The rise in Bank Rate despite the Omicron variant signals that the MPC will act to bring inflation down whatever the environment. It has also made clear its intentions to tighten policy further. While the economic outlook will be challenging, the signals from policymakers suggest their preference is to tighten policy unless data indicates a more severe slowdown.

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Capital Strategy 2022/23– 2024/25

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Capital Strategy Report 2022/23

Contents

1. Background and Context

This capital strategy is a report for 2022/23, giving a high-level overview of how capital expenditure, capital financing and treasury management activity contribute to the provision of local public services along with an overview of how associated risk is managed and the implications for future financial sustainability.

It addresses the capital components of the wider financial strategies adopted by the Authority. It identifies the links and relationships that need to be made in considering and implementing the Capital Programme to support the County Plan objectives. This is done through the Medium Term Financial Plan (MTFP) and alerts services to the governance and control framework within which the investment planning and delivery takes place.

This is the last budget setting for Somerset County Council, given the local Government Reorganisation in Somerset, and this is reflected in the strategy taken towards capital approvals capital. Firstly by reviewing priorities and slippage in the short-term to reduce the capital programme. Secondly it constrains new programme approvals to only those that are Health and Safety related, those with the highest priority, and those that are wholly externally funded being considered. This strategy therefore has a focus for 2022/23 but as decisions made this year on capital and treasury management will have financial consequences for many years into the future the potential implications for forward years are set out.

This report summarises the requirements of and compliance to both national regulatory and to local policy frameworks. Both the Prudential Code and Treasury Management Code have been revised during December 2021. The revised Codes include clarification and examples of what is and is not classified as prudent borrowing activity. These added principles are intended to protect the public purse and avoid misinterpretation of the Code's provisions. The focus is around strengthening the governance and transparency arrangements surrounding commercial activity as well as actively discouraging this activity funded by borrowing. The other edits include proposing of a liability benchmark to be adopted as a treasury management tool over the coming year and integration of Environmental, Social and Governance risks into the policy framework.

The Capital Programme is the term used for the Council's rolling plan of investment in both its own assets and those of its partners. The programme spans multi-years and contains a mix of individual schemes, many spanning more than one year. Some schemes will be specific investment projects while others may provide for an overarching schedule of thematic works e.g. "Highways".

Investing in assets can include expenditure on:

- Infrastructure such as highways, open spaces, coast protection;
- New build;
- Enhancement of buildings through renovation or remodelling;
- Major plant, equipment and vehicles;
- Capital contributions to other organisations enabling them to invest in assets that contributes to the delivery of the Council's priorities.

The Capital Programme is distinct from the Council's revenue budget which funds day-to-day services, but they are both linked and are managed together. This ensures they contribute to the Council's objectives set out in the County Plan to achieve the most beneficial balance of investment within the resources available.

There is a strong link with the Treasury Management Strategy[1] that provides a framework for the borrowing and lending activity of the Council supporting the historic investment programme. This capital strategy and the capital MTFP align to service planning and the corporate asset strategy. Asset information is overseen by the Corporate Property Group which manages the built estate as Corporate Landlord and additional (non-property information) is maintained by Services.

2. Capital Expenditure and Financing

Capital expenditure is where the Council spends money on assets, such as property or vehicles, that will be used for more than one year. In local government this includes spending on assets owned by other bodies, and loans and grants to other bodies enabling them to buy assets.

The Council has the ability to set a de-minimis level to capture only significant assets, however does not opt to do so. This allows the Council to review every item of expenditure and capitalise as appropriate.

- For details of the Council's policy on capitalisation, see the accounting policy (No.13 PPE) within the annual statement of accounts: gov.uk/how-the-council-works/budgets-and-accounts/

[1] Treasury Management Strategy link: *to be added when approved at Full Council*

In 2022/23, the Council is planning capital expenditure of £107.728m. The following table shows our planned spend for the future:

Table 1: Estimates of Capital Expenditure

	2020/21 actual £m	**2021/22 forecast £m**	**2022/23 budget £m**	**2023/24 budget £m**	**2024/25 budget £m**
Capital Expenditure	122.091	173.773	109.244	45.902	16.159

This table includes both the current approved capital programme and the proposed 2022/23 programme due to be put to Full Council on 23rd February 2022. For example, the 2022/23 budget of £109.244m is made up of £72.162m current programme and £37.082m 2022/23 proposed new schemes.

Service managers bid annually to include projects in the Council's capital programme. Bids are collated by corporate finance who calculate the financing cost (which can be nil if the project is fully externally financed). The bids are appraised against a set criterion including a comparison of service priorities against the affordability of the financing costs. The Senior Leadership Team undertakes a final review before the draft capital programme is then presented to relevant Scrutiny Committee(s) prior to its consideration by the Cabinet in February for recommendation to Council in February each year.

For full details of the Council's 2022/23 capital programme, see section 16 of the main 2022/23 MTFP report and appendix 7 of the papers to Full Council on 23rd February 2022.

All capital expenditure must be financed, either from external sources (government grants and other contributions such as S106 and CIL), the Council's own resources (revenue, reserves and capital receipts) or debt (borrowing, leasing and Private Finance Initiative). The planned financing of the above expenditure is as follows:

Table 2: Capital financing

	2020/21 actual £m	2021/22 forecast £m	2022/23 budget £m	2023/24 budget £m	2024/25 budget £m
External sources	81.219	134.144	65.008	15.925	10.222
Own resources:					
Capital receipts	1.172	6.468	2.484	1.432	0.000
Revenue / Reserves	1.291	0.704	1.060	0.000	0.000
Debt	39.219	32.457	40.692	28.545	5.937
TOTAL	**122.901**	**173.773**	**109.244**	**45.902**	**16.159**

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). Planned MRP budgets are as follows:

Table 3: MRP for the repayment of debt

	2020/21 actual £m	2021/22 forecast £m	2022/23 budget £m	2023/24 budget £m	2024/25 budget £m
Own resources	3.620	4.382	5.329	6.286	7.254

- The Council's full minimum revenue provision statement is available in appendix 9 of the 2022/23 MTFP papers to Full Council on 23rd February 2022.

The Council's cumulative outstanding amount of debt finance is measured by the capital financing requirement (CFR). This increases with new debt-financed capital expenditure and reduces with MRP, lease principal repayments and capital receipts used to replace debt. The CFR is expected to increase by £34.044m during 2022/23. Based on the above figures for expenditure and financing, the Council's estimated CFR is as follows:

Table 4: Prudential Indicator: Estimates of Capital Financing Requirement

	31.03.2021 actual £m	31.03.2022 forecast £m	31.03.2023 budget £m	31.03.2024 budget £m	31.03.2025 budget £m
TOTAL CFR	**458.106**	**484.976**	**520.020**	**549.949**	**547.740**

Asset disposals: 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. The Council plans to receive £5.150m of capital receipts in the current financial year.

Table 5: Capital receipts

	2020/21 actual £m	2021/22 forecast £m	2022/23 budget £m
TOTAL asset sales	**6.047**	**5.150**	**5.000**

Department for Levelling Up, Housing and Communities (DLUHC) have issued a ‘flexible use of capital receipts’ directive. This allows transformation projects which will save revenue budget to be funded from capital receipts. This directive was issued in 2016 and as part of Government announcements in February 2021 this is extended to March 2026. The authority’s use of receipts under this directive is a total of £17.267m to March 2020. The Authority has not applied the directive since, however this additional flexibility remains available. An Efficiency Strategy will be required if this flexibility is recommended and would require full Council approval.

3. Treasury Management

Treasury management is the activity of 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 typically runs a cash surplus in the short term, particularly at the start of the financial year, as revenue income is received before it is spent.

Due to decisions taken in the past, the Authority currently has long term borrowing of £324.550m at an average interest rate of 4.66%. The authority continues to maximise the use of the cash held before taking costly external debt, this is referred to as internal borrowing. It is anticipated the level of internal borrowing at 31/03/2022 will be £76.410m.

The budget for debt interest paid in 2022/23 is £15.378m, based on an average debt portfolio of £364.550m at an average interest rate of 4.21%. The budget for Treasury and strategic investment income in 2022/23 is £1.360m, based on an average investment portfolio of £220m at an average return of 0.7%. (These figures are net of balances held on behalf of external investors i.e. the Local Enterprise Partnership).

Borrowing strategy: The Council's main objectives when borrowing continues to address the key issue of affordability without compromising the longer-term stability of the debt portfolio. It strives to achieve as low but more certain cost of finance while retaining flexibility should plans change in future. These objectives are often conflicting, and the Council therefore seeks to strike a balance between cheaper short-term loans (currently available at around 0.10%) and long-term fixed rate loans where the future cost is known but is higher (currently 1.5 to 2.5%).

Projected levels of the Council's total outstanding debt (which comprises of borrowing and Private Financing Initiatives (PFI) liabilities, are shown below, compared with the capital financing requirement (with reference to table 4 above).

Table 6: Prudential Indicator: External Debt and the Capital Financing Requirement

	31.3.2021 actual £m	31.3.2022 forecast £m	31.3.2023 budget £m	31.3.2024 budget £m	31.3.2025 budget £m
Short term debt	7.220	10.000	10.000	10.000	10.000
Long term debt *	334.173	332.099	325.814	312.993	288.701
Assumed debt not yet taken	0.000	0.000	40.000	80.000	120.000
PFI & leases	42.533	39.872	38.669	37.350	36.031
Total external borrowing	**383.926**	**381.971**	**414.483**	**440.343**	**454.732**
Capital Financing Requirement	**458.106**	**484.976**	**529.020**	**549.949**	**547.740**

*(reduces for MRP set aside & actual debt repayments)

Statutory guidance is that debt should remain below the capital financing requirement, except in the short-term. As can be seen from table 6, the Council expects to comply with this in the medium term.

Affordable borrowing limit: The Council is legally obliged to set an affordable borrowing limit (also termed the authorised limit for external debt) each year. In line with statutory guidance, a lower "operational boundary" is also set as a warning level should debt approach the limit.

Table 7: Prudential Indicators: Authorised limit and operational boundary for external debt

	2020/21 limit £m	2021/22 limit £m	2022/23 limit £m	2023/24 limit £m	2024/25 limit £m
Authorised limit – borrowing	399.570	397.572	451.924	485.927	509.649
Authorised limit – PFI and leases	55.533	52.872	51.301	49.989	49.677
Authorised limit – total external debt	**455.103**	**450.444**	**503.225**	**535.916**	**559.326**
Operational boundary – borrowing	369.570	367.572	406.924	440.927	464.649
Operational boundary – PFI and leases	47.533	44.872	43.301	41.989	40.677
Operational boundary – total external debt	**417.103**	**412.444**	**450.225**	**482.916**	**505.326**

**There is a change to the accounting standards for leasing, due for adoption 1st April 2022 having been deferred by 1 year as announced by CIPFA in November 2020. The impact of this will be to bring all material leases greater than one year onto the authority's balance sheet, thus creating additional borrowing liability, this is estimated to be £6.7m. Any new leases being entered during 2022/23 will also effect the limits and an estimate of this has been allowed for separately within the Authorised borrowing Limit.*

4. Investment Strategy

Treasury investments: is the management of the Council's cash flows, borrowing and treasury investments, and the associated risks. The Council has significant debt and treasury investment portfolios 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.

Investments made for service reasons or for the purpose of generating a positive income (net of costs), known as non-treasury investments, are not considered to be part of treasury management.

This capital strategy contains the prudential indicators approved by the Council. The Treasury management strategy contains further details on treasury investments criteria and governance. There are also 3 Treasury management indicators that are set out in section 4 of the Treasury Management Strategy for the adoption by the Council.

- the Treasury Management Strategy can be found as item 9 on the Cabinet agenda for 8th February 2021 and as part of the 2021/22 MTFP papers to Full Council on 17th February 2021.

Risk management: No treasury management activity is without risk. The successful identification, monitoring and control of risks are the prime criteria by which the effectiveness of its treasury management activities will be measured. The main risks to the Council's treasury activities are:

- Credit and Counterparty Risk (security of investments)
- Liquidity Risk (inadequate cash resources)
- Market or Interest Rate Risk (fluctuations in price / interest rate levels)
- Refinancing Risk (impact of debt maturing in future years)
- Legal & Regulatory Risk.

The Authority's policy on treasury investments is to prioritise security and liquidity over yield; that is to focus on minimising risk rather than maximising returns in accordance with DLUHC guidance. 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, 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. The strategy includes some prudential indicators which manage risk in setting the boundaries.

Governance: Decisions on treasury management investment and borrowing are delegated to the Director of Finance & Governance and staff, who must act in line with the annual treasury management strategy approved by Full Council each year. In formulating the Treasury Management Strategy, and the setting of Prudential Indicators, Somerset County Council (SCC) adopts the Treasury Management Framework and Policy recommended by CIPFA, see **appendix A** of the Treasury Management Strategy.

Further governance is provided by the comprehensive Treasury Management Practices (TMP's) which set out the main categories of risk that may impact on the achievement of Treasury Management objectives.

A mid-year and an annual outturn report on treasury management activity are presented to Full Council. The audit committee is responsible for scrutinising treasury management decisions.

Treasury (Commercial) investments: Describing the Council's approach to non-treasury investment is a requirement of the DLUHC.

With central government financial support for local public services declining, the Council explored the options of investing in non-treasury investments purely or mainly for financial gain. With financial return being the main objective, with this comes higher risk on commercial investment than with treasury investments. Borrowing to invest purely for commercial income gain is strongly discouraged by Treasury, to the point the PWLB is explicit in not being used for this sole purpose. The revision to the Prudential Code, 2021, also tightens the regulatory controls on this type of activity. Given both considerations the Authority does not plan to make this type of investment and therefore does not have a current Investment Strategy.

As it remains an option available to the Authority, a policy paper was endorsed at Cabinet on 18th December 2019, the full paper can be found here; http://democracy.somerset.gov.uk/ieListDocuments.aspx?CId=134&MId=740&Ver=4

This sets out the regulatory boundaries, options available and outlines the appropriate governance be put in place should any of the arrangements be taken forward.

5. Other long-term liabilities

In addition to debt of £383.926m detailed above, the Council is committed to making future payments to cover its pension fund deficit. The deficit reported in the 2020/21 accounts was £993.554m (as at 31/03/2021). It has also set aside £11.194m (as at 31/03/2021) as a provision to cover risks of insurance claims, business rate appeals and other legal claims. The Council is also at risk of having to pay for contingent liabilities but has not put aside any money because of the low risk and uncertainties around potential value.

Governance: Decisions on incurring new discretional liabilities will initially be considered by service managers for discussion with the relevant director. If it is recommended that the liability may be undertaken then the relevant director will consult with the Chief Finance Officer (S151 Officer), Monitoring Officer and County Solicitor before any recommendation is made to the Senior Leadership Team prior to any decisions taken. Depending on the extent of the liability envisaged, it may be necessary to make a formal decision through a democratic process. The risk of liabilities crystallising and requiring payment is monitored by corporate finance and reported quarterly to audit committee. New liabilities exceeding £500m are reported to Cabinet and Full Council for approval.

- Further details on provisions and contingent liabilities are on pages 145 and 158 of the 2020/21 statement of accounts: http://www.somerset.gov.uk/information-and-statistics/financial-information/budgets-and-accounts/

6. Revenue Budget Implications

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

Table 8: Prudential Indicator: Proportion of financing costs to net revenue stream

	2020/21 actual	**2021/22 forecast**	**2021/23 budget**	**2023/24 budget**	**2024/25 budget**
Financing costs (£m)	23.907	24.621	25.735	26.810	27..841
Proportion of net revenue stream	6.63%	6.59%	6.43%	6.57%	6.75%

- Further details on the revenue implications of capital expenditure can be found in section 16 of the main 2022/23 MTFP report to Full Council on 23rd February 2022.

Sustainability: Due to the long-term nature of capital expenditure and financing, the revenue budget implications of expenditure incurred in the next few years will extend into the future years. The Director of Finance & Governance is satisfied the proposed capital programme is prudent, affordable and sustainable. This follows full challenge of all capital bids against set criteria of affordability and service need.

Only schemes that will have fully approved funding in place are consider as part of the capital programme and the cost impact of borrowing forms part of the revenue medium term financial planning.

7. Knowledge and Skills

The Council employs professionally qualified and experienced staff in all positions with responsibility for making capital expenditure, borrowing and investment decisions. For example, the Director of Finance & Governance and section 151 Officer will always be a qualified accountant with substantial experience and there is a range of significant experience and expertise within the Treasury Team. Where necessary, the Council pays for junior staff to study towards relevant professional qualifications, for example CIPFA.

Where the Council needs additional resources, external validation of officers work or 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. This approach is more cost effective than employing additional resources directly and ensures that the Council has access to knowledge and skills commensurate with its risk appetite.

Minimum Revenue Provision Statement 2022/23

Where the Authority 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). Under Regulation 27 of the Local Authorities (Capital Finance and Accounting) (England) Regulations 2003 [as amended], local authorities are required to charge a Minimum Revenue Provision (MRP) to their revenue account in each financial year. Before 2008, the 2003 Regulations contained details of the method that local authorities were required to use when calculating MRP. This has been replaced by the current Regulation 28 of the 2003 Regulations, which gives local authorities flexibility in how they calculate MRP, providing the calculation is 'prudent'. In calculating a prudent provision, local authorities are required to have regard to statutory guidance (issued by the Secretary of State).

An underpinning principle of the local authority financial system is that all capital expenditure must be financed either from capital receipts, capital grants (or other contributions) or eventually from revenue income. The broad aim of prudent provision is to require local authorities to put aside revenue over time to cover their Capital Financing Requirement (CFR). In doing so, local authorities should align the period over which they charge MRP to one that is commensurate with the <u>period over which their capital expenditure provides benefits</u> (often referred to as 'useful economic life').

The guidance requires the Authority to approve an Annual MRP Statement each year and recommends several options for calculating a prudent amount of MRP.

Having reviewed the options suggested by the guidance and considered the historic information available to the authority for previous years capital expenditure funded from un-supported borrowing, the Authority proposes to continue an MRP policy based on two distinct components:

1. An element based on the period the capital expenditure provides benefit to the authority, as per the maximum useful economic lives (UEL) in the table below:

ASSET CLASS	MAXIMUM UEL
Freehold Land	999 years
Freehold Buildings	99 years (dependant on specific-asset information provided by the Council's RICS qualified valuation team)
Leased Land	Length of lease term or asset UEL, whichever is lower
Leased Buildings	Length of lease term or asset UEL, whichever is lower
Plant & Equipment (owned)	10 years
Plant & Equipment (leased)	Length of lease term or asset UEL, whichever is lower
IT	7 years
Intangible (software licences)	Length of licence term
Vehicles	8 years
Infrastructure	64 years
Heritage	999 years
Assets Held for Sale	Dependant on the asset class prior to being reclassified as held for sale

- For un-supported loans funded capital expenditure prior to 1st April 2018 there was no direct link between individual assets and their funding types, so it has not been possible for the authority to analyse the CFR (as at 31st March 2018) by specific loans-funded assets. It is the Council's intention to apportion the CFR balance (as at 31st March 2018) of £366.115m over the weighted average life (based on the useful economic lives) of the Council's entire asset portfolio – as reported in the 17/18 published accounts.

- Any capital expenditure funded from un-supported borrowing post 1st April 2018 <u>will</u> have a direct link to the benefit being received (asset) on the accounting system, it is therefore the Council's intention to put aside revenue for this element of the CFR on an asset by asset basis – having considered the useful economic lives in the table above.

Paragraph 40 of the statutory guidance suggests that the MRP should normally commence in the financial year following the one in which the expenditure was incurred; so capital expenditure incurred during 2022/23 will not be subject to a MRP charge until 2023/24.

2. An additional element to ensure the authority has enough put aside to meet the repayment dates of the loans when they fall due.

Paragraph 14 of the statutory guidance identifies a concern over an authorities' ability to fully provide for its debt based on current levels of MRP. As relying on continuing access to PWLB to repay debt when it falls due does not represent a prudent approach, we are continuing to make an additional MRP payment, to date £3.6m, over and above the MRP charge identified in point 1. This additional amount is planned to ensure we have enough put aside to meet the repayment dates of existing debt instruments when they fall due. This has been confirmed by a detailed review of the current debt maturity profile. We will continue to monitor the MRP and repayment profile of the Council's debt instruments, and if future borrowing creates a potential shortfall, we will increase the additional MRP accordingly to ensure significant provision is put aside.

Based on the Authority's estimated Capital Financing Requirement on 31st March 2022 of £529.020, the budget for 2022/23 MRP has been set as follows:

	2022/23 MRP £m
Capital Expenditure	
Capital expenditure before 01.04.2018	1.039
Capital expenditure incurred 2018/19 to 2020/21	2.144
Capital expenditure estimated for 2021/22	1.146
Additional prudent provision	1.000
Total	**5.329**

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Grant Thornton

Somerset County Council and Pension Fund Audit Progress Report and Sector Update

Year ending 31 March 2021

12 January 2022

Contents

The contents of this report relate only to the matters which have come to our attention, which we believe need to be reported to you as part of our audit planning process. It is not a comprehensive record of all the relevant matters, which may be subject to change, and in particular we cannot be held responsible to you for reporting all of the risks which may affect the Council or all weaknesses in your internal controls. This report has been prepared solely for your benefit and should not be quoted in whole or in part without our prior written consent. We do not accept any responsibility for any loss occasioned to any third party acting, or refraining from acting on the basis of the content of this report, as this report was not prepared for, nor intended for, any other purpose.

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Introduction

This paper provides the Audit 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 (theseare a tool to use, if helpful, rather than formal questions requiring responses for audit purposes)

Members of the Audit 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.

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Progress at January 2022

Financial Statements Audit

We undertook our initial planning in March 2021 to inform the Audit Plan.

In June 2021 we issued a detailed audit plan, setting out our proposed approach to the audit of the Council and Pension Fund's 2020/21 financial statements.

The Accounts and Audit (Amendment) Regulations 2021 pushed back the date by which principal authorities needed to publish their draft financial statements to the first working day of August. In 2020 this date was pushed back to 31 August. The Council published their accounts ahead of the deadline.

The date by which authorities were required to publish audited financial statements was 30 September. In 2020 this date was pushed back to 30 November.

We began our work on your draft financial statements in August 2021.

We reported the findings from our work in the Audit Findings Report (AFR) to the Committee in November 2021 and provided an unqualified opinion on the financial statements on 30th November 2021.

Value for Money

The new Code of Audit Practice (the "Code") came into force on 1 April 2020 for audit years 2020/21 and onwards. The most significant change under the new Code is the introduction of an Auditor's Annual Report, containing a commentary on arrangements to secure value for money and any associated recommendations, if required.

The new approach is more complex, more involved and is planned to make more impact.

Under the 2020 Code of Audit Practice, for relevant authorities other than local NHS bodies auditors are required to issue our Auditor's Annual Report no later than 30 September or, where this is not possible, issue an audit letter setting out the reasons for delay.

As a result of the ongoing pandemic, and the impact it has had on both preparers and auditors of accounts to complete their work as quickly as would normally be expected, the National Audit Office (NAO) has updated its guidance to auditors to allow us to postpone completion of our work on arrangements to secure value for money and focus our resources firstly on the delivery of our opinions on the financial statements. This is intended to help ensure as many as possible could be issued in line with national timetables and legislation. The extended deadline for the issue of the Auditor's Annual Report is now no more than three months after the date of the opinion on the financial statements.

For Somerset County Council the deadline for completion of this work is 28th February 2022.

Our VFM work is in progress and we will issue our Auditors Annual Report prior to the 3 month deadline.

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Progress at January 2022 (cont.)

Other areas

Certification of claims and returns

We also certify the Authority's Teachers Pensions' Return in accordance with procedures agreed with the Teachers' Pension Agency. The certification work for the 2020/21 return was reported on 30th November 2021, in advance of the deadline.

No amendments or significant issues were reported as part of our work.

IAS19 Assurance Letters to Admitted Bodies auditors

We have provided written assurances to the auditors of admitted bodies to the Pension Fund in accordance with the agreed timescales.

Meetings

We continue to meet regularly with senior Finance Officers as part of our regular liaison meetings and continue to be in discussions with finance staff regarding emerging developments and to ensure the audit process is smooth and effective.

Events

We provide a range of workshops, along with network events for members and publications to support the Council. Your officers will be invited to attend our Financial Reporting Workshop in January and February 2022, 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. 2020/21 is the third 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 and 2019/20 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 discussed this with your s151 Officer including any proposed variations to the Scale Fee set by PSAA Limited, and have communicated fully with the Audit Committee. The final proposed fees for the 2020/21 audit are included within the Progress Report.

As a firm, we are absolutely committed to meeting the expectations of the FRC with regard to audit quality and local government financial reporting.

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Audit Deliverables

2020/21 Deliverables	Planned Date	Status
Audit Plan We are required to issue a detailed audit plan to the Corporate Governance Committee setting out our proposed approach in order to give an opinion on the Council's 2020/21 financial statements and the Auditor's Annual Report on the Council's Value for Money arrangements.	July 2021	Complete
Audit Findings Report The Audit Findings Report was reported to the December Committee.	November 2021	Complete
Auditors Report This includes the opinion on your financial statements.	November 2021	Complete
Auditor's Annual Report This Report communicates the key issues arising from our Value for Money work.	February 2022	In Progress

2020/21 Audit-related Deliverables	Planned Date	Status
Teachers' Pension Return – certification This is the report we submit to the Teachers' Pension Agency based upon the mandated agreed upon procedures we are required to perform.	30 November 2021	Complete
IAS19 Assurance Letters to Admitted Body Auditors These are the letters that we provide to the auditors of admitted bodies to the Pension Fund, on request, to provide assurance over the controls in place with the administration of the Pension Fund and the valuations of investments.	Various – depending on specific requests	Complete

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Financial Reporting Council annual report

On 29 October, the Financial Reporting Council (FRC) published its annual report setting out the findings of its review of the work of local auditors. The report summarises the results of the FRC's inspections of twenty audit files for the last financial year. A link to the report is here:

FRC AQR Major Local Audits October 2021

Grant Thornton are one of seven firms which currently delivers local audit work. Of our 330 local government and NHS audits, 87 are currently defined as 'major audits' which fall within the scope of the AQR. This year, the FRC looked at nine of our audits.

Our file review results

The FRC reviewed nine of our audits this year. It graded six files (67%) as 'Good' and requiring no more than limited improvements. No files were graded as requiring significant improvement, representing an impressive year-on-year improvement. The FRC described the improvement in our audit quality as an 'encouraging response by the firm to the quality findings reported in the prior year.' Our Value for Money work continues to be delivered to a high standard, with all of the files reviewed requiring no more than limited improvement. We welcome the FRC findings and conclusions which demonstrate the impressive improvement we have made in audit quality over the past year.

The FRC also identified a number of good practices including effective challenge of management's valuer, use of an auditor's expert to assist with the audit of a highly specialised property valuation, and the extent and timing of involvement by the audit partner on the VFM conclusion.

Our "Opinion" results over the past three years are shown in the table below:

Grade	Number 2020/21	Number 2019/20	Number 2018/19
Good with limited improvements (Grade 1 or 2)	6	1	1
Improvements required (Grade 3)	3	5	2
Significant improvements required (Grade 4)	0	0	1
Total	**9**	**6**	**4**

Our "VFM" results over the past two years are shown in the table below. The FRC did not review VFM in 2018/19:

Grade	Number 2020/21	Number 2019/20
Good with limited improvements (Grade 1 or 2)	6	6
Improvements required (Grade 3)	0	0
Significant improvements required (Grade 4)	0	0
Total	**6**	**6**

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Financial Reporting Council annual report (cont.)

Quality Assurance Department (QAD) Reviews

In addition to the reviews undertaken by the FRC on major local audits, the QAD team from the ICAEW undertake annual reviews of non-major local audits as well as reviews of Foundation Trusts on behalf of NHSE&I.

The QAD reviewed five of our audits this year and graded all of them (100%) as 'Satisfactory / generally acceptable' for both the financial statements and VFM elements of the audit, which is the highest grading.

Grade	Number 2020/21	Number 2019/20	Number 2018/19
Satisfactory / generally acceptable	5	6	2
Improvement required	0	1	0
Significant improvement required	0	0	0
Total	5	7	2

Our continued commitment to Audit quality and continuous improvement

Our work over the past year has been undertaken during the backdrop of COVID-19, when the public sector has faced the huge challenge of providing essential services and helping safeguard the public during the pandemic. Local government, in particular, have been at the forefront of supporting local communities and businesses.

As auditors we have had to recognise the competing priorities and challenges facing the finance teams and the whole local government sector whilst staying focused on the principles of good governance and financial management, things which are more important than ever. We are very proud of the way we have worked effectively with audited bodies, demonstrating empathy in our work whilst still upholding the highest audit quality.

Over the coming year we will make further investments in audit quality including strengthening our quality and technical support functions, and increasing the level of training, support and guidance for our audit teams. We will address the specific improvement recommendations raised by the FRC, including:

- Enhanced training for local auditors on key assumptions within property valuations, and how to demonstrate an increased level of challenge
- Formalising our arrangements for the consideration of complex technical issues by Partner Panels.

As part of our enhanced Value for Money programme, we will focus on identifying the scope for better use of public money, as well as highlighting weaknesses in governance or financial stewardship where we see them.

Conclusion

Local audit plays a critical role in the way public sector audits and society interact, and it depends on the trust and confidence of all those who rely on it. As a firm we're proud to be doing our part to promote good governance, effective stewardship and appropriate use of public funds.

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Final Audit Fees for 2020-21

We confirm below our final fees charged for the audit and provision of non-audit services.

Audit fees for Somerset County Council Audit	**2019-20 Final Fee	2020-21 Planned fee	* 2020-21 Final fee
Scale Fee published by PSAA	76,902	76,902	76,902
Raising the bar / regulatory factors / local VFM issues	9,500	9,500	9,500
Enhanced audit procedures for Property, Plant and Equipment	4,850	7,350	7,350
Enhanced audit procedures for Pensions	3,000	2,500	2,500
Increased audit requirements of revised ISA's and Accounting Standards	2,000	11,500	11,500
Additional work on Value for Money (VFM) under new NAO Code	-	19,000	19,000
Additional work due to Covid-19 and client issues	43,420	-	-
Total audit fees (excluding VAT)	£139,672	£126,752	£126,752

Audit fees for Somerset Pension Fund Audit	** 2019-20 Final Fee	2020-21 Planned fee	* 2020-21 Final fee
Scale Fee published by PSAA	18,371	18,371	18,371
Raising the bar / regulatory factors	2,000	2,000	2,000
Enhanced audit procedures for Level 3 Investment Valuations	1,750	1,750	1,750
Increased audit requirements of revised ISA's (540 / 240 / 700)	-	8,000	8,000
Additional work due to Covid-19 and client delays		-	-
Total audit fees (excluding VAT)	£28,521	£30,121	£30,121

Non-audit fees for other services	Proposed fee	Final fee
Certification of Teachers' Pension Fund return	5,000	5,000
IAS 19 Procedures for admitted bodies	7,000	7,000
Total non-audit fees (excluding VAT)	£12,000	£12,000

- The final fee variation is subject to approval by PSAA.

** As approved by PSAA in respect of the 2019-20 audit

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Sector Update

Page 84

Authorities 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 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

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What can be learned from Public Interest Reports?– Grant Thornton

2020 will be remembered as a tumultuous year in local government, with the pandemic creating unprecedented pressure on the sector. It also saw the appearance of two Public Interest Reports (PIRs), followed by another in January this year – the first to be issued in the sector since 2016. PIR's can be issued by local auditors if there are significant concerns around council activity, such as major failings in finance and governance.

The recent PIRs have made headlines because, up to this point, very few have ever been issued. But, as our latest report "Lessons from recent Public Interest Reports" explores, all three illustrate some of the fundamental issues facing the wider sector and provide a lesson for all local authorities around: weaknesses in financial management; governance and scrutiny practices; and council culture and leadership; which, when combined, can provide fertile ground for the kind of significant issues we might see in a PIR.

The COVID-19 pandemic highlighted four essential factors we probably always knew about local government, have often said, but which are now much better evidenced:

1) Local government has provided fantastic support to its communities in working with the NHS and other partners to deal with the multifaceted challenges of the pandemic.
2) Britain's long centralised approach to government has been exposed to some degree in terms of its agility to tailor pandemic responses to regional and local bodies. This is recognised by the current government who continue to pursue the options for devolution of powers to local bodies. Track and Trace delivered centrally has not been as successful as anticipated and, according to government figures, local interventions have had more impact.
3) Years of reduced funding from central government have exposed the underlying flaws in the local authority business model, with too much reliance on generating additional income.
4) Not all authorities exercise appropriate care with public money; not all authorities exercise appropriate governance; and not all authorities have the capability of managing risk, both short and long term. Optimism bias has been baked into too many councils' medium-term plans.

The PIRs at Nottingham City Council (August 2020), the London Borough of Croydon (October 2020), and Northampton Borough Council (January 2021) are clear illustrations of some of the local government issues identified above. The audit reports are comprehensive and wide-ranging and a lesson for all local authorities. Local authorities have a variety of different governance models. These range from elected mayor to the cabinet and a scrutiny system approach, while others have moved back to committee systems. Arguments can be made both for and against all of these models. However, in the recent PIR cases, and for many other local authorities, it's less about the system of governance and more about how it operates, who operates it and how willing they are to accept scrutiny and challenge.

There are a number of lessons to be learned from the recent PIR reports and these can be broken down into three key areas which are explored further in our report:

1) The context of local government in a COVID-19 world
2) Governance, scrutiny, and culture
3) Local authority leadership.

The full report is available here:

https://www.grantthornton.co.uk/en/insights/lessons-from-recent-public-interest-reports/

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Annual Transparency Report – Grant Thornton

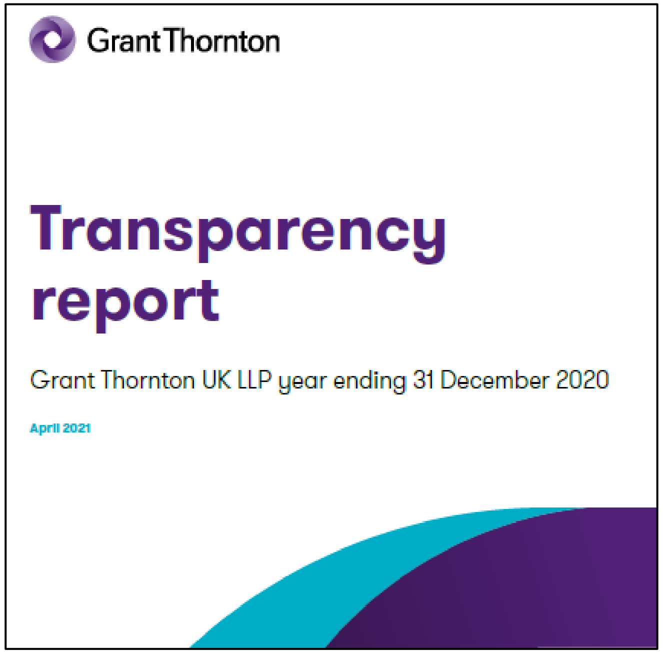
As auditors of several listed entities as well as nearly one hundred major local audits, we are required as a firm to publish an annual transparency report.

The report contains a variety of information which we believe is helpful to audit committees as well as wider stakeholders. The Financial Reporting Council (FRC) in their thematic review of transparency reporting noted that they are keen to see more Audit Committee Chairs actively engaging and challenging their auditors on audit quality based on the information produced in Transparency reports on a regular basis. We agree with the FRC and are keen to share our transparency report and discuss audit quality with you more widely.

The transparency report provides details of our:

- Leadership and governance structures
- Principal risks and Key Performance Indicators
- Quality, risk management and internal control structure
- Independence and ethics processes
- People and culture
- Compliance with the Audit Firm Governance code and EU Audit directive requirements

We have made significant developments in the year as part of our Local Audit Investment Plan to improve our audit quality. We welcome an opportunity to discuss these developments and our transparency report should you wish.


GrantThornton

Transparency report

Grant Thornton UK LLP year ending 31 December 2020

April 2021

The full report is available here:

[Transparency report 2020 (grantthornton.co.uk)]

Local authority Covid-19 pressures – MHCLG

Outturn figures from the Ministry of Housing, Communities & Local Government (MHCLG) show that local authorities in England reported additional cost pressures of £12.8bn relating to COVID-19 in 2020-21. Overall, local authorities spent £7.2bn responding to the pandemic last year, with the largest share of additional expenditure going on adult social care services at £3.2bn.

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Additional expenditure due to COVID-19 by class and service area (£ millions) (2020-21)

	Shire District	Shire County	Unitary Authority	Metropolitan District	London Borough	Total
Adult Social Care – total	0.473	1,254.880	848.656	663.404	413.842	**3,181.254**
Children's social care - total (excluding SEND)	0.000	94.933	131.127	89.799	62.987	**378.846**
Housing - total (including homelessness services) excluding HRA	63.129	5.254	74.949	42.281	112.971	**298.584**
Environmental and regulatory services - total	33.564	68.097	67.512	66.704	63.556	**299.433**
Finance & corporate services - total	48.222	53.445	83.984	76.923	78.284	**340.858**
All other service areas not listed in rows above	184.550	634.578	584.924	564.737	395.137	**2,363.926**
Total	**329.937**	**2,111.187**	**1,791.153**	**1,503.848**	**1,126.777**	**6,862.902**

Income losses due to COVID-19 by class and source of income (£ millions) (2020-21)

	Shire District	Shire County	Unitary Authority	Metropolitan District	London Borough	Total
Business rates	276.498	0.000	194.192	207.351	537.667	**1,215.708**
Council tax	399.037	0.000	217.633	191.219	232.727	**1,040.616**
Sales fees and charges	516.426	194.923	553.907	396.745	475.728	**2,137.728**
Commercial income	82.448	24.159	120.629	204.211	52.154	**483.600**
Other	33.494	39.947	27.163	53.664	45.166	**199.435**
Total	**1,307.903**	**259.029**	**1,113.524**	**1,053.190**	**1,343.441**	**5,077.087**

Ministry of Housing, Communities & Local Government

The figures are available in full here: https://www.gov.uk/government/publications/local-authority-covid-19-financial-impact-monitoring-information

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Government response to MHCLG Select Committee report on Local Authority financial sustainability & the section 114 regime – MHCLG

Government has published a response to the Housing, Communities & Local Government (HCLG) Committee report on local authority financial sustainability and the section 114 regime, published in July.

The HCLG report states "In recent years, the financial sustainability of local government has faced successive challenges, including increased demand for services, especially social care, changes to the level of funding equalisation between councils and, most recently, the COVID-19 pandemic. In some instances, councils have been in such acute financial trouble that they have approached the Ministry of Housing, Communities and Local Government for financial assistance; three of these—Northamptonshire in 2018, Croydon in late 2020 and Slough in July 2021—issued section 114 notices, essentially declaring they had run out of money. Our inquiry has sought to identify the most serious threats facing local councils' finances. In light of the various factors we consider in the report, including the somewhat delayed Fairer Funding Review, renewed discussion about property taxes and the need to reform funding for social care, the time is right to consider a more radical review of local government finances—and our report makes various recommendations about how this should be done. We also consider what happened at Croydon—which prompted us to look at the section 114 regime—in the annex to our report."

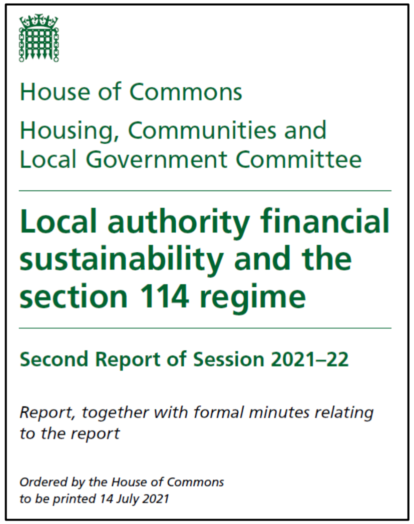
The report includes sections on:

- Social Care
- Funding
- COVID-19
- Local authority commercial investment
- Audit and control

The report made 13 recommendations, and the Government response to these was published in October. The response notes "Moving forward, we will work to provide the sector with a sustainable financial footing, enabling it to deliver vital frontline service and support other government priorities. We will also take stock, including of the impact of the pandemic on local authority resources and service pressures, to determine any future reforms."

The initial report can be found here: https://committees.parliament.uk/publications/6777/documents/72117/default/

Government response can be found here: https://www.gov.uk/government/publications/local-authority-financial-sustainability-and-the-section-114-regime


House of Commons
Housing, Communities and Local Government Committee

Local authority financial sustainability and the section 114 regime

Second Report of Session 2021–22

Report, together with formal minutes relating to the report

Ordered by the House of Commons to be printed 14 July 2021

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Government response to Redmond review – MHCLG

Government has published an update on the Ministry of Housing, Communities & Local Government response to Sir Tony Redmond's independent review into the effectiveness of external audit and transparency of financial reporting in local authorities.

The MHCLG press release states "The Audit, Reporting and Governance Authority (ARGA) – the new regulator being established to replace the Financial Reporting Council (FRC) – will be strengthened with new powers over local government audit, protecting public funds and ensuring councils are best serving taxpayers.

The new regulator, which will contain a standalone local audit unit, will bring all regulatory functions into one place, to better coordinate a new, simplified local audit framework.

ARGA will continue to act as regulator and carry out audit quality reviews as the FRC does now. It will now also provide annual reports on the state of local audit and take over responsibility for the updated Code of Local Audit Practice – the guidelines councils are required to follow.

The government has confirmed that the Public Sector Audit Appointments (PSAA) will continue as the appointing body for local audit, in charge of procurement and contract management for local government auditors.

In the immediate term, MHCLG will set up and chair a Liaison Committee, which will comprise senior stakeholders across the sector that will oversee the governance of the new audit arrangements and ensure they are operating effectively."

The press release goes on to state the "measures finalise the government's response to Sir Tony Redmond's independent review into local audit, carried out last year.

The government has already announced £15 million to support councils with additional costs in audit fees, and recently consulted on the distribution of this funding. Government is also consulting on improving flexibility on audit fee setting and has extended the deadline for when councils must publish their audited accounts.

Ministry of Housing, Communities & Local Government

The press release can be found here:

[Government publishes update to audit review response - GOV.UK (www.gov.uk)]

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Public Accounts Committee (PAC) – Local auditor reporting on local government in England & government response

The PAC inquiry examined the timeliness of auditor reporting on English local public bodies' financial statements covering 2019-20. The National Audit Office (NAO) report, on which this inquiry is based, found that "delays in the delivery of audit opinions beyond the deadlines for publishing local authority accounts, alongside concerns about audit quality and doubts over audit firms' willingness to continue to audit local public bodies, highlight that the situation needs urgent attention."

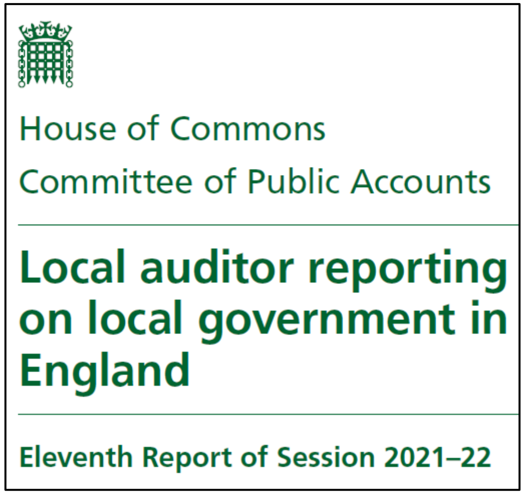
The PAC report found "Without urgent action from government, the audit system for local authorities in England may soon reach breaking point. With approximately £100 billion of local government spending requiring audit each year, the Ministry of Housing, Communities & Local Government (the Department) has become increasingly complacent in its oversight of a local audit market now entirely reliant upon only eight firms, two of which are responsible for up to 70% of local authority audits. This has not been helped by the growing complexity of local authority accounts, with audit firms now asked to carry out more work in each audit, comply with new regulatory demands and adapt to the new multifaceted landscape in which local authorities operate, while also struggling to hire and retain experienced auditors."

Key conclusions were:

- The marked decline in the timeliness of external audit undermines accountability and hampers effective decision-making.
- There is a pressing risk of market collapse due to an over reliance on a small number of audit firms and significant barriers to entry.
- The commercial attractiveness to audit firms of auditing local authorities has declined.
- The rapidly diminishing pool of suitably qualified and experienced staff increases the risks to the timely completion of quality audits.
- We are not convinced that the recently announced new local audit arrangements will meet the pressing need for effective system leadership now.
- Unless local authority accounts are useful, relevant and understandable they will not aid accountability.

The report made recommendations in each of these areas. The government response was published on 28 October.

The PAC report and response can be found here: Timeliness of local auditor reporting on local government in England - Committees - UK Parliament


House of Commons
Committee of Public Accounts

Local auditor reporting on local government in England

Eleventh Report of Session 2021–22

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2020/21 audited accounts – Public Sector Audit Appointments

Public Sector Audit Appointments (PSAA) has reported that only 9% of local government audits for 2020/21 were completed by the end of September. This is a sharp contraction on the 45% filed on time for 2019-20, and is the third successive year where the number of accounts produced on schedule has reduced.

PSAA state "The challenges posed by COVID-19 have contributed to the current position. However, a range of further pressures documented in the Redmond Report are also continuing to impact performance. In particular there is a shortage of auditors with the knowledge and experience to deliver the required higher quality audits of statements of accounts, which increasingly reflect complex structures and transactions, within the timeframe expected. The growing backlog of audits is also a concern, with 70 of the 2019/20 audits still incomplete."

Grant Thornton commented "Audit quality remains a priority for our firm and we continue to work hard with local audit stakeholders to ensure the delivery of high quality audits in as timely a fashion as is practicable. Unfortunately, much of this work will be delivered past the 30 September target date, owing to ongoing constraints posed by the COVID-19 pandemic and the backlog this has caused. We remain committed to public sector audit and are now focused on delivering the majority of our local audits by December 2021."

Public Sector Audit Appointments

The news article can be found here: https://www.psaa.co.uk/2021/10/news-release-2020-21-audited-accounts-psaa/

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2023-24 audit appointments – Public Sector Audit Appointments

Following a consultation exercise Public Sector Audit Appointments (PSAA) has invited all principal local government including police and fire bodies to become opted-in authorities. At the same time it published its procurement strategy and prospectus for the national scheme from April 2023. Both documents have evolved in response to the feedback provided by the market engagement exercise and consultation on the draft prospectus undertaken during June 2021.

PSAA state "Our primary aim is to secure the delivery of an audit service of the required quality for every opted-in body at a realistic market price and to support the drive towards a long term competitive and more sustainable market for local public audit services.

The objectives of the procurement are to maximise value for local public bodies by:

- securing the delivery of independent audit services of the required quality;
- awarding long term contracts to a sufficient number of firms to enable the deployment of an appropriately qualified auditing team to every participating body;
- encouraging existing suppliers to remain active participants in local audit and creating opportunities for new suppliers to enter the market;
- encouraging audit suppliers to submit prices which are realistic in the context of the current market;
- enabling auditor appointments which facilitate the efficient use of audit resources;
- supporting and contributing to the efforts of audited bodies and auditors to improve the timeliness of audit opinion delivery; and
- establishing arrangements that are able to evolve in response to changes to the local audit framework.

PSAA set out the proposed timeline, which anticipates contracts being awarded in August 2022.

The news article can be found here:
https://www.psaa.co.uk/2021/09/psaa-publishes-its-prospectus-and-procurement-strategy-and-invites-eligible-bodies-to-opt-in-from-april-2023/

The procurement strategy can be found here:

https://www.psaa.co.uk/about-us/appointing-person-information/appointing-period-2023-24-2027-28/procurement-strategy/

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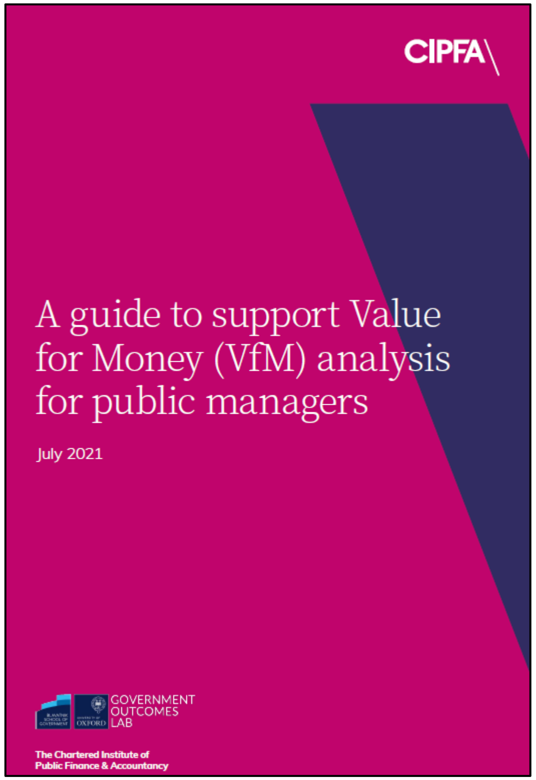
Guide to support Value for Money (VfM) analysis for public managers – CIPFA

The Chartered Institute of Public Finance and Accountancy (CIPFA) has published this guide which complements a VfM toolkit which has been published separately. Both were developed under a collaborative project between Government Outcomes Lab (GO Lab) and CIPFA.

CIPFA state "The guide is aimed at public managers planning to assess Value for Money (VfM) of outcomes-based contract (OBC) programmes, or any other type of programme with an outcome-focus, using prospective information. This involves assessing economic validity of the programme with respect to 'doing nothing' as well as the closest comparator."

CIPFA explain that the guide:

- Describes what VfM represents in public provision of social services with a special focus on outcome-based contracts (OBCs). In particular the guide emphasises the link between economy and effectiveness criteria.
- Promotes thinking about longer-term effects of interventions, such as outcomes and impact, at the design/ planning stage of programmes. This means that having a good appreciation for efficiency is helpful but not necessary, especially when outcomes are both identifiable and measurable.
- Explain how it could be used to appraise public programmes with respect to anticipated costs and value of them using prospective information.



The guide is available to CIPFA members through the website.

Climate change risk: A good practice guide for Audit and Risk Assurance Committees – NAO

Page 94

The National Audit Office (NAO) has published this guide to help Audit Committees recognise how climate change risks could manifest themselves and support them in challenging senior management on their approach to managing climate change risks.

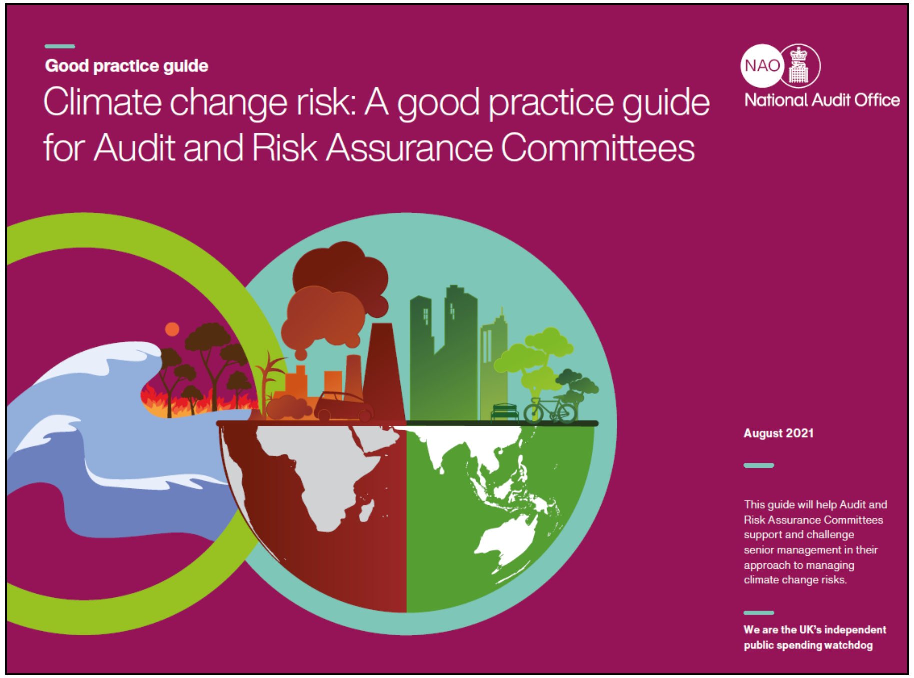
The NAO comment "Audit and Risk Assurance Committees (ARACs) play a key role in supporting and advising the board and Accounting Officer in their responsibilities over risk management.

This guide will help ARACs recognise how climate change risks could manifest themselves and support them in challenging senior management on their approach to managing climate change risks. We have outlined specific reporting requirements that currently apply.

Our primary audience is ARAC chairs of bodies that we audit, but the principles of the guide will be relevant for bodies across the wider public sector. It promotes good practice and should not be viewed as mandatory guidance.

Climate change and the nature of its impacts on organisations globally is changing rapidly. This guide acknowledges the evolving nature of climate change and its associated risks and opportunities and will be refreshed in the future to reflect those changes."

The guide includes sections on "How to support and challenge management". This includes sections on governance and leadership; collaboration; risk identification and assessment; risk treatment, monitoring and reporting and continual improvement. There is also a "Complete list of questions that Audit and Risk Assurance Committees can ask" for each of these areas. The guide also includes "Key guidance and good practice materials" with links.



The report can be found here:

[Climate change risk: A good practice guide for Audit and Risk Assurance Committees - National Audit Office (NAO) Report]

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Local government and net zero in England – NAO

Page 95

The National Audit Office (NAO) report responds to a request from the Environmental Audit Committee to examine local government and net zero. It considers how effectively central government and local authorities in England are collaborating on net zero, in particular to:

• clarify the role of local authorities in contributing to the UK's statutory net zero target; and

• ensure local authorities have the right resources and skills for net zero.

The NAO comment "While the exact scale and nature of local authorities' roles and responsibilities in reaching the UK's national net zero target are to be decided, it is already clear that they have an important part to play, as a result of the sector's powers and responsibilities for waste, local transport and social housing, and through their influence in local communities. Government departments have supported local authority work related to net zero through targeted support and funding. However, there are serious weaknesses in central government's approach to working with local authorities on decarbonisation, stemming from a lack of clarity over local authorities' overall roles, piecemeal funding, and diffuse accountabilities. This hampers local authorities' ability to plan effectively for the long-term, build skills and capacity, and prioritise effort. It creates significant risks to value for money as spending is likely to increase quickly.

MHCLG, BEIS and other departments recognise these challenges and are taking steps to improve their approach. Their progress has understandably been slowed by the COVID-19 pandemic, but there is now great urgency to the development of a more coherent approach."

Key findings include:

- Central government has not yet developed with local authorities any overall expectations about their roles in achieving the national net zero target.
- There is little consistency in local authorities' reporting on net zero, which makes it difficult to get an overall picture of what local authorities have achieved.
- Neither MHCLG nor HM Treasury has assessed the totality of funding that central government provides to local government that is linked with net zero.

The report can be found here:

https://www.nao.org.uk/report/local-government-and-net-zero-in-england/

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Cyber and information security: Good practice guide – NAO

Page 96

The National Audit Office (NAO) has published this guide to help Audit Committees scrutinise cyber security arrangements. To aid them, this guidance complements government advice by setting out high-level questions and issues for audit committees to consider.

The NAO state "Audit committees should gain the appropriate assurance for the critical management and control of cyber security and information risk.

Cyber security is the activity required to protect an organisation's data, devices, networks and software from unintended or unauthorised access, change or destruction via the internet or other communications systems or technologies. Effective cyber security relies on people and management of processes as well as technical controls.

Our guide supports audit committees to work through this complexity, being able to understand and question the management of cyber security and information risk.

It takes into account several changes which affect the way in which we interact with and manage our information and can drive increased risk. These include changes to the way we work and live due to the COVID-19 pandemic and the ongoing demand to digitise and move to cloud-based services.

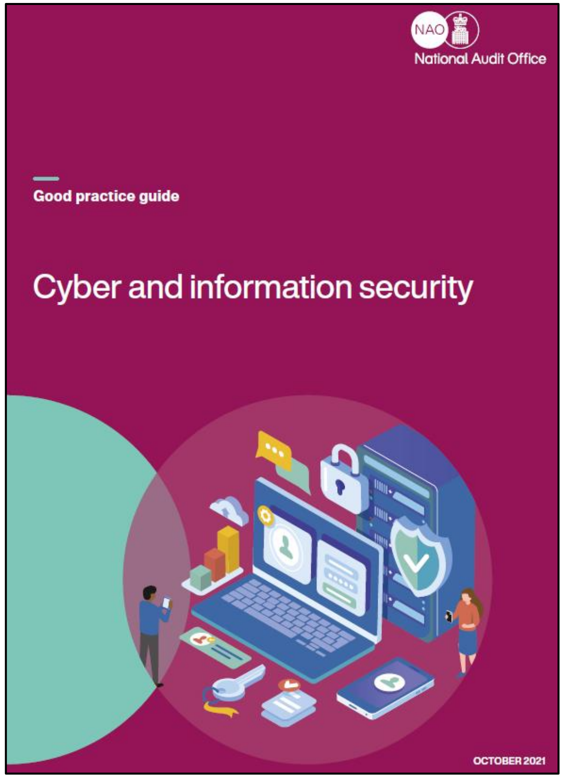
The strategic advice, guidance and support provided by government has also been updated to keep pace with these changes, detailing the impact and risks on the management of cyber security and information risk.

The guide provides a checklist of questions and issues covering:

- The overall approach to cyber security and risk management
- Capability needed to manage cyber security
- Specific aspects, such as information risk management, engagement and training, asset management, architecture and configuration, vulnerability management, identity and access management, data security, logging and monitoring and incident management."

The report can be found here:

https://www.nao.org.uk/report/cyber-security-and-information-risk-guidance/



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Somerset County Council

Report of Internal Audit Activity

Progress Report- January 2022

Unrestricted

Internal Audit Update – January 2021/22 'At a Glance'

The Headlines

Opinion based reviews completed in the period

- Three Limited
- One Reasonable

Satisfactory progress in relation to plan delivery

- 27 reviews completed/report stage
- 17 reviews in progress
- 13 reviews to start – follow-ups make up around half of this total

Additions to the Plan

13 new reviews included in the plan.

Improvements from the implementation of agreed actions
A data dashboard has been produced to support management overview. Overdue actions are unchanged from November but have reduced by 21% during the year-to-date.

Range of innovations and enhancements made to our internal audit process throughout the year
Data analytics continues to drive/support reviews; comparative benchmarking exercises offer useful insight and suggested practices.

Internal Audit Assurance Opinions 2021/22

	Jan	YTD
Substantial	0	0
Reasonable	1	4
Limited	3	6
No Assurance	0	0
Total	**4**	**10**

Internal Audit Agreed Actions 2021/22

	Jan	YTD
Priority 1	7	7
Priority 2	19	34
Priority 3	5	23
Total	**31**	**64**

Summary

As part of our rolling plan reports, we will detail progress against the approved plan and any updates in scope and coverage.

We will also provide details of any significant risks that we have identified in our work, along with the progress of mitigating significant risks previously identified through audit activity.

The contacts at SWAP in connection with this report are:

Lisa Fryer
Assistant Director
lisa.fryer@swapaudit.co.uk

David Hill
Chief Executive
david.hill@swapaudit.co.uk

Summary

This is the January progress update for 2021/22 and reports against the plan agreed by this Committee in March 2021. The schedule provided at **Appendix D** details progress made to date and new work agreed.

The assurance opinion ratings have been determined in accordance with the Internal Audit "Audit Framework Definitions" as detailed at **Appendix A** of this document. The Committee can take assurance that improvement actions have been agreed with management to address each finding reported.

To assist the Committee in its important monitoring and scrutiny role, in those cases where weaknesses have been identified in service/function reviews that are considered to represent significant service risks, a summary of the key audit findings that have resulted in the 'limited Assurance Opinion' can be found at **Appendix B**. There were three to report over the period as well as one reasonable opinion audit. In total there have been four Reasonable and six Limited Assurance audits finalised over the year so far. A significant proportion of Limited Assurance Opinions is expected as the audit plan is focused towards those areas of highest risk to the Council. The implementation of agreed actions have all been scheduled during 22/23 and follow-up audits will then be carried out.

A follow-up review is performed in respect of all limited assurance opinion audits. The results of follow-up reviews performed in the period can be found in **Appendix C**. This is important to provide evidence that recommendations have been implemented to reduce areas of risk identified. This was found to be the case for two of the reviews, the third will continue to be monitored to gain assurance that the remaining actions are implemented.

As well as assurance provided by follow-up audits, this year the managers responsible for agreed actions relating to limited assurance audits have provided progress updates to internal audit. The results can be seen on page 4 of this report. The total number of overdue actions reported is very similar to the previous progress report. Taking the year as a whole though, there is a reduction of 21% of overdue actions reported.

Internal Audit Plan Update

Our audit plan coverage assessment is designed to provide an indication of whether we have provided sufficient, independent assurance to monitor the organisation's risk profile effectively.

For those areas where no audit coverage is planned, assurance should be sought from other sources to provide a holistic picture of assurance against key risks.

SWAP audit plan coverage, changes to the plan, and performance measures

The table below provides a visual representation of how our completed audits and work in progress for 2021/22 financial year to date provides assurance over key strategic risks areas in the Internal Audit Plan. As the year builds and more work is completed, coverage across the key risk areas will increase. 'Adequate' coverage reflects delivery of planned assurance levels.

Risk Universe	Coverage
Climate Change	
Organisational resilience	• Business continuity • Hybrid working • Data centre & back-ups
Supplier Disruption	• Commissioning governance • Adults commissioning
Sustainable MTFP	• School deficit/surplus balances • SEND costed packages
Safeguarding Children	• Schools safeguarding follow-up. • Safeguarding complaints and concerns
External Influences and Uncertainties	• Commissioning governance • Adults commissioning
Local Government Reorganisation	• Audits associated with organisational resilience (above) • Audits associated with MTFP (above) • Business Recovery – post Covid • Commissioning governance
Market Management and development	Contract management advisory review

	Good coverage complete
	Adequate coverage complete
	Coverage in progress
	No coverage to date

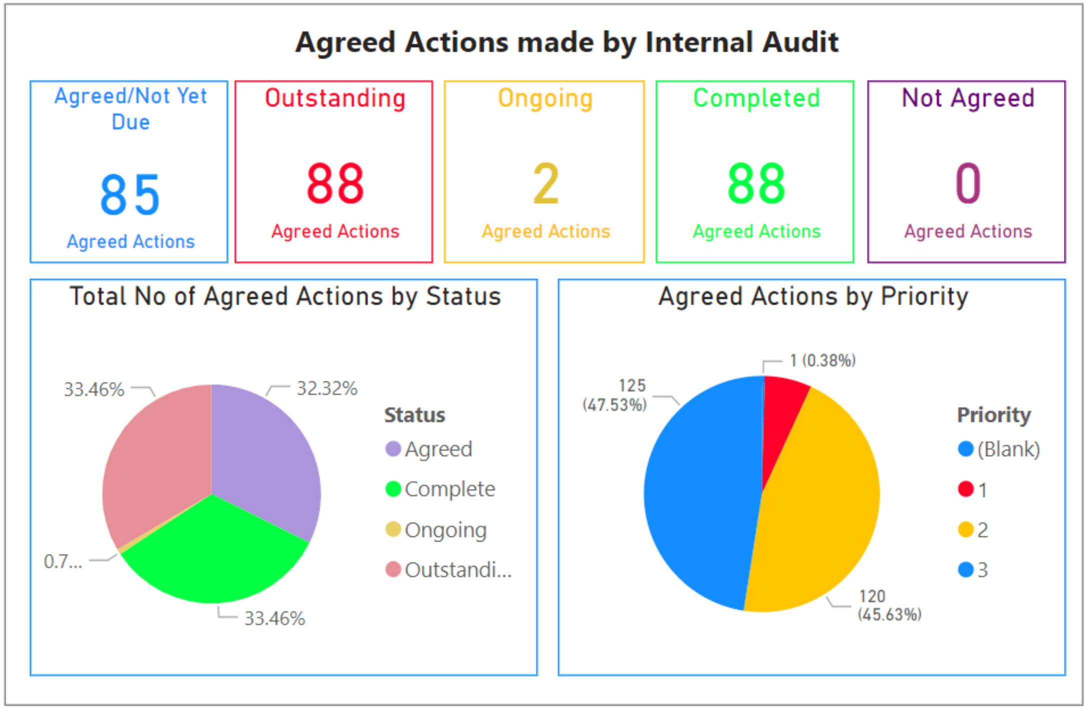
Internal Audit Plan Update

Follow up work confirms the responsive nature of management in implementing agreed actions to mitigate exposure to areas of risk.

Implementation of Agreed Management Actions

As well as assurance provided by follow-up audits, this year the managers responsible for agreed actions relating to limited assurance audits have provided progress updates to internal audit. The results from both have been used to produce the summary below.

The table below shows a total of 88 overdue actions remain, compared to 89 in November. There were 113 overdue actions in the September update, giving an overall reduction of 21% during the year to date.



Internal Audit Definitions — Appendix A

Assurance Definitions	
No Assurance	Immediate action is required to address fundamental gaps, weaknesses or non-compliance identified. The system of governance, risk management and control is inadequate to effectively manage risks to the achievement of objectives in the area audited.
Limited	Significant gaps, weaknesses or non-compliance were identified. Improvement is required to the system of governance, risk management and control to effectively manage risks to the achievement of objectives in the area audited
Reasonable	There is a generally sound system of governance, risk management and control in place. Some issues, non-compliance or scope for improvement were identified which may put at risk the achievement of objectives in the area audited.
Substantial	A sound system of governance, risk management and control exists, with internal controls operating effectively and being consistently applied to support the achievement of objectives in the area audited.

Definition of Corporate Risks

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

Categorisation of Recommendations

In addition to the corporate risk assessment it is important that management know how important the recommendation is to their service. Each recommendation has been given a priority rating at service level with the following definitions:

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.

<table>
<tr><td rowspan="3">Special Educational Needs and Disability (SEND) Costed Packages</td><td>Audit Objective</td><td rowspan="3">

Limited</td><td colspan="4">Priority Actions</td></tr>
<tr><td rowspan="2">The costed package process is inadequately designed or not applied equitably, resulting in challenge from stakeholders, impaired outcomes for affected children or failure to ensure value for money is achieved.</td><td>1</td><td>2</td><td>3</td><td>Total</td></tr>
<tr><td></td><td>4</td><td>1</td><td>5</td></tr>
</table>

SEND costed packages have been developed to help support children to stay in mainstream schools rather than provide very expensive independent provision. The costed package is an agreement to give additional funding to a school that is ringfenced to specific children.

The Inclusion team has agreed to complete five actions to address our findings by 1st September 2022. One action has already been completed.

Summary of Findings

- There is a reasonable process in place, though further development is needed. Applications for support are subject to adequate scrutiny by senior officers. Most respondents of the Special Educational Needs Coordinator (SENCO) survey performed believed costed packages can meet SEND needs. There are good processes to ensure schools receive agreed funds.
- While a process for agreeing costed packages is in place, the Inclusion service has not yet formalised this. Our SENCO survey indicates there are several areas where the process could be improved. Most pertinently, the Inclusion service has not yet produced any guidance to support schools with applications.
- The Inclusion team has not issued a standard form schools can use for costed package requests, meaning inconsistent information is received. Survey responses indicate various forms exist and highlighted uncertainty about which to use. The Inclusion team has prepared a draft form, but this will need updating when new approaches are implemented.
- The Placement and Transport (PAT) Panel outcomes do not consistently record which officer has authorised a costed package. One regular authoriser is not included in budget delegation tables. We cannot provide assurance that packages and subsequent expenditure had been agreed appropriately for all samples we reviewed.

Adults – Quality Assurance Framework	Audit Objective	Assurance	Priority Actions			
			1	2	3	Total
	To establish how Adult Services monitors the extent to which it is achieving its performance objectives & practice standards and takes action to address shortfalls.	 Limited	2	5	1	8

It is important to acknowledge the amount of disruption and change the service has faced on the back of the pandemic, with challenges relating to demand and supply both internally and in the wider health and care workforce.

The service is committed to improvement in how quality assurance activity is both conducted and used. There have been several developments which will assist future improvements. A new adult case management system (Eclipse) has been rolled out across the service, a new performance reporting suite has been developed and made available to all staff and the service has also published a Practice Quality Framework to provide improved direction to staff on the expected standards.

It has been agreed to complete the actions to address our findings by the end of November 2022.

Summary of Findings

- Quality assurance activity is often reactive and not driven by a planned approach. Outcomes are not consistently captured and monitored to confirm they have been addressed.
- Quality assurance outcomes collected outside of audits are not fed into an overarching action plan, meaning that important learning points are not always captured or communicated to the wider workforce.
- There are opportunities to enhance the performance information made available via the new Reporting Suite.
- Quality assurance is largely focussed on quantitative assessments and there is little review of quality outcomes. Feedback on the customer experience is ad-hoc and not consistently sought.

<table>
<tr><td rowspan="3">Berkley School – Financial Controls</td><td>Audit Objective</td><td rowspan="3">

Limited</td><td colspan="4">Priority Actions</td></tr>
<tr><td rowspan="2">To provide assurance that the expected financial controls within the school are operating effectively and appropriately.</td><td>1</td><td>2</td><td>3</td><td>Total</td></tr>
<tr><td>5</td><td>8</td><td>1</td><td>14</td></tr>
</table>

This review on financial controls was requested by governors and fully supported by the headteacher. Newly-appointed governors required assurance that the financial controls were operating effectively and in line with the school's Finance Policy.

The school is committed to making the necessary improvements and to complete the actions to address our findings by the end of April 2022. Action has already started in relation to the majority of the findings made.

Summary of Findings

- The root cause for many of the control weaknesses, identified in this audit review, is a lack of a division of duties; particularly for expenditure, budget monitoring and reconciliations.
- The School Finance Policy did not reflect financial practice at the school.
- Audit trails were found to be incomplete for both income and expenditure records.
- Authorising Officers and limits need to be formally agreed and reflected in the updated finance policy.

Follow up Audit	Scope and Objective	Progress assessment				
			Completed	In progress	Not Started	Total
Apprenticeship Scheme	To provide assurance that the agreed actions within the 2020-21 report have been implemented.	Priority 1	-	-	-	**-**
		Priority 2	3	0	-	**3**
		Priority 3	2	1	1	**4**
		Total	**5**	**1**	**1**	**7**

Summary of Findings

We are pleased to report there has been satisfactory progress towards the audit recommendations and no further follow-up work is required.

The Apprenticeship Team have taken forward actions in relation to working with schools to improve their understanding and uptake of apprenticeship opportunities. There has also been an overall increase in the number of apprentice and upskilling starters for the year ending 31st March 2021, compared to previous years. The Manager's Guide and the SharePoint site for Apprenticeships have both been updated to provide enhanced guidance in a number of areas.

We recommended that the Apprenticeship Team should ensure that central monitoring is undertaken for all completed apprenticeships to identify and monitor the retention of apprentices within the Council, and to address any thematic issues for those who have gained employment elsewhere. It has not been possible to progress this action yet, due to delays in the Education Skills Funding Agency's portal being updated to provide more timely data. This will be taken forward as soon as possible.

Follow up Audit	Scope and Objective	Progress assessment				
			Completed	In progress	Not Started	Total
Public Health Nursing CQC Readiness	To provide assurance that the agreed actions within the 2020-21 report have been implemented.	Priority 1	-	-	-	-
		Priority 2	4	2	-	6
		Priority 3	9	-	-	9
		Total	**13**	**2**	**-**	**15**

Summary of Findings

We are pleased to report that most of the actions have now been completed and no further follow-up work is required.

The original audit was requested to provide assurance to the service that in the event of a CQC inspection, that staff teams had sufficient understanding of the governance arrangements, practices and processes that have changed and developed since their transfer from Somerset Partnership NHS Trust. The audit focused specifically on the CQC questions relating to the degree to which the service is safe and well-led.

The Service has restructured teams, and in all interviews, there were positive comments about the strength of communications at both a local and whole service level.

Staff were also consistently positive about the accessibility and approachability of senior managers, and the new Head of Public Health Operations arranging to engage with staff on a regular basis.

Follow up Audit	Scope and Objective	Progress assessment				
			Completed	In progress	Not Started	Total
Compliance with Corporate Purchasing Policy	To provide assurance that the agreed actions within the 2020-21 report have been implemented.	Priority 1	-	-	-	-
		Priority 2	-	2	-	2
		Priority 3	1	2	1	4
		Total	**1**	**4**	**-**	**6**

Summary of Findings

Commercial & Procurement have now updated the policies held on their SharePoint site. The procurement webpage on the external website has also been updated to reflect that only those contracts worth more than £25,000 will be invited to tender. The external website now includes the most recently approved Contract Procedure Rules (CPRs) document.

Because the Ten Point Plan (TPP) is no longer in place, we have assessed one recommendation as being superseded and this hasn't been included in the above table.

The Terms of Reference for the Strategic Commissioning Group (SCG) has not yet been reviewed. The remaining actions remain in progress. Though the CPRs have been updated in line with our recommendations, the revisions have not been formally approved. Commissioning guidance needs to be updated to illustrate links to the revised CPRs. We could not find evidence that the Strategic Commissioning Group (SCG) had reviewed all waivers we tested.

Because actions remain in progress, we will continue to monitor them through our Recommendation Tracking.

Audit Type	Audit Area	Status	Opinion	No of Rec	1 = Major	↔	3 = Medium
					Recommendation		
					1	2	3
Complete							
Operational	Accounts Payable - Vendor Management	Final	Limited	5		3	2
Operational	School Exclusion Data	Final	Limited	6		5	1
ICT	Data Centre and Back-up Review	Final	Limited	5		3	2
Operational	Adults – Commissioning Community Support	Final	Reasonable	5		2	3
Follow-up	Highways Application for Payment – Follow-up	Final	N/A				
Grant	BDUK Grant certification	Final	Certified				
Advisory	**New** – Updated Contract Management Framework	Final	N/A				
Advisory	**New** – Anti-Fraud and Corruption Policy Review	Final	N/A				
Governance	Hybrid Working	Final	Reasonable	3			3
Governance	Business Continuity	Final	Reasonable	9		2	7
Advisory	**New** – Fraud Risk Assessment	Final	N/A				
Follow-up	Safeguarding in Schools	Final	N/A				
ICT	Secondary Data Centre Review – Advisory	Final	N/A				
Operational	Economic Recovery – Post Covid 19	Final	Reasonable	4		2	2
Operational	SEND Costed Packages	Final	Limited	5		4	1
Operational	Adults – Quality Assurance Framework	Final	Limited	8	2	5	1

Audit Type	Audit Area	Status	Opinion	No of Rec	1 = Major	↔	3 = Medium
					Recommendation		
					1	2	3
Operational	**New** – Berkley School Financial Audit	Final	Limited	14	5	8	1
Follow-up	Apprenticeship Scheme	Final	N/A				
Follow-up	Transfer of Public Health Nursing Services	Final	N/A				
Follow-up	Compliance with Corporate Purchasing Policy	Final	N/A				
Grant	**New** - Additional Dedicated Home to School and College Transport Grant	Final	Certified				
Grant	**New** - Bus Subsidy Ring fenced (revenue) Grant	Final	Certified				
Reporting							
Operational	School Surplus and Deficit Balances	Draft					
Governance	Strategic Commissioning	Draft					
Governance	Property Condition – Schools	Draft					
Investigation	**New** – Project Management Investigation	Draft					
ICT	Incident Management	Draft					
In Progress							
Operational	Children's Safeguarding – Complaints and Concerns	In Progress					
Operational	**New** - Transport – Governance/Budgets/Financial Control	In Progress					
Operational	**New** – Children's Social Care Safe Recruitment and Training	In Progress					
Governance	Contracts Register	In Progress					

Audit Type	Audit Area	Status	Opinion	No of Rec	1 = Major	⟷	3 = Medium
					Recommendation		
					1	2	3
Advisory	**New** – Whistleblowing Policy Review	In Progress					
Advisory	**New** – Adopt South-West	In Progress	Audit lead by Devon Audit Partnership				
Follow-up	Supplier Resilience	In Progress					
Follow up	Lone Working	In Progress					
Follow-up	Health and Safety – Premises Management	In Progress					
Follow-up	Healthy Organisation	In Progress					
Grant	Local Transport Capital Block Funding Grant	In Progress					
Grant	Covid Related Bus Services Support Grant Restart Tranche 3/4/5	In Progress					
Grant	**New** - Covid Community Testing Funding Grant	In Progress					
Advisory	Recommendation Tracking	Ongoing					
Grant	Supporting Families Claims	Ongoing					
Advisory	CiFAS – Blue Badges	Ongoing					
Advisory	Somerset Unitary preparations	Ongoing					
Waiting to go Live							
Governance	Climate Change	Waiting to go live					
Governance	Project Management – Benefits Realisation	Waiting to go live					

Audit Type	Audit Area	Status	Opinion	No of Rec	1 = Major	↔	3 = Medium
					Recommendation		
					1	2	3
Governance	Emergency Planning	Waiting to go live					
Operational	Adults – Eclipse System	Waiting to go live					
ICT	Follow-up – ICT Governance	Waiting to go live					
ICT	Follow-up - Cyber Security Framework Review	Waiting to go live					
Follow up	Children's Education, Health and Care Plans	Waiting to go live					
Follow up	Corporate Management of Health and Safety	Waiting to go live					
Follow-up	Creditors	Waiting to go live					
Follow-up	Risk Management	Waiting to go live					
Follow-up	Adults Mental Health – Financial Decision Making	Waiting to go live					
Follow-up	Role of the Somerset Manager	Waiting to go live					
Grant	**New** - Emergency Active Travel Fund Grant	Waiting to go live					
Deferred							
Governance	Election Delivery	Deferred	Elections deferred, audit moved to Q1 22/23				

Audit Type	Audit Area	Status	Opinion	No of Rec	1 = Major ↔ 3 = Medium Recommendation		
					1	2	3
Governance	Capital Accounting	Deferred	Audit deferred to release days for Fraud/Policies review.				
Operational	Property – Compliance with Regulations	Deferred	Audit deferred and replaced with Project Management Investigation.				
Operational	Property – Corporate Landlord Model	Deferred	Audit deferred and replaced with Project Management Investigation.				
Governance	ECI – Budget Management	Deferred	Reviewed Children's & Adults in recent plans both reasonable. Deferred to release days for release days for Fraud/Policies review.				
Operational	CDM Regulations (Construction Design Management) Maintenance and Infrastructure Highways	Deferred	Replaced with Street Works Permitting. Audit moved to 22/23.				
Operational	Schools - SFVS	Deferred	Replaced with higher risk work.				
Operational	Schools – Procurement Cards	Deferred	Replaced with higher risk work.				
Follow-up	Cash Handling	Deferred	Request to defer to 22/23.				
Operational	Adults – Workforce Planning	Deferred	Request to defer to 22/23.				
Follow-up	Adults – FAB Assessments	Deferred	Deferred to 22/23 due to delayed implementation of new FAB system.				
Operational	**New** – Street Works Permitting	Deferred	Recent external review undertaken and request to delay to 22/23.				
Follow-up	Community Learning Partnerships	Deferred	Reschedule for 22/23 in line with implementation of agreed actions				
Follow-up	Career Development & Pathways	Deferred	Reschedule for 22/23 in line with implementation of agreed actions				
Operational	Delivering Democratic Arrangements using virtual and/or hybrid meetings	Removed	Arrangements in place – removed to release days for higher risk audit work.				

Audit Type	Audit Area	Status	Opinion	No of Rec	1 = Major		3 = Medium
					Recommendation		
					1	2	3
Operational	Project Management – Implementation of the Children's Early Help Module	Removed	Removed to release days for Safeguarding review ahead of OFSTED inspection.				

Somerset County Council
Audit Committee –
27 January 2022

Strategic Risk Management Update

Lead Officer: Jason Vaughan, Director of Finance & Governance and Section 151 Officer
Author: Pam Pursley, Risk Manager
Contact Details: ppursley@somerset.gov.uk
Cabinet Member: Cllr Mandy Chilcott
Division and Local Member: All

1. **Executive Summary**

1.1. The management of risk has a direct link to the Council's Business Plan, the Medium-Term Financial Plan, forms an integral part of the Annual Governance Statement (AGS) and is a major component of the External Auditor's Value for Money Audit. Risk management is an essential component of good corporate governance.

1.3 The Account and Audit Regulations 2015 require the Council to have in place effective arrangements for the management of risk. These arrangements are reviewed annually and reported as part of the Annual Governance Statement (AGS).

1.4 This report contains the latest information strategic risk information obtained from our risk management system, JCAD Core

1.5 This report does not include the programme and project risks for the LGR. There is a risk management framework (which includes identification, management and reporting of risk) in place that is managed by the LGR programme group and is reported to the LGR Programme Steering Group and the CEO Programme Board.

1.6 While investigations into the replacement of the financial system are ongoing the associated risks are currently included under ORG0053 attached at Appendix A as well as the LGR risk register. These will be updated as the Discovery phase progresses.

2. **Items for Consideration**

2.1 Review the current strategic risk report Appendix A is a record of the strategic risks owned by individual members of SLT.

3. **Background**

3.1. Strategic risk management is the process of identifying, quantifying, and mitigating any risk that affects or is inherent in an organization's business strategy, strategic objectives, and strategy execution

4. **Current Strategic Risks**

4.1 There are 7 strategic risks recorded in JCAD that pose a threat to the achievement of the priorities of the Council. These risks and their current status are attached at Appendix A.

5. Conclusion

5.1 All strategic Risks have been reviewed and a progress update provided. All strategic risks have been approved by SLT and are regularly monitored by the Strategic Risk Management Group (SRMG).

Strategic Risk Review & Control Measure Report – 19/01/2022 – Appendix A

Strategic Risks - SCC(SLT)

Risk	Cause	Consequence	Current Risk Assessment	Controlled Risk Assessment
ORG0009 Strategic Risk 2020: Safeguarding Children: We fail to deliver our statutory service delivery duties and legal obligations in relation to vulnerable children.	Systemic leadership, financial constraints and management challenges	Possible abuse, injury or loss of life to a vulnerable child through lack of provision of service. Reduced public confidence; emergency measures; increased inspection; personal litigation claims; negative publicity for both the Council and partners; possible financial penalty or service is removed from Council control.	Amber - High Risk **15** Impact **5** Likelihood **3**	Amber - High Risk 15 Impact 5 Likelihood 3

Next Review Date	Last Review Date	Days Overdue	Risk Owner
15/01/2022	15/10/2021	4	Julian Wooster

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Risk Review Update

Review Summary: There is a national crisis in Children's Social Work resulting in significant challenges at this time with Social Care recruitment. A variety of different measures, both immediate and longer term have been put in place to address the recruitment challenges.
In the meantime, Children's Social Care continue to have robust quality assurance systems in place to ensure that statutory requirements in relation to vulnerable children are met. Updated on 23/06/2021 17:30:59

Control Measure	Control Review Update	Status	Days Overdue	Review Date	Control Owner
ORG0009/057 CS and Education Service review of all risks and actions via workshops held with Assistant Directors		In Progress (Reactive)	0	28/02/2022	Adrienne Parry

JCAD

Strategic Risks - SCC(SLT)

Risk	Cause	Consequence	Current Risk Assessment	Controlled Risk Assessment	Next Review Date	Last Review Date	Days Overdue	Risk Owner
ORG0024 Strategic Risk 2019: Market management and development: Failure to effectively monitor and manage our markets (and supply chains) to ensure we optimise value for money, income generation opportunities and protect ourselves	Lack of coordination across the organisation in terms of our commercial and market development activity. There is limited understanding and shared learning of supplier strengths and weaknesses, or around concerns with our markets. There is also a lack of control over our principal supply chains.	Loss of customer confidence and trust in the Council, impacting on the reputation of the council. Lack of supplier confidence, restricting our ability to deliver front line services.	Yellow - Medium Risk **9** Impact 3 Likelihood 3	Yellow - Medium Risk 9 Impact 3 Likelihood 3	19/07/2022	19/01/2022	0	Jason Vaughan

Risk Review Update

Review Summary: 65% of those registered have now completed the foundation course and we are currently sending reminders to those that still are required to attend Updated on 08/03/2021 15:42:04

Control Measure	Control Review Update	Status	Days Overdue	Review Date	Control Owner
ORG0024/004 Putting in place effective contract management at a senior level throughout the Council	Review Summary: 65% of those registered have now completed the foundation course. Covid has	In Progress (Reactive)	0	19/07/2022	Claire Griffiths

JCAD

Strategic Risks - SCC(SLT)

Risk	Cause	Consequence	Current Risk Assessment	Controlled Risk Assessment	Next Review Date	Last Review Date	Days Overdue	Risk Owner
ORG0053 Strategic Risk 2020: Organisational Resilience: Without the minimum level of capacity and resource, the resilience of the organisation is compromised.	1. Emergency response to Covid-19 - redeployment of staff, staff absence 2. Competing priorities including LGR demands, high service pressures etc 4. Assets & Infrastructure e.g., SAP, B Block refurbishment & LGR challenges	Additional pressure on service delivery	Red - V. High Risk **20** Impact **5** Likelihood **4**	V. Low Risk 10 Impact 5 Likelihood 2	07/02/2022	05/01/2022	0	Chris Squire

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Risk Review Update

Review Summary: 06/01/2022 - Review date put to February as a CCU exercise is arranged for 20th January which should test and inform this risks Updated on 16/11/2021 16:18:19

Control Measure	Control Review Update	Status	Days Overdue	Review Date	Control Owner
ORG0053/005 CCU Maintenance of generic joint response frameworks for the Somerset Local Authorities	Review Summary: Joint Corporate Response and Recovery Plan was reviewed and reissued to all	In Progress (Reactive)	0	10/11/2022	Nicola Dawson
ORG0053/011 Information Governance Asset register	Review Summary: Work ongoing but will need to be brought in to the IG LGR project as will need to	In Progress (Reactive)	0	22/06/2022	Rebecca Martin
ORG0053/006 CCU Maintenance of the Somerset Local Authorities Civil Contingencies Partnership	Review Summary: Resilience Board meetings were held in February, July and October 2021. Agreed	In Progress (Reactive)	0	10/05/2022	Nicola Dawson
ORG0053/007 CCU Maintenance of community resilience capabilities through the Somerset Prepared Partnership	Review Summary: CCU maintains the Somerset Prepared website and quarterly newsletters with	In Progress (Reactive)	0	10/05/2022	Nicola Dawson
ORG0053/008 CCU Participation and coordination with local multi-agency structures	Review Summary: CCU continues to engage with multi-agency planning with the Avon and Somerset	In Progress (Reactive)	0	10/05/2022	Nicola Dawson

Strategic Risks - SCC(SLT)

Control Measure	Control Review Update	Status	Days Overdue	Review Date	Control Owner
ORG0053/001 BCP Annual corporate guidance and templates update or after activation of the corporate business continuity plan.	Review Summary: Update of templates postponed due to need to focus on Covid response. Additional	In Progress (Reactive)	0	05/04/2022	Nicola Dawson
ORG0053/002 BCP Ensure all service level business continuity plans are updated annually.	Review Summary: CCU requested Strategic Managers to ensure all service business continuity	In Progress (Reactive)	0	05/04/2022	Nicola Dawson
ORG0053/004 CCU Delivery of an annual training and exercising programme for staff with identified response roles	Review Summary: CCU aims to run an annual programme of emergency training and exercises for	In Progress (Reactive)	0	05/04/2022	Nicola Dawson
ORG0053/009 H&S Create common processes so staff can be interchanged across County	Review Summary: Covid-19 response ongoing since Feb 2020 . Tender awarded, process mapping	In Progress (Reactive)	0	20/03/2022	Heidi Boyle
ORG0053/010 ICT Increase awareness & understanding SCC around suspicious or unsolicited email with attachments & website file downloads	Software purchased and running. Tested with SLT and members with a Phish campaign. All user	In Progress (Reactive)	0	28/02/2022	Dave Littlewood

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JCAD

Strategic Risks - SCC(SLT)

Risk	Cause	Consequence	Current Risk Assessment	Controlled Risk Assessment
ORG0054 Strategic Risk 2020: Climate Change: SCC fails to take action to mitigate and adapt to climate change. This includes failing to commit adequate resources and/or failing to act early enough	At present agreement with the Districts to co-fund key enabling activities is limited to 4 projects. Unless sufficient funding is agreed between the 5 Councils it will not be possible to deliver on all the agreed outcomes and Actions as set out in the Thematic Action Plans	Adverse reputation, political fall-out and failure to act	Red - V. High Risk **25** Impact **5** Likelihood **5**	Red - V. High Risk 25 Impact 5 Likelihood 5

Next Review Date	Last Review Date	Days Overdue	Risk Owner
04/01/2022	04/10/2021	15	Michele Cusack

Risk Review Update

Review Summary: Subject to MTFP deliberations Updated on 18/05/2021 15:36:56

Control Measure	Control Review Update	Status	Days Overdue	Review Date	Control Owner
ORG0054/002 Funding required to enable implementation of key activities	Review Summary: Joint Implementation Board established, Governance and Terms of Reference	In Progress (Reactive)	0	01/09/2022	Michele Cusack

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Strategic Risks - SCC(SLT)

Risk	Cause	Consequence	Current Risk Assessment	Controlled Risk Assessment	Next Review Date	Last Review Date	Days Overdue	Risk Owner
ORG0056 Strategic Risk 2021: Potential for significant supplier disruption across all services but greatest risk to demand and sustainability of funding in the care provision sector, transport services and Waste.	External influences and uncertainties, e.g. Covid19 pandemic and it's effect on suppliers concurrently with the effects of leaving the EU and the formation of an Integrated Care System & Local Government Reorganisation,	increased costs, reduced staffing, effects on local / national suppliers may impact on our commissioning activity and result in SCC not achieving the outcomes it seeks.	Red - V. High Risk **16** Impact 4 Likelihood 4	Yellow - Medium Risk 12 Impact 4 Likelihood 3	22/01/2022	22/12/2021	0	Paula Hewitt

Risk Review Update

Review Summary: Risk remains high with the Omicron variant now spreading. P Hewitt 22/12/21 Updated on 24/11/2021 10:45:36

Control Measure	Control Review Update	Status	Days Overdue	Review Date	Control Owner
ORG0056/001 Work with Commissioners to reflect the impacts of Covid-19 on the provider engagement document	Review Summary: Provider engagement document will be progressed once work to understand service	In Progress (Reactive)	0	25/03/2022	Sunita Mills
ORG0056/002 SCG/Recovery Board overview of commissioning activity to identify any indications of impacts of C19, ICS & LGR, & agree action	Review Summary: Recovery Board has been stood down. SCG will continue to seek and understand	In Progress (Reactive)	0	24/01/2022	Sunita Mills

JCAD

Strategic Risks - SCC(SLT)

Risk	Cause	Consequence	Current Risk Assessment	Controlled Risk Assessment	Next Review Date	Last Review Date	Days Overdue	Risk Owner
ORG0057 Strategic Risk 2020: Sustainable MTFP: The forecast costs of services in the form of the budget must match the financial resources available. There is a risk that the costs exceed the available resources.	The government has delayed significant reforms to local government funding. The Fair Funding Review and Business Rates Retention Scheme were due to be implemented in 2021/22 financial year but have both been delayed and are now expected in 2023/24.	The Council does not set a balanced budget and reduces reserves to an unacceptable low level	Yellow - Medium Risk **12** Impact 4 Likelihood 3	V. Low Risk 6 Impact 3 Likelihood 2	05/05/2022	10/01/2022	0	Jason Vaughan

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Risk Review Update

Review Summary: The 2022/23 Budget proposals are for a balanced budget with no use of reserves to support on-going expenditure. There has been a robust review of budgets in developing the 2022/23 budget proposals. The level of general reserves has increased from £19.7m to £23m and is therefore at a robust level and there are additional Earmarked Reserves set aside for specific purposes including £10m for the LGR implementation costs which will deliver £18.5m of savings over the next few years. Updated on 05/02/2021 09:11:54

Control Measure	Control Review Update	Status	Days Overdue	Review Date	Control Owner

Strategic Risks - SCC(SLT)

Risk	Cause	Consequence	Current Risk Assessment	Controlled Risk Assessment	Next Review Date	Last Review Date	Days Overdue	Risk Owner
ORG0059 Strategic Risk 2021: Local Government Reorganisation in Somerset does not deliver the single unitary authority as defined, for Vesting Day on 1st April 2023	Insufficient staff capacity and capability, MTFP and in-year financial challenges, Ongoing impacts of Covid-19, Working relationships with partners and stakeholders break down	Significant governance and processes required for a functioning organisation are not in place leading to financial and reputational damage as well as adversely effecting service delivery	Red - V. High Risk 16 Impact 4 Likelihood 4	V. Low Risk 4 Impact 4 Likelihood 1	05/02/2022	05/01/2022	0	Carlton Brand

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Risk Review Update

Review Summary: Risk likelihood has increased due to expected pressure on staff owing to the COVID Omicron variant, this is expected to temporary. A Programme Recruitment Protocol is due to be approved, 3x FTE Programme Managers are in place along with programme governance structure and SCC are actively considering where it can release resources by reducing activity in low priority areas.

Draft Structural change orders received which confirmed CA status for SCC and elections for 2022. LGR scorecard due to go live from the end of the January. Checkpoint review carried out and programme-level risk management arrangements largely in place. Updated on 02/11/2021 13:32:11

Control Measure	Control Review Update	Status	Days Overdue	Review Date	Control Owner
ORG0059/001 Robust programme management with strong partnership engagement	Review Summary: Checkpoint review took place in December 2021 with all workstreams. LGR	In Progress (Reactive)	0	05/02/2022	Stephen Marsh

Audit Committee Work Programme

Future Agenda Items	Notes
10 March 2022	
External Audit Plan and Sector Update	To receive an update on the external audit timetable and audit work undertaken, and any initial findings
Internal Audit Plan and Audit Charter	To consider the proposed internal Audit Plan and internal Audit Charter
Internal Audit update report	SWAP overview and general update of the progress made against the Audit Plan
Annual Report to Council	To approve the Committee's Annual report to Full Council (July meeting)
16 June 2022	
Risk Management update	To review the Strategic Risk Register
Debtor Management report	To consider the performance of collecting monies owed to the County Council
28 July 2022	
Draft Annual Governance Statement (AGS)	For members to review the content of the draft AGS for the current year. (The AGS is a mandatory statement that sits alongside the Statement of Accounts and provides assurance that SCC has effective internal controls in place)
Annual Audit Opinion from SWAP	To receive the annual audit opinion from the Council's internal auditors
Internal Audit Update	Progress report from SWAP on the status of the current Internal Audit Plan, noting any high risks identified
External Audit Update	An update on the progress of Grant Thornton's audit work and progress
Anti-Fraud and Corruption Report	Our formal annual review of national fraud risks, our fraud policies and our work to prevent and detect frauds against the County Council
External Audit Plan for the Council and Pension Fund	To approve the external auditors audit plans for the Council and the Pension Fund
22 September 2022	
External Audit Update	An update on the progress of the audit as it moves towards a conclusion following the approval of the accounts in July

Internal Audit Update	The regular progress report from SWAP on the completion of the current Internal Audit Plan, highlighting any high risks that have arisen from their work
Risk Management	The regular update on progress in mitigating the highest scoring risks
Debtor Management	The usual update report on collection of monies owed to the County Council, and an update on management progress against the latest SWAP audit
Partial Audit and Risks	To review any completed internal audits that have only received a Partial Assurance, where the dates in the agreed Action Plan show progress should have been made
Tba - November 2022	Pre-Committee meeting SofA briefing/training
24 November 2022	
Statement of Accounts	To approve both the County Council's and Pension Fund's accounts, final Annual Governance Statement and Value for Money arrangements
National Audit Office report	For members to consider a report from the NAO that looks at the governance requirements of transformational projects
External Audit Update	An update on Grant Thornton's work and planning progress, and an update from the audit sector in general
Internal Audit Update	The regular progress report from SWAP on the completion of the current Internal Audit Plan, highlighting any high risks that have arisen from their work