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Horsham District Council

Audit Committee

Wednesday, 18th December, 2019 at 5.30 pm
Conference Room, Parkside, Chart Way, Horsham

Councillors: Stuart Ritchie (Chairman)

Tony Bevis
John Blackall
Paul Clarke
Ruth Fletcher
Jack Saheid

You are summoned to the meeting to transact the following business

Glen Chipp
Chief Executive

Agenda

		Page No.
1.	**Apologies for absence**	
2.	**Minutes** To approve as correct the minutes of the meeting held on 9th October 2019. *(Note: If any Member wishes to propose an amendment to the minutes they should submit this in writing to committeeservices@horsham.gov.uk at least 24 hours before the meeting. Where applicable, the audio recording of the meeting will be checked to ensure the accuracy of the proposed amendment.)*	3 - 6
3.	**Declarations of Members' Interests** To receive any declarations of interest from Members of the Committee	
4.	**Announcements** To receive any announcements from the Chairman of the Committee or the Chief Executive	
5.	**Audit Planning Report** To receive the Audit Planning Report	7 - 40
6.	**Internal Audit - Quarterly Update Report** To receive the Internal Audit – Quaterterly Update Report	41 - 56

Audit Committee
9 OCTOBER 2019

Present: Councillors: Stuart Ritchie (Chairman), John Blackall, Paul Clarke, Ruth Fletcher and Jack Saheid

Apologies: Councillors: Paul Marshall
Absent: Councillors: Tony Bevis

AAG/16 **MINUTES**

The minutes of the meeting held on 11th July were approved as a correct record and signed by the Chairman.

AAG/17 **DECLARATIONS OF MEMBERS' INTERESTS**

None.

AAG/18 **ANNOUNCEMENTS**

None.

AAG/19 **ANNUAL AUDIT LETTER 2018 - 19**

The External Audit Assistant Manager presented the Annual Audit Letter with the purpose of identifying key issues arising from the 2018/19 audit.

There were questions around the IASB Conceptual Framework for Financial Reporting and around new accounting standard IFRS 16 (Leases). The auditor explained that on the balance sheet, income and expenditure were unlikely to alter much but recording of assets and liabilities was likely to alter more.

AAG/20 **RISK MANAGEMENT - QUARTERLY UPDATE**

The Project Assurance Manager presented the Corporate Risk Register to September 2019. She highlighted the four risks currently considered to be high. They were:

- Funding from Government was less generous than assumed in the Medium Term Financial Strategy.
- Uncertainty in the UK and world economy.
- Increase in costs of homelessness, housing services, recycling and transport.
- Decrease in Rateable Value and potentially backdated refunds to 2010. This was a new risk included in the report which was that nationally NHS Foundation Trusts and some NHS Trusts have applied for mandatory charitable

relief on their business rates on the basis that they should be treated as charities.

The Project Assurance Manager clarified that some of the risks in the report had originated as departmental risks.

There was a discussion around the effect that a general election would have on finances and the committee felt Brexit would have more of an effect due to uncertainty in the economy. A new risk surrounding this – CRR34 – has been identified.

There was a further discussion regarding the likelihood that the Government would offset the Council's parking income against what they gave the Council.

The Chairman requested a comment from the Chief Executive on the new rules around data sharing. The Chief Executive clarified that most of the data the Council processed was local data.

RESOLVED
That the Committee note the report.

AAG/21 **RISK MANAGEMENT QUARTERLY UPDATE - APPENDIX 2**

Exclusion of the Press and Public

RESOLVED

That, under Section 100A(2) of the Local Government Act 1972, the press and public be excluded from the meeting for the following items of business on the grounds that they involve the likely disclosure of exempt information, as defined in Part I of Schedule 12A of the Act, by virtue of the paragraph specified against each item, and in all the circumstances of the case, the public interest in maintaining the exemption outweighs the public interest in disclosing the information.

AAG/22 **INTERNAL AUDIT AND INTERNAL CONTROL UPDATE REPORT**

The Chief Internal Auditor presented Members with the Internal Audit Progress Report for quarter 1 for 2019/20. Three audits had been completed.

An opinion of substantial assurance was given for the Homelessness Reduction Act and Print Procurement audits. There were no high or medium priority actions to report to the Committee.

An opinion of reasonable assurance was given for the audit of purchase cards. Attention was drawn to two particular control weaknesses relating to transaction

approvals and split transactions. Remedial action has been agreed for both issues.

The Chief Internal Auditor noted that proactive counter fraud work was ongoing. In addition, a new Counter Fraud Strategy and Framework was being written for the Council. This document sets out the Council's commitment to preventing, detecting and deterring fraud and corruption to ensure public funds are used for their intended purposes.

98% of high and medium agreed actions over a rolling period of 12 months had been implemented. The Chief Internal Auditor drew attention to the fact that the Senior Leadership Team had recently reviewed how purchase orders were dealt with in order to resolve a long-outstanding action.

AAG/23 **URGENT BUSINESS**

There was no urgent business.

The meeting closed at 6.48 pm having commenced at 5.30 pm

CHAIRMAN

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Horsham District Council

Audit planning report

Year ended 31 March 2020

December 2019

EY

Building a better working world

Members of the Audit Committee

Horsham District Council
Parkside
Chart Way
Horsham
West Sussex
RH12 1RL

December 2019

Dear Audit Committee Members

Audit planning report

We are pleased to attach our Audit Plan which sets out how we intend to carry out our responsibilities as auditor. Its purpose is to provide the Audit Committee with a basis to review our proposed audit approach and scope for the 2019/20 audit in accordance with the requirements of the Local Audit and Accountability Act 2014, the National Audit Office's 2015 Code of Audit Practice, the Statement of Responsibilities issued by Public Sector Audit Appointments (PSAA) Ltd, auditing standards and other professional requirements. It is also to ensure that our audit is aligned with the Committee's service expectations.

This plan summarises our initial assessment of the key risks driving the development of an effective audit for the Council, and outlines our planned audit strategy in response to those risks.

This report is intended solely for the information and use of the Audit Committee and management, and is not intended to be and should not be used by anyone other than these specified parties.

We welcome the opportunity to discuss this report with you on 19 December 2019 as well as understand whether there are other matters which you consider may influence our audit.

Yours faithfully

Andrew Brittain

For and on behalf of Ernst & Young LLP

Contents

Public Sector Audit Appointments Ltd (PSAA) issued the "Statement of responsibilities of auditors and audited bodies". It is available from the PSAA website (https://www.psaa.co.uk/audit-quality/statement-of-responsibilities/).The Statement of responsibilities serves as the formal terms of engagement between appointed auditors and audited bodies. It summarises where the different responsibilities of auditors and audited bodies begin and end, and what is to be expected of the audited body in certain areas.
The "Terms of Appointment and further guidance (updated April 2018)" issued by the PSAA sets out additional requirements that auditors must comply with, over and above those set out in the National Audit Office Code of Audit Practice (the Code) and in legislation, and covers matters of practice and procedure which are of a recurring nature.
This report is made solely to the Audit Committee and management of Horsham District Council in accordance with the statement of responsibilities. Our work has been undertaken so that we might state to the Audit Committee, and management of Horsham District Council those matters we are required to state to them in this report and for no other purpose. To the fullest extent permitted by law we do not accept or assume responsibility to anyone other than the Audit Committee and management of Horsham District Council for this report or for the opinions we have formed. It should not be provided to any third-party without our prior written consent.

01 Overview of our 2019/20 audit strategy

Overview of our 2019/20 audit strategy

The following 'dashboard' summarises the significant accounting and auditing matters outlined in this report. It seeks to provide the Audit Committee with an overview of our initial risk identification for the upcoming audit and any changes in risks identified in the current year.

Audit risks and areas of focus

Risk / area of focus	Risk identified	Change from PY	Details
Misstatements due to fraud or error	Fraud risk	No change in risk of focus	As identified in ISA 240, management is in a unique position to perpetrate fraud because of its ability to manipulate accounting records directly or indirectly and prepare fraudulent financial statements by overriding controls that would otherwise appear to be operating effectively. In addition to our overall response, we consider where these risks may manifest themselves and identify separate fraud risks as necessary below.
Risk of fraud in revenue recognition Inappropriate capitalisation of revenue expenditure	Fraud risk	No change in risk of focus	Under ISA240 there is a presumed risk that revenue may be misstated due to improper recognition of revenue. In the public sector, this requirement is modified by Practice Note 10, issued by the Financial Reporting Council, which states that auditors should also consider the risk that material misstatements may occur by the manipulation of expenditure recognition. Our judgement is the significant risk at the Council relates to the improper capitalisation of revenue expenditure.
Pension Liability Valuation	Inherent risk	No change in risk or focus.	The Local Authority Accounting Code of Practice and IAS19 require the Council to make extensive disclosures within its financial statements regarding its membership of the Local Government Pension Scheme administered by West Sussex County Council. The Council's pension fund asset is a material estimated balance and the Code requires that this asset be disclosed on the Council's balance sheet. The information disclosed is based on the IAS 19 report issued to the Council by the actuary to the County Council. Accounting for this scheme involves significant estimation and judgement and therefore management engages an actuary to undertake the calculations on their behalf. ISAs (UK and Ireland) 500 and 540 require us to undertake procedures on the use of management experts and the assumptions underlying fair value estimates.

Overview of our 2019/20 audit strategy

Risk / area of focus	Risk identified	Change from PY	Details
Valuation of Land and Buildings	Inherent risk	No change in risk or focus.	The fair value of Property, Plant and Equipment (PPE) represents a significant balance in the Council's accounts and are subject to valuation changes, impairment reviews and depreciation charges. Management is required to make material judgements and apply estimation techniques to calculate the year-end balances recorded in the balance sheet.
IFRS 16 – readiness assessment	Inherent risk	New risk identified this year.	IFRS 16 (leases) applies from 1 April 2020. We will assess the arrangements HDC have in place to implement the new standards for the 2020/21 financial year.
Group Accounts	Inherent risk	New risk identified this year.	The council have indicated that they have formed a wholly owned subsidiary in 2019/20. The Council will need to provide us an updated group boundary assessment to assess whether group accounts are required for 2019/20

Materiality

Planning materiality
£1,609k

Materiality has been set at £1,609k, which represents 2% of the prior years gross expenditure on provision of services.

Performance materiality
£1,207k

Performance materiality has been set at £1,207k, which represents 75% of materiality.

Audit differences
£80k

We will report all uncorrected misstatements relating to the primary statements (comprehensive income and expenditure statement, balance sheet, movement in reserves statement, cash flow statement and collection fund) greater than £80k. Other misstatements identified will be communicated to the extent that they merit the attention of the Audit Committee.

Overview of our 2019/20 audit strategy

Audit scope

This Audit Plan covers the work that we plan to perform to provide you with:

- Our audit opinion on whether the financial statements of Horsham District Council give a true and fair view of the financial position as at 31 March 2019 and of the income and expenditure for the year then ended; and

- Our conclusion on the Council's arrangements to secure economy, efficiency and effectiveness.

We will also review and report to the National Audit Office (NAO), to the extent and in the form required by them, on the Council's Whole of Government Accounts return.

Our audit will also include the mandatory procedures that we are required to perform in accordance with applicable laws and auditing standards.

When planning the audit we take into account several key inputs:

- Strategic, operational and financial risks relevant to the financial statements;
- Developments in financial reporting and auditing standards;
- The quality of systems and processes;
- Changes in the business and regulatory environment; and,
- Management's views on all of the above.

By considering these inputs, our audit is focused on the areas that matter and our feedback is more likely to be relevant to the Council.

Taking the above into account, and as articulated in this audit plan, our professional responsibilities require us to independently assess the risks associated with providing an audit opinion and undertake appropriate procedures in response to that. Our Terms of Appointment with PSAA allow them to vary the fee dependent on "the auditors assessment of risk and the work needed to meet their professional responsibilities". PSAA are aware that the setting of scale fees has not kept pace with the changing requirements of external audit with increased focus on, for example, the valuations of land and buildings, the auditing of groups, the valuation of pension obligations, the introduction of new accounting standards such as IFRS 9 and 16 in recent years as well as the expansion of factors impacting the value for money conclusion. Therefore to the extent any of these are relevant in the context of Horsham District Council's audit, we will discuss these with management as to the impact on the scale fee.

02 Audit risks

Our response to significant risks

We have set out the significant risks (including fraud risks denoted by*) identified for the current year audit along with the rationale and expected audit approach. The risks identified below may change to reflect any significant findings or subsequent issues we identify during the audit.

	What is the risk?	What will we do?
Misstatements due to fraud or error	As identified in ISA 240, management is in a unique position to perpetrate fraud because of its ability to manipulate accounting records directly or indirectly and prepare fraudulent financial statements by overriding controls that would otherwise appear to be operating effectively.	▸ Inquiry of management about risks of fraud and the controls put in place to address those risks. ▸ Understanding the oversight given by those charged with governance of management's processes over fraud. ▸ Consideration of the effectiveness of management's controls designed to address the risk of fraud. Performing mandatory procedures regardless of specifically identified fraud risks, including: ▸ Testing the appropriateness of journal entries recorded in the general ledger and other adjustments made in the preparation of the financial statements ▸ Assessing accounting estimates for evidence of management bias, and ▸ Evaluating the business rationale for significant unusual transactions. In addition to our overall response, we consider where these risk may manifest themselves and identify separate fraud risks as necessary below.

Our response to significant risks

We have set out the significant risks identified for the current year audit along with the rationale and expected audit approach. The risks identified below may change to reflect any significant findings or subsequent issues we identify during the audit.

Risk of fraud in revenue recognition - inappropriate capitalisation of revenue expenditure

Financial statement impact

Inappropriate capitalisation of revenue expenditure would decrease the net expenditure from the general fund, and increase the value of non-current assets.

What is the risk?

Under ISA 240 there is a presumed risk that revenue may be misstated due to improper revenue recognition. In the public sector, this requirement is modified by Practice Note 10 issued by the Financial Reporting Council, which states that auditors should also consider the risk that material misstatements may occur by the manipulation of expenditure recognition.

From our risk assessment, we have assessed that the risk manifests itself solely through the inappropriate capitalisation of revenue expenditure to improve the financial position of the general fund.

Capitalised revenue expenditure can be funded through borrowing with only minimal MRP charges recorded in the general fund, deferring the expenditure for 30+ years when the borrowing is repaid.

What will we do?

Our approach will focus on:

► For significant additions we will examine invoices, capital expenditure authorisations, leases and other data that support these additions. We review the sample selected against the definition of capital expenditure in IAS 16.

► We will extended our testing of items capitalised in the year by lowering our testing threshold. We will also review a larger random sample of capital additions below our testing threshold.

► Journal testing – we will use our testing of Journals to identify high risk transactions, such as items originally recorded as revenue expenditure and subsequently capitalised.

Other areas of audit focus

We have identified other areas of the audit, that have not been classified as significant risks, but are still important when considering the risks of material misstatement to the financial statements and disclosures and therefore may be key audit matters we will include in our audit report.

What is the risk/area of focus?	What will we do?
Pension asset Valuation The Local Authority Accounting Code of Practice and IAS19 require the Council to make extensive disclosures within its financial statements regarding its membership of the Local Government Pension Scheme administered by West Sussex County Council. The Council's pension fund asset is a material estimated balance and the Code requires that this asset be disclosed on the Council's balance sheet. At 31 March 2019 this totalled £2,961k. The information disclosed is based on the IAS 19 report issued to the Council by the actuary to the County Council. Accounting for this scheme involves significant estimation and judgement and therefore management engages an actuary to undertake the calculations on their behalf. ISAs (UK and Ireland) 500 and 540 require us to undertake procedures on the use of management experts and the assumptions underlying fair value estimates.	We will: ▸ Liaise with the auditors of West Sussex Pension Fund to obtain assurances over the information supplied to the actuary in relation to West Sussex County Council. ▸ Assess the work of the Pension Fund actuary (Hymans Robertson) including the assumptions they have used by relying on the work of PWC - Consulting Actuaries commissioned by Public Sector Auditor Appointments for all Local Government sector auditors, and considering any relevant reviews by the EY actuarial team; and ▸ Review and test the accounting entries and disclosures made within the Council's financial statements in relation to IAS19. ▸ We will engage early with the Council, and their actuary, to understand the ongoing impact of the McCloud judgement on the IAS19 liability.
Valuation of Land and Buildings The fair value of Property, Plant and Equipment (PPE) represents a significant balance in the Council's accounts and are subject to valuation changes, impairment reviews and depreciation charges. Management is required to make material judgements and apply estimation techniques to calculate the year-end balances recorded in the balance sheet.	We will: ▸ Consider the work performed by the Council's valuer, including the adequacy of the scope of the work performed, their professional capabilities and the results of their work; ▸ Sample test key asset information used by the valuers in performing their valuation (e.g. floor plans to support valuations based on price per square metre) and challenge the key assumptions used by the valuer; ▸ Consider the annual cycle of valuations to ensure that assets have been valued within a 5 year rolling programme as required by the Code for PPE. ▸ Review assets not subject to valuation in 2019/20 to confirm that the remaining asset base is not materially misstated; and ▸ Test accounting entries have been correctly processed in the financial statements.

Other areas of audit focus (continued)

What is the risk/area of focus?	What will we do?
IFRS 16 Leases This new accounting standard is applicable for local authority accounts from the 2020/21 financial year and will change: ▸ How operating leases are recognised (as lessee); and ▸ The disclosure requirements for operating leases (as lessee). The 2020/21 Cipfa Code of practice on local authority accounting has not yet been issued. However, the Code requires the disclosure of information relating to the impact of an accounting change that will be required by a new accounting standard, but one which has not yet been implemented.	We will: ▸ Assess the authority's implementation arrangements that should include an impact assessment paper setting out the application of the new standard, transitional adjustments and planned accounting for 2019/20; and ▸ Review additional disclosure requirements.
Group Accounts The council have indicated that they have formed a wholly owned subsidiary in 2019/20. The Council will need to provide us an updated group boundary assessment. The Group boundary assessment should include whether group accounts would be material to the users of the financial statement from both a qualitative and quantitative perspective. Should group accounts be required we will need to provide an update to the Audit Committee as there are significant accounting and auditing implications.	We will: ▸ Review the Councils group boundary assessment taking into account both qualitative and quantitative perspective set out in the CIPFA guidance 'Accounting for collaborations' ▸ If group accounts are required, we will update the Audit Committee on the planned audit approach.

03 Value for Money Risks

Value for Money

Background

We are required to consider whether the Council has put in place 'proper arrangements' to secure economy, efficiency and effectiveness on its use of resources. This is known as our value for money conclusion.

For 2019/20 this is based on the overall evaluation criterion:

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

Proper arrangements are defined by statutory guidance issued by the National Audit Office. They comprise your arrangements to:

- Take informed decisions;
- Deploy resources in a sustainable manner; and
- Work with partners and other third parties.

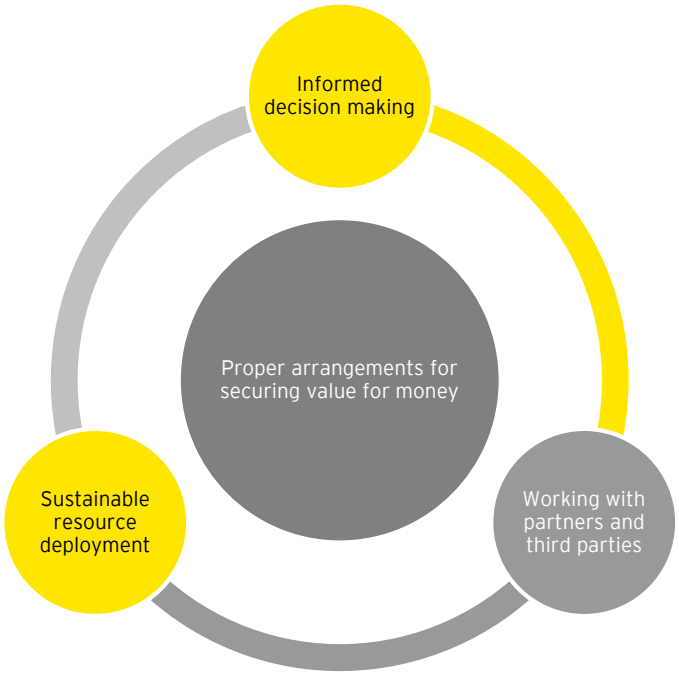
In considering your proper arrangements, we will draw on the requirements of the CIPFA/SOLACE framework for local government to ensure that our assessment is made against a framework that you are already required to have in place and to report on through documents such as your annual governance statement.

We are only required to determine whether there are any risks that we consider significant, which the Code of Audit Practice defines as:

"A matter is significant if, in the auditor's professional view, it is reasonable to conclude that the matter would be of interest to the audited body or the wider public"

Our risk assessment supports the planning of sufficient work to enable us to deliver a safe conclusion on arrangements to secure value for money and enables us to determine the nature and extent of further work that may be required. If we do not identify any significant risks there is no requirement to carry out further work. We consider business and operational risks insofar as they relate to proper arrangements at both sector and organisation-specific level.

Our risk assessment will therefore considered both the potential financial impact of the issues we have identified, and also the likelihood that the issue will be of interest to local taxpayers, the Government and other stakeholders. At this preliminary stage, we have not identified any significant risks but we will keep this assessment under review and update the Audit Committee as soon as possible if risks are identified during the remainder of our audit.

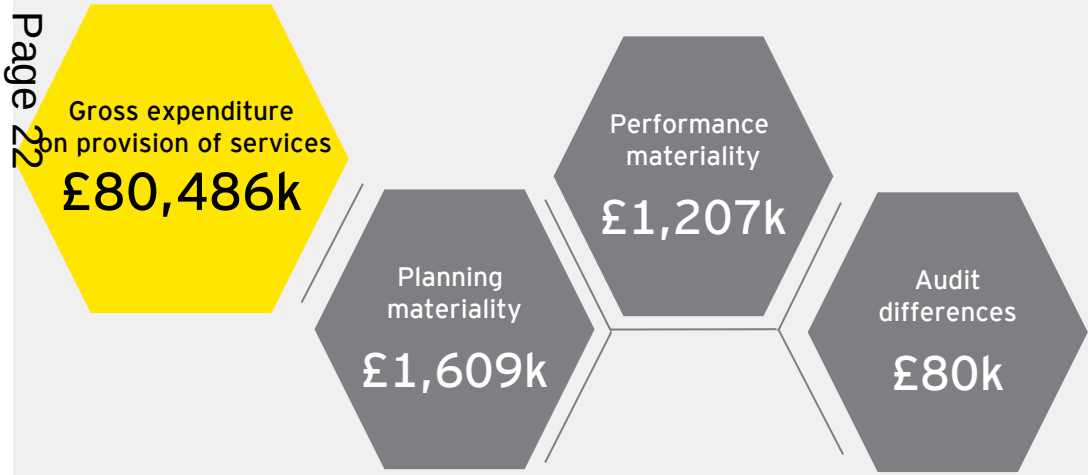


04 Audit materiality

Materiality

Materiality

For planning purposes, materiality for 2019/20 has been set at £1,609k. This represents 2% of the Council's prior year gross expenditure on provision of services. It will be reassessed throughout the audit process. We have provided supplemental information about audit materiality in Appendix C.



We request that the Audit Committee confirm its understanding of, and agreement to, these materiality and reporting levels.

Key definitions

Planning materiality – the amount over which we anticipate misstatements would influence the economic decisions of a user of the financial statements.

Performance materiality – the amount we use to determine the extent of our audit procedures. We have set performance materiality at £1,609k which represents 75% of planning materiality.

Audit difference threshold – we propose that misstatements identified below this threshold are deemed clearly trivial. We will report to you all uncorrected misstatements over this amount relating to the comprehensive income and expenditure statement, balance sheet, and collection fund that have an effect on income or that relate to other comprehensive income.

Other uncorrected misstatements, such as reclassifications and misstatements in the cashflow statement and movement in reserves statement or disclosures, and corrected misstatements will be communicated to the extent that they merit the attention of the Audit Committee, or are important from a qualitative perspective.

05 Scope of our audit

Our Audit Process and Strategy

Objective and Scope of our Audit scoping

Under the Code of Audit Practice our principal objectives are to review and report on the Council's financial statements and arrangements for securing economy, efficiency and effectiveness in its use of resources to the extent required by the relevant legislation and the requirements of the Code.

We issue an audit report that covers:

1. Financial statement audit

Our objective is to form an opinion on the financial statements under International Standards on Auditing (UK).

We also perform other procedures as required by auditing, ethical and independence standards, the Code and other regulations. We outline below the procedures we will undertake during the course of our audit.

Procedures required by standards

- Addressing the risk of fraud and error;
- Significant disclosures included in the financial statements;
- Entity-wide controls;
- Reading other information contained in the financial statements and reporting whether it is inconsistent with our understanding and the financial statements; and
- Auditor independence.

Procedures required by the Code

- Reviewing, and reporting on as appropriate, other information published with the financial statements, including the Annual Governance Statement; and
- Reviewing and reporting on the Whole of Government Accounts return, in line with the instructions issued by the NAO

2. Arrangements for securing economy, efficiency and effectiveness (value for money)

We are required to consider whether the Council has put in place 'proper arrangements' to secure economy, efficiency and effectiveness on its use of resources.

Our Audit Process and Strategy (continued)

Audit Process Overview

Our audit involves:

- Identifying and understanding the key processes and internal controls; and
- Substantive tests of detail of transactions and amounts.

For 2019/20 we plan to follow a substantive approach to the audit as we have concluded this is the most efficient way to obtain the level of audit assurance required to conclude that the financial statements are not materially misstated.

Analytics:
We will use our computer-based analytics tools to enable us to capture whole populations of your financial data, in particular journal entries. These tools:

- Help identify specific exceptions and anomalies which can then be subject to more traditional substantive audit tests; and
- Give greater likelihood of identifying errors than random sampling techniques.

We will report the findings from our process and analytics work, including any significant weaknesses or inefficiencies identified and recommendations for improvement, to management and the Audit Committee.

Internal audit:
We will regularly meet with the Chief Internal Auditor, and review internal audit plans and the results of their work. We will reflect the findings from these reports, together with reports from any other work completed in the year, in our detailed audit plan, where they raise issues that could have an impact on the financial statements.

06 Audit team

Audit team and the use of specialists

The core audit team is lead by Andrew Brittain, Associate Partner and Jack Dunkley as Manager.

Use of specialists

When auditing key judgements, we are often required to rely on the input and advice provided by specialists who have qualifications and expertise not possessed by the core audit team. The area where either EY or third party specialists provide input for the current year audit is:

Area	Specialists
Pensions IAS 19 entries	Hymans Robertson, PwC Actuaries and EY Actuaries
Property valuation	Wilks Head & Eve, and EY Real Estates

In accordance with Auditing Standards, we will evaluate each specialist's professional competence and objectivity, considering their qualifications, experience and available resources, together with the independence of the individuals performing the work.

We also consider the work performed by the specialist in light of our knowledge of the Council's business and processes and our assessment of audit risk in the particular area. For example, we would typically perform the following procedures:

- Analyse source data and make inquiries as to the procedures used by the specialist to establish whether the source data is relevant and reliable;
- Assess the reasonableness of the assumptions and methods used;
- Consider the appropriateness of the timing of when the specialist carried out the work; and
- Assess whether the substance of the specialist's findings are properly reflected in the financial statements.

07 Audit timeline

Timetable of communication and deliverables

Timeline

Below is a timetable showing the key stages of the audit and the deliverables we have agreed to provide to you through the audit cycle in 2019/20.

From time to time matters may arise that require immediate communication with the Audit Committee and we will discuss them with the Audit Committee Chair as appropriate. We will also provide updates on corporate governance and regulatory matters as necessary.

Audit phase	Timetable	Audit committee timetable	Deliverables
Planning: Risk assessment and setting of scopes.	November		
Walkthrough of key systems and processes	December	Audit Committee	Audit Planning Report
	January		
Testing of routine processes Interim audit testing	February		
	March		
	April	Audit Committee	Interim Audit Update report
	May		
Year end audit Audit Completion procedures	June		
	July	Audit Committee	Audit Results Report Audit opinions and completion certificates
	August		
	Autumn	Audit Committee	Annual Audit Letter

08 Independence

Introduction

The FRC Ethical Standard and ISA (UK) 260 "Communication of audit matters with those charged with governance", requires us to communicate with you on a timely basis on all significant facts and matters that bear upon our integrity, objectivity and independence. The Ethical Standard, as revised in June 2016, requires that we communicate formally both at the planning stage and at the conclusion of the audit, as well as during the course of the audit if appropriate. The aim of these communications is to ensure full and fair disclosure by us to those charged with your governance on matters in which you have an interest.

Required communications	
Planning stage	**Final stage**
▸ The principal threats, if any, to objectivity and independence identified by Ernst & Young (EY) including consideration of all relationships between the you, your affiliates and directors and us; ▸ The safeguards adopted and the reasons why they are considered to be effective, including any Engagement Quality review; ▸ The overall assessment of threats and safeguards; ▸ Information about the general policies and process within EY to maintain objectivity and independence. ▸ Where EY has determined it is appropriate to apply more restrictive independence rules than permitted under the Ethical Standard	▸ In order for you to assess the integrity, objectivity and independence of the firm and each covered person, we are required to provide a written disclosure of relationships (including the provision of non-audit services) that may bear on our integrity, objectivity and independence. This is required to have regard to relationships with the entity, its directors and senior management, its affiliates, and its connected parties and the threats to integrity or objectivity, including those that could compromise independence that these create. We are also required to disclose any safeguards that we have put in place and why they address such threats, together with any other information necessary to enable our objectivity and independence to be assessed; ▸ Details of non-audit services provided and the fees charged in relation thereto; ▸ Written confirmation that the firm and each covered person is independent and, if applicable, that any non-EY firms used in the group audit or external experts used have confirmed their independence to us; ▸ Written confirmation that all covered persons are independent; ▸ Details of any inconsistencies between FRC Ethical Standard and your policy for the supply of non-audit services by EY and any apparent breach of that policy; ▸ Details of any contingent fee arrangements for non-audit services provided by us or our network firms; and ▸ An opportunity to discuss auditor independence issues.

In addition, during the course of the audit, we are required to communicate with you whenever any significant judgements are made about threats to objectivity and independence and the appropriateness of safeguards put in place, for example, when accepting an engagement to provide non-audit services.

We also provide information on any contingent fee arrangements, the amounts of any future services that have been contracted, and details of any written proposal to provide non-audit services that has been submitted;

We ensure that the total amount of fees that EY and our network firms have charged to you and your affiliates for the provision of services during the reporting period, analysed in appropriate categories, are disclosed.

Relationships, services and related threats and safeguards

We highlight the following significant facts and matters that may be reasonably considered to bear upon our objectivity and independence, including the principal threats, if any. We have adopted the safeguards noted below to mitigate these threats along with the reasons why they are considered to be effective. However we will only perform non –audit services if the service has been pre-approved in accordance with your policy.

Overall Assessment

Overall, we consider that the safeguards that have been adopted appropriately mitigate the principal threats identified and we therefore confirm that EY is independent and the objectivity and independence of Andrew Brittain, your audit engagement partner and the audit engagement team have not been compromised.

Self interest threats

A self interest threat arises when EY has financial or other interests in the Council. Examples include where we receive significant fees in respect of non-audit services; where we need to recover long outstanding fees; or where we enter into a business relationship with you. At the time of writing, there are no long outstanding fees.

We believe that it is appropriate for us to undertake permissible non-audit services and we will comply with the policies that you have approved.

None of the services are prohibited under the FRC's ES or the National Audit Office's Auditor Guidance Note 01 and the services have been approved in accordance with your policy on pre-approval. The ratio of non audit fees to audits fees is not permitted to exceed 70%.

At the time of writing, we have not undertaken any non-audit work, therefore no additional safeguards are required.

A self interest threat may also arise if members of our audit engagement team have objectives or are rewarded in relation to sales of non-audit services to you. We confirm that no member of our audit engagement team, including those from other service lines, has objectives or is rewarded in relation to sales to you, in compliance with Ethical Standard part 4.

There are no other self interest threats at the date of this report.

Self review threats

Self review threats arise when the results of a non-audit service performed by EY or others within the EY network are reflected in the amounts included or disclosed in the financial statements.

There are no self review threats at the date of this report.

Management threats

Partners and employees of EY are prohibited from taking decisions on behalf of management of the Council. Management threats may also arise during the provision of a non-audit service in relation to which management is required to make judgements or decision based on that work.

There are no management threats at the date of this report.

Relationships, services and related threats and safeguards

Other threats
Other threats, such as advocacy, familiarity or intimidation, may arise. There are no other threats at the date of this report.

Other communications

EY Transparency Report 2018
Ernst & Young (EY) has policies and procedures that instil professional values as part of firm culture and ensure that the highest standards of objectivity, independence and integrity are maintained. Details of the key policies and processes in place within EY for maintaining objectivity and independence can be found in our annual Transparency Report which the firm is required to publish by law. The most recent version of this Report is for the year ended 28 June 2019 and can be found here: https://www.ey.com/en_uk/who-we-are/transparency-report-2019

09 Appendices

Appendix A

Fees

The duty to prescribe fees is a statutory function delegated to Public Sector Audit Appointments Ltd (PSAA) by the Secretary of State for Communities and Local Government.

This is defined as the fee required by auditors to meet statutory responsibilities under the Local Audit and Accountability Act 2014 in accordance with the requirements of the Code of Audit Practice and supporting guidance published by the National Audit Office, the financial reporting requirements set out in the Code of Practice on Local Authority Accounting published by CIPFA/LASAAC, and the professional standards applicable to auditors' work.

	Planned fee 2019/20	Scale fee 2019/20	Final Fee 2018/19
	£	£	£
Total Fee – Code work (1)	TBC	38,572	41,460
Total audit	TBC	38,572	41,460
Other non-audit services not covered above (Housing Benefits) (2)	7,556	N/A	TBC
Total other non-audit services	7,556	N/A	TBC
Total fees	TBC	38,572	TBC

All fees exclude VAT

Note:

(1) the 18/19 Code work includes an additional fee of £2,888, which relates to additional work reviewing the treatment of collective investment vehicles under IFRS 9, and the changes to the pension liability following the 'McCloud' ruling. We have agreed the variation with officers, but are awaiting approval from PSAA. For 19/20 the scale fee may be impacted by a range of factors (see page 7), which we will update the committee on, as the audit progresses.

(2) The 18/19 work has just been completed and a final fee will be determined shortly. For 19/20 the planned fee represents the base fee, i.e. not including any extended testing.

All fees exclude VAT.

The agreed fee presented is based on the following assumptions:

- Officers meeting the agreed timetable of deliverables;
- Our accounts opinion and value for money conclusion being unqualified;
- Appropriate quality of documentation is provided by the Council; and
- The Council has an effective control environment.

If any of the above assumptions prove to be unfounded, we will seek a variation to the agreed fee. This will be discussed with the Council in advance.

Fees for the auditor's consideration of correspondence from the public and formal objections will be charged in addition to the scale fee.

Appendix B

Required communications with the Audit Committee

We have detailed the communications that we must provide to the Audit Committee .

Required communications	What is reported?	Our Reporting to you When and where
Terms of engagement	Confirmation by the Audit Committee of acceptance of terms of engagement as written in the engagement letter signed by both parties.	The statement of responsibilities serves as the formal terms of engagement between the PSAA's appointed auditors and audited bodies.
Our responsibilities	Reminder of our responsibilities as set out in the engagement letter	The statement of responsibilities serves as the formal terms of engagement between the PSAA's appointed auditors and audited bodies.
Planning and audit approach	Communication of the planned scope and timing of the audit, any limitations and the significant risks identified.	Audit planning report
Significant findings from the audit	▸ Our view about the significant qualitative aspects of accounting practices including accounting policies, accounting estimates and financial statement disclosures ▸ Significant difficulties, if any, encountered during the audit ▸ Significant matters, if any, arising from the audit that were discussed with management ▸ Written representations that we are seeking ▸ Expected modifications to the audit report ▸ Other matters if any, significant to the oversight of the financial reporting process	Audit results report
Going concern	Events or conditions identified that may cast significant doubt on the entity's ability to continue as a going concern, including: ▸ Whether the events or conditions constitute a material uncertainty ▸ Whether the use of the going concern assumption is appropriate in the preparation and presentation of the financial statements ▸ The adequacy of related disclosures in the financial statements	Audit results report
Misstatements	▸ Uncorrected misstatements and their effect on our audit opinion, unless prohibited by law or regulation ▸ The effect of uncorrected misstatements related to prior periods ▸ A request that any uncorrected misstatement be corrected ▸ Corrected misstatements that are significant ▸ Material misstatements corrected by management	Audit results report

Required communications with the Audit Committee (continued)

		Our Reporting to you
Required communications	**What is reported?**	**When and where**
Fraud	▸ Enquiries of the Audit Committee to determine whether they have knowledge of any actual, suspected or alleged fraud affecting the entity ▸ Any fraud that we have identified or information we have obtained that indicates that a fraud may exist ▸ A discussion of any other matters related to fraud	Audit results report
Related parties	▸ Significant matters arising during the audit in connection with the entity's related parties including, when applicable: ▸ Non-disclosure by management ▸ Inappropriate authorisation and approval of transactions ▸ Disagreement over disclosures ▸ Non-compliance with laws and regulations ▸ Difficulty in identifying the party that ultimately controls the entity	Audit results report
Independence	Communication of all significant facts and matters that bear on EY's, and all individuals involved in the audit, objectivity and independence Communication of key elements of the audit engagement partner's consideration of independence and objectivity such as: ▸ The principal threats ▸ Safeguards adopted and their effectiveness ▸ An overall assessment of threats and safeguards ▸ Information about the general policies and process within the firm to maintain objectivity and independence	Audit Planning Report Audit Results Report
External confirmations	▸ Management's refusal for us to request confirmations ▸ Inability to obtain relevant and reliable audit evidence from other procedures	Audit results report

Appendix B

Required communications with the Audit Committee (continued)

Required communications	What is reported?	Our Reporting to you When and where
Consideration of laws and regulations	▸ Audit findings regarding non-compliance where the non-compliance is material and believed to be intentional. This communication is subject to compliance with legislation on tipping off ▸ Enquiry of the Audit Committee into possible instances of non-compliance with laws and regulations that may have a material effect on the financial statements and that the Audit Committee may be aware of	Audit results report
Internal controls	▸ Significant deficiencies in internal controls identified during the audit	Audit results report
Representations	Written representations we are requesting from management and/or those charged with governance	Audit results report
Material inconsistencies and misstatements	Material inconsistencies or misstatements of fact identified in other information which management has refused to revise	Audit results report
Auditors report	▸ Any circumstances identified that affect the form and content of our auditor's report	Audit results report
Fee Reporting	▸ Breakdown of fee information when the audit plan is agreed ▸ Breakdown of fee information at the completion of the audit ▸ Any non-audit work	Audit planning report Audit results report
Certification work	Summary of certification work undertaken	Certification report

Additional audit information

Other required procedures during the course of the audit	
In addition to the key areas of audit focus outlined in section 2, we have to perform other procedures as required by auditing, ethical and independence standards and other regulations. We outline the procedures below that we will undertake during the course of our audit.	
Our responsibilities required by auditing standards	▸ Identifying and assessing the risks of material misstatement of the financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion. ▸ Obtaining an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Council's internal control. ▸ Evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by management. ▸ Concluding on the appropriateness of management's use of the going concern basis of accounting. ▸ Evaluating the overall presentation, structure and content of the financial statements, including the disclosures, and whether the financial statements represent the underlying transactions and events in a manner that achieves fair presentation. ▸ Obtaining sufficient appropriate audit evidence regarding the financial information of the entities or business activities within the Council to express an opinion on the financial statements. Reading other information contained in the financial statements, the Audit Committee reporting appropriately addresses matters communicated by us to the Audit Committee and reporting whether it is materially inconsistent with our understanding and the financial statements; and ▸ Maintaining auditor independence.

Additional audit information (continued)

Purpose and evaluation of materiality

For the purposes of determining whether the accounts are free from material error, we define materiality as the magnitude of an omission or misstatement that, individually or in the aggregate, in light of the surrounding circumstances, could reasonably be expected to influence the economic decisions of the users of the financial statements. Our evaluation of it requires professional judgement and necessarily takes into account qualitative as well as quantitative considerations implicit in the definition. We would be happy to discuss with you your expectations regarding our detection of misstatements in the financial statements.

Materiality determines:

- The locations at which we conduct audit procedures to support the opinion given on the financial statements; and
- The level of work performed on individual account balances and financial statement disclosures.

The amount we consider material at the end of the audit may differ from our initial determination. At this stage, however, it is not feasible to anticipate all of the circumstances that may ultimately influence our judgement about materiality. At the end of the audit we will form our final opinion by reference to all matters that could be significant to users of the accounts, including the total effect of the audit misstatements we identify, and our evaluation of materiality at that date.

Report to Audit Committee

18th December 2019

By the Horsham Chief Internal Auditor

INFORMATION REPORT

Not Exempt

Internal Audit Progress Report – Quarter 2 (01/07/19 - 30/09/19)

Executive Summary

To provide Members with an update on all internal audit and counter-fraud activity completed during the quarter, including a summary of all key findings. The report also includes details of progress on delivery of the annual audit plan along with an update on the performance of the internal audit service during the period.

Recommendations

The Committee is recommended to:

- Note the report and consider any further action required in response to the issues raised; and
- Identify any new or emerging risks for consideration for inclusion in the internal audit plan.

Reasons for Recommendations

i) To comply with the requirements set out in the Public Sector Internal Audit Standards 2013 (amended April 2017).

ii) The Audit Committee is responsible for reviewing the effectiveness of the Council's systems of internal control.

Background Papers

Internal Audit Strategy and Annual Plan 2019-20

Wards affected: All.

Report Author: Paul Miller, Horsham Chief Internal Auditor

Contact Details: Russell Banks, Orbis Chief Internal Auditor Tel No. 01273 481447

Paul Miller, Horsham Chief Internal Auditor Tel No. 01403 215319

Background Information

1 Introduction and Background

Background

1.1 This progress report covers work completed between 1 July 2019 and 30 September 2019.

Supporting Information

1.2 The current annual plan for internal audit is contained within the Internal Audit Strategy and Annual Plan 2019-20 which was approved by the Audit Committee on 10 April 2019.

2 Relevant Policy / Professional Standards

2.1 Internal Audit follows the mandatory standards set out in the Public Sector Internal Audit Standards (PSIAS) published by the Chartered Institute of Public Finance and Accountancy (CIPFA) and the Chartered Institute of Internal Auditors.

2.2 The Council's Constitution supports the statutory requirements outlined above. Financial Procedure Rule 4e 27 states that: "the Chief Finance Officer, as determined by the Council, will ensure that the Council has appropriate arrangements in place to maintain an adequate and effective internal audit". The terms of reference for internal audit are detailed in the Council's Internal Audit Charter which is approved and reviewed by the Audit Committee.

3 Conclusion and Reasons for Recommendation

3.1 Key audit findings from final reports are summarised in Appendix A.

3.2 Overall, of the seven formal audits finalised during the quarter, one received an opinion of 'minimal assurance' (see separate exempt report), three received an opinion of 'partial assurance' and two received an opinion of 'reasonable assurance'. We did not give an opinion for our review of the Year of Culture as this was undertaken part way through the project.

3.3 Formal follow up reviews continue to be carried out for all audits where 'minimal assurance' opinions have been given and for higher risk areas receiving 'partial assurance'. Progress on action tracking is provided in Section 3 of Appendix A, and details of outstanding high and medium actions are provided in Section 3.4.

3.4 Members will recall that flexibility was built into the audit plan to allow resources to be directed to any new and emerging risks. We continue to liaise with departments to identify these but would also welcome input from Members. Details of those reviews added and removed from the plan so far this year are set out in section 4 of Appendix A.

3.5 Progress against our performance targets (focussing on a range of areas relating to our service) can be found in section 5 of Appendix A. All targets have been assessed as on target (green).

4 Next Steps

4.1 The Committee will be kept informed about progress in terms of the delivery of the audit plan for 2019/20.

5 Outcome of Consultations

5.1 Heads of Service / Service Managers are consulted during each audit. At the end of each review, audit findings are discussed with the Heads of Service at a final meeting, and actions are agreed. An action plan is incorporated into the final report including details of responsible officers and agreed implementation dates. There are occasions when a director may also be consulted, particularly for audits which span a number of departments.

6 Other Courses of Action Considered but Rejected

6.1 Not applicable.

7 Resource Consequences

7.1 This report summarises information about the work undertaken by Internal Audit, and therefore there are no direct financial or HR consequences.

8 Legal Consequences

8.1 There are no legal consequences. Where compliance issues are identified during audit fieldwork, the Head of Legal & Democratic Services (or relevant legal specialist) will be consulted.

9 Risk Assessment

9.1 All Internal Audit work is undertaken using a risk based approach.

10 Other Considerations

10.1 Internal Audit is a reporting function and there are no consequences in respect of Crime & Disorder; Human Rights; Equality & Diversity; or Sustainability. However these areas are considered where appropriate during audit fieldwork.

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Appendix A

Internal Audit and Counter Fraud

Quarter 2 Progress Report 2019/20

CONTENTS

1. Summary of Completed Audits

Cultural Compliance – Property and Facilities

1.1 The Property and Facilities Team delivers management services across the Council; leads on property development and investment activity; and manages assets and property within the Council's investment and operational portfolios.

1.2 The purpose of the audit was to provide assurance that:

- Management has put in place appropriate arrangements for monitoring delivery of the service and assessing its performance and effectiveness;
- There is an adequate budget setting and monitoring process in place, and that appropriate measures are taken in a timely manner to address budget pressures;
- Expenditure is only incurred for legitimate Council business and is in line with the relevant procurement process;
- Where chargeable services are delivered, appropriate prices are set and regularly reviewed and that all income attributable to the work undertaken by the service is invoiced correctly;
- There is effective staff supervision and performance management including administration of staff development and well-being in accordance with the Council's procedures;
- Assets purchased for the Council are held securely and appropriately managed.

1.3 Overall, we were only able to provide an opinion of **partial assurance** as a number of areas of non-compliance were identified.

1.4 The following improvements have therefore been agreed with management as a result:

- The budget monitoring and forecasting process has been strengthened to help enable monthly reviews to be completed within expected timescales. The Head of Property and Facilities has rebuilt the budget on a bottom up basis for the current financial year. This means that budgets more accurately reflect historic expenditure trends which will enable improved monitoring going forward;
- Purchase orders will be raised, where appropriate, when the purchase is outside of contractual arrangements or not based on a variable price;
- Expenditure limits on purchase cards have been reduced to a single transaction limit of £250 and a monthly credit limit of £750. The Property & Facilities Team will only purchase items for their team and not on behalf of other services;
- All relevant contractual information will be provided to the Council's Procurement Team for inclusion in the central contracts register, and a contract for a service currently being provided will be signed;
- The corporate induction process has now been completed for all new starters. All overdue online mandatory HR training modules had been completed prior to the final audit report being issued.
- A follow up will be conducted as part of the 2020/21 audit plan to confirm that all agreed actions have been implemented.

Emergency Planning

1.5 An emergency may be defined as an event or situation which threatens serious damage to human welfare, the environment, and national security (war or terrorism). Such an event will require a response beyond the everyday resources of the emergency services and those organisations that support them.

1.6 The Council, under the Civil Contingencies Act 2004, is a Category One responder and has a number of duties under this Act:

- Assess the risk of emergencies occurring and use this to inform contingency planning;
- Put in place emergency plans;
- Put in place business continuity management arrangements;
- Put in place arrangements to make information available to the public about civil protection matters and maintain arrangements to warn, inform and advise the public in the event of an emergency;
- Share information with other local responders to enhance co-ordination and efficiency, and, provide advice and assistance to the business and voluntary organisations regarding business continuity management.

1.7 As the definition of an emergency includes terrorism, the Counter-Terrorism and Border Security Act (2019) was included as part of this audit to consider the Council's responsibilities in respect their 'Prevent' duty.

1.8 Emergency Planning for the Council is coordinated by the Emergency Planning Officer, who is part of the Health and Wellbeing & Community Safety Team, reporting to the Health & Wellbeing/Community Safety Manager.

1.9 The purpose of the review was:

- To ensure that the Council is in compliance with the Civil Contingencies Act 2004;
- To ensure that, for civil emergencies, proper processes are in place; resources have been identified; roles and responsibilities have been clearly defined; and appropriate training has been provided;
- To ensure that the Counter-Terrorism and Border Security Act 2019 has been considered and mitigating action has been implemented by the Council.

1.10 Overall, we found a range of control weaknesses and we were only able to provide an opinion of **partial assurance.**

1.11 The following areas for improvement have been agreed with management as a result:

- A 'Prevent' risk assessment and strategy/action plan will be developed to satisfy the Council's 'Prevent' duty. In addition, all front-line staff who deal with internal and external customers will be required to complete the Counter-Terrorism Prevent e-learning training;
- The Council's Emergency Plan has been brought up to date to reflect changes in management responsibilities following the departure of a senior officer who fulfilled a pivotal role in the process;
- The Emergency Communications and Strategy Plan will be reviewed, updated, approved and distributed to all relevant staff as soon as possible. In addition, training will be provided in the use of social media communications in the event of an emergency;

- Responsibility for sense-checking departmental business continuity plans (annually) has been formally assigned to the Council's Emergency Planning Officer;
- A proactive strategy/plan will be developed, alongside Economic Development, to provide advice and assistance to local businesses and voluntary organisations to enable them to develop their own business continuity management plans;
- The Rest Centre Plan will be updated to include all current members of staff who are part of 'Silver Command', rest centre managers and rest centre volunteers.

Contract Management: Supplier Resilience

1.12 A recent analysis of expenditure showed that Horsham District Council spends, annually, around £23.5m on externally sourced goods, works and services. This is spread across 1,600 suppliers with annual expenditure in excess of £3m in some cases.

1.13 Expenditure covers major construction/engineering works; the provision of a commercial vehicle fleet; and also services, both back office support to the Council itself, and front line services to the District's residents.

1.14 Reliance on contractors for the provision of these goods, works and services requires effective contract management to ensure that the Council receives the level and standard of works required (and paid for). It also increases risk to the Council as contractors are not under its direct control and less may be known about them than would be the case for directly provided services. This can be complicated further by the presence of extended supply chains and interdependencies amongst contractors who may be carrying out work for each other, so the failure of one supplier could have a knock-on effect on others

1.15 A number of high-profile supplier failures - most significantly the collapse of Carillion – has focussed attention on these risks and public bodies are having to reassess the way they manage their suppliers. Furthermore, there is significant uncertainty over the effect that Brexit will have on the movement of both goods and labour in a post-Brexit environment and how this will affect the Council's suppliers.

1.16 It is, therefore, essential that the Council has a sound understanding of its suppliers and the impact the failure of either suppliers or their ability to deliver contracted services may have. Whilst the Council has a clear responsibility to engage with its suppliers, this responsibility may become blurred where contractors are appointed through frameworks, which carry out varying levels of checks themselves.

1.17 The purpose of the review was to ensure:

- Due diligence checks identify, in a timely manner, contractors that are at risk of becoming insolvent; do not maintain adequate public liability insurance; or do not have effective business continuity or risk management arrangements in place.
- Market and industry intelligence is sufficient to allow the early enough identification of suppliers or market sectors at risk of failing to enable appropriate steps to be taken.
- Effective business continuity arrangements mitigate the effects of any supply chain failures.

1.18 We found that a number of expected controls were missing, and therefore we were only able to provide an opinion of **partial assurance.**

1.19 The following improvements have been agreed, including a number of fundamental contract management controls which have been built into the Council's documented procedures:

- The Council's critical contracts will be identified;
- Supplier failure will be included in the Council's risk registers for critical contracts;
- The loss of a major supplier will be included in business continuity plan risk assessments;
- Departmental business continuity plans will be checked upon receipt and challenged if they fail to provide appropriate mitigation against the risk of supplier failure;
- For critical contracts, financial health checks will be undertaken on an annual basis;
- For critical contracts, insurances (for example public liability) will be checked annually;
- For critical contracts, Heads of Service will check their contractors' business continuity plans (where appropriate).

General Data Protection Regulations

1.20 As part of the Internal Audit Plan for 2019/2020 we carried out a review of Horsham District Council's key controls and processes to support compliance with the General Data Protection Regulation (GDPR). In doing so, adherence to the provisions of the existing Data Protection Act 2018 (DPA) were also assessed.

1.21 Failure to comply with the GDPR could result in reputational damage and substantial fines by the Information Commissioner's Office of up to 4% of annual global revenue or 20 million euros, whichever is the greater.

1.22 The Information Commissioner's Office '12 Steps to GDPR Compliance' was used as a basis for our audit programme. Testing included discussions with, and evidence provided by, the Data Protection Officer and the officer who leads on Information Governance.

1.23 Notably there has been substantial effort towards ensuring compliance. However, in specific cases despite the controls in place, there remain a few areas where improvement is required to strengthen the current control framework to meet current GDPR requirements.

1.24 We were able to provide **Reasonable Assurance** over the controls operating within the area.

1.25 A summary of the status against each of the 12 steps is outlined in the following table:

Ref	ICO Step	Status		Ref	ICO Step	Status
1	Governance & Awareness	Amber		7	Consent	Green
2	Information You Hold	Amber		8	Children	N/A
3	Communicating Privacy Information	Amber		9	Data Breaches	Amber

4	Individuals Rights	Green		10	Data Protection by Design and Data Protection Impact Assessments	Amber
5	Subject Access Requests	Green		11	Data Protection Officers	Green
6	Lawful Basis for Processing Personal Data	Green		12	International	N/A

1.26 We agreed six medium priority actions with management to manage the risks associated with non-compliance. These include the availability of policies and procedures, regularly reviewing and recording the review of privacy notices; improving the data breach register; and maintaining a central log of third party contracts.

Asset Management (ICT Equipment)

1.27 The Technology Services department is responsible for delivering IT services for the Council. The team provides equipment to approximately 370 employees, casuals, contractors and Members. There were 566 individual computers listed on the Asset Register (as at June 2019).

1.28 In 2017, the Council carried out a major refresh of IT equipment, in order to prepare for the implementation of Windows 10. The Council obtained 450 new computers consisting of 231 laptops, 121 tablets and 98 Desktop PCs, replacing all of the existing stock. In order to encourage more "agile working", a decision was taken to issue laptops and/or tablet computers to most users rather than fixed desktop PCs. Whilst it is recognised that "agile working" generally improves productivity and increases resilience in an organisation, new risks are introduced with the large number of portable devices, including theft, damage and potential breaches of confidentiality. As a result of this refresh, the Council is now placing greater reliance on the effective control of IT equipment.

1.29 The purpose of the audit was to provide assurance that controls are in place to meet the following objectives:

- Appropriate governance arrangements are in place for the procurement and disposal of hardware assets;
- Accurate and current information is held of all of the Council's hardware assets;
- All hardware assets are returned to Technology Services when an employee leaves the Council or no longer requires the equipment;
- To ensure that maintenance is not carried out on equipment that is still protected by consumer legislation or when a warranty is still in place.

1.30 We were able to provide **Reasonable Assurance** over the controls operating within the area under review because effective controls are in place for the allocation of ICT equipment to new users; the maintenance of the asset register; and the recovery of IT assets when someone leaves the Council.

1.31 There is, however, a requirement to introduce a formally documented policy and procedure for the disposal of redundant computers and other IT equipment that are surplus to requirements. We identified a significant number of items of redundant equipment housed within the store cupboards as well as broken and unserviceable computers that the Council is retaining that may have a residual value. These could be sold through the Council's eBay account or be offered to a recycling company.

1.32 Two medium and six low priority actions (two of which have been implemented) were agreed with management to manage the associated risks identified with these findings.

Year of Culture (Project Review)

1.33 The Horsham Year of Culture (YOC) is a celebration of culture and heritage taking place across the whole of the district. The aim of the project was to raise the profile of culture and heritage within the district, with a programme of events throughout 2019, leaving a cultural legacy that will be enjoyed in future years.

1.34 The total cost of the project was expected to be in the region of £746k (as at 2/8/19), being funded through contributions from the Council (£434k over three years), external contributions (e.g. sponsorship) and income from ticket sales for events.

1.35 The primary objective of this audit was to provide assurance that effective controls are in place for the overall management of the YOC project that will help to ensure that the project is a success and outcomes are achieved.

1.36 The purpose of the audit was to provide assurance that:

- Appropriate governance procedures are in place for the project; risks and issues are identified, understood and appropriately managed; and that sign-off is obtained from appropriate officers where required;
- Arrangements are in place that will enable effective monitoring of project objectives;
- Effective processes are in place for the financial management of the overall project;
- Key projects have been identified and are being appropriately managed.

1.37 The audit review was undertaken mid-way through the year so that, should any fundamental control weaknesses be identified, there would be an opportunity to take appropriate remedial action during the life of the project. As the project was still in progress during the audit review, we did not provide an assurance opinion. However, at the time of the review, we concluded that the overall project governance was working effectively. We found that:

- The Year of Culture (YOC) project had a defined and documented governance structure in place.
- The Senior Leadership Team (SLT) receives regular progress updates.
- A risk register is maintained for the project, which is well detailed providing information about the risks, mitigations, owners and review dates.
- An issues log is maintained by the project board, which is updated and reviewed at each board meeting.
- The budget is monitored on a regular basis with updates provided at SLT meetings and to the project board on a fortnightly basis.

- Whilst an overspend position may not be considered ideal, Members are aware of a potential overspend of up to £140k as detailed in the January 2019 Cabinet report.
- The Knepp Castle project (Midsummers Night's Dream performance) was to be the largest single event of the YOC in terms of financial investment by the Council (initial estimate £150,000). However, a decision was made to cancel the event on May 2nd 2019. This decision originated from the newly appointed Head of Service following a review of the risks surrounding the project. In broad terms, the costs were higher than expected and ticket sales fell well short of expectations. The likely outcome of continuing to run this event would have resulted in a substantial financial loss to the Council. It is our opinion that there was sufficient evidence and justification to support the decision.

1.38 We identified some areas for improvement as part of our review, and the following actions were therefore agreed:

- Consideration will be given to reviewing the project objectives and outcomes for the YOC with a view to amending them to 'SMART' objectives. This would be useful at the end of the project when assessing the overall success of the project.
- Monitoring of the project objectives/outcomes will be introduced to enable action to be taken during the project where it appears that specific outcomes may not be achieved.
- Project underspends / overspends will be forecasted in the monthly returns submitted to the Finance Team. In addition, the project board will meet with Finance on a regular basis to ensure that budget figures are correct and effective budget monitoring takes place.
- When involving Finance as part of monitoring the overall financial position for the YOC, they will also be given oversight of the individual budgets for the key projects to help ensure that effective budget monitoring is taking place.
- A lessons learned exercise will be undertaken, by the project board, to ascertain why the Knepp Castle event was cancelled. This will help to prevent similar outcomes for events like this occurring in the future.

2. Counter Fraud and Investigation Activities

Proactive Counter Fraud Work

2.1 The Orbis Internal Audit structure came into effect from 1st April 2018. The integrated structure was designed to deliver resilience, flexibility and quality, along with specific specialisms. A key strand of the structure was the formation of a Counter Fraud Team that would deliver both reactive and proactive fraud services across the partnership. Work to date has focussed on the following areas:

National Fraud Initiative Exercise

2.2 Work is in progress to review the results of the NFI data matching exercise, and this work is ongoing.

Fraud Risk Assessment

2.3 A Fraud risk assessment has been undertaken to ensure that the current fraud threat for the Council has been considered and appropriate mitigating actions identified.

Counter-Fraud Strategy and Framework

2.4 The Orbis Counter Fraud Team has developed a Counter-Fraud Strategy and Framework for Horsham and this has been approved by the Council's Senior Leadership Team. Fraud awareness training is scheduled to take place for all directors and senior managers in January 2020.

3. Action Tracking

3.1 All high and medium priority actions agreed with management as part of individual audit reviews are subject to action tracking. As at the end of quarter 2, 99% of high and medium priority actions due had been implemented within agreed timescales.

3.2 The implementation of high and medium priority agreed audit actions (based on a 12 month rolling period) is summarised in the following table:

Period to:	High & Medium Priority Agreed Actions Due	Not implemented	Implemented	% Implemented
30/09/19	73	1	72	99%

3.3 Internal Audit will continue to work with senior management to ensure that sufficient attention is given to actions that remain overdue and an update on progress will continue to be reported to this committee.

3.4 Details of the outstanding priority agreed action:

Audit / Agreed Action	Directorate	Due Date	Revised Date	Progress to date
Medium Priority *Purchase Orders (POs):* Review the take up of purchase orders and encourage usage, with the expectation that the use of PO's (as measured by POs raised as a percentage of invoices received) will increase.	Corporate Resources	31/12/17	31/03/2020	November 2019 Management Update: The Senior Leadership Team (SLT) has agreed that services will be encouraged to review their processes and use purchase orders where possible. Finance will hold training sessions to help services understand the process involved and also the benefits of using a purchase order. The take up of purchase orders is being reviewed and

				the issue will be revisited, but for now, the expectation is that the use of PO's will increase over the next few months.

4. Amendments to the Audit Plan

4.1 In accordance with proper professional practice, the internal audit plan for the year remains under regular review to ensure that the service continues to focus its resources in the highest priority areas based on an assessment of risk. Through discussions with management, the following reviews have been added to the audit plan during the year:

- Review of HDC-LGSS file transfer process.
- A review of mileage claims, following an identified irregularity.
- Review of officer declarations of interest resulting in improvements in data capture and guidance.

4.2 Through the same process, audits may be removed or deferred from the audit plan and, where appropriate, will be considered for inclusion in the 2020/21 plan as part of the overall risk assessment completed during the annual audit planning process. Whilst the audit plan continues to be on track, the team will be under pressure to deliver all of the remaining work within the agreed allocation of days. This is due to the additional work undertaken (as outlined above), and also due to the extended work involved in finalising a number of audits where the overall opinion has been *partial* or *minimal*.

4.3 An early conversation has taken place with the Director of Corporate Resources outlining available options in the event of further additional unexpected work / extensions of work between now and the end of the current financial year.

5. Internal Audit Performance

5.1 In addition to the annual assessment of internal audit effectiveness against Public Sector Internal Audit Standards (PSIAS), the performance of the service is monitored on an ongoing basis against a set up agreed key performance indicators as set out in the following table:

Aspect of Service	Orbis IA KPI	Target	RAG score	Actual Performance
Quality	Annual Audit Plan agreed by Audit Committee	By end April	**G**	Approved by Audit Committee on 10 April 2019
	Annual Audit Report and Opinion	By end July	**G**	2018/19 report presented to the Audit Committee on 11 July 2019
	Customer Satisfaction levels	90% satisfied	**G**	100%
Productivity and process efficiency	Audit Plan – completion to draft report stage	90%	**G**	64% completed to draft report stage at the end of Quarter 2, against a target of 45%
Compliance with professional standards	Public Sector Internal Audit Standards complied with	Conforms	**G**	January 2018 - External assessment by the South West Audit Partnership gave an opinion

				of 'Generally Conforms' – the highest of three possible rankings
	Relevant legislation such as the Police And Criminal Evidence Act, Criminal Procedures and Investigations Act	Conforms	**G**	No evidence of non-compliance identified
Outcome and degree of influence	Implementation of management actions agreed in response to audit findings	95% for high & Medium priority agreed actions	**G**	99%
Our staff	Professionally qualified / accredited	80%	**G**	96.3%[1]

[1] Includes part-qualified staff and staff currently training for a professional qualification.

Appendix B

Audit Opinions and Definitions

Opinion	Definition
Substantial Assurance	Controls are in place and are operating as expected to manage key risks to the achievement of system or service objectives.
Reasonable Assurance	Most controls are in place and are operating as expected to manage key risks to the achievement of system or service objectives.
Partial Assurance	There are weaknesses in the system of control and/or the level of non-compliance is such as to put the achievement of the system or service objectives at risk.
Minimal Assurance	Controls are generally weak or non-existent, leaving the system open to the risk of significant error or fraud. There is a high risk to the ability of the system/service to meet its objectives.

Report to Audit Committee

19th December 2019
By the Director of Corporate Resources
INFORMATION REPORT

Not Exempt

Risk Management ~ Quarterly Report

Executive Summary

This report includes an update on the Corporate Risk Register for consideration and provides an update on progress with the quarterly departmental risk register reviews.

Recommendations

That the Committee is recommended to:

i) Note the contents of this report.

Reasons for Recommendations

As part of good governance, it is important that this document is considered by Members.

Background Papers

Covalent Performance Management System / Corporate Risk Register

Wards affected: All

Contact: Julie McKenzie, Project Assurance Manager 01403-215306

Background Information

1 Introduction and Background

1.1 The Audit Committee is charged with responsibility for monitoring the effectiveness of the Council's risk management arrangements.

1.2 The report provides details of key changes to the Council's Corporate Risk Register, and an update on progress regarding the departmental risk registers (see 3.1 and 3.2 below).

2 Relevant Council Policy

2.1 The Council's Risk Management Policy is detailed in the Council's Risk Management Toolkit. The Council's Risk Management Strategy is a component part of the Policy, and this document sets out to achieve the following objectives:

- Fully integrate risk management into the culture of the Council and its strategic and service planning processes;
- Ensure that the risk management framework is understood and that ownership and accountability for managing risks is clearly assigned;
- Ensure the benefits of risk management are realised through maximising opportunities and minimising threats;
- Ensure consistency throughout the Council in the management of risk.

3 Details

3.1 Corporate Risk Register

The Senior Leadership Team has reviewed the Corporate Risk Register and comments have been updated to reflect the current position for each risk (see Appendix 1).

The Corporate Risk profile is shown in the following heat map which shows the total number of risks in each segment. The red / amber / green zones are in accordance with the Council's risk appetite.

	CRR01c CRR02 CRR03 CRR06 CRR18 CRR33 CRR34	CRR01b CRR19 CRR32		CRR30
		CRR05 CRR31		
			CRR17	

There are four risks which are currently considered to be high and ten medium risks. The high risk area relates to the following:

CRR01b	Funding from Government is less generous than assumed in the Medium Term Financial Strategy (MTFS) from 2021
CRR19	Uncertainty in the UK and World economy – impact on financial markets and sterling leading to recession
CRR30	Increase in costs of homelessness, housing services, recycling and transport.
CRR32	Decrease in Rateable Value, and potentially backdated refunds to 2010.

Please see the risk register in Appendix 1 which provides full details of all risks on the "live" register together with details of the control actions and responsible officers.

3.2 Departmental Risk Register

Departmental risk registers have been reviewed and updated.

4 Outcome of Consultations

4.1 Officers who are responsible for control actions and the Senior Leadership Team have been consulted in updating the Corporate Risk Register.

5 Other Courses of Action Considered but Rejected

5.1 Not applicable.

6 Financial Consequences

6.1 There are no financial consequences.

7 Legal Consequences

7.1 There are no legal consequences.

8 Staffing Consequences

8.1 There are no staffing consequences.

9 Risk Assessment

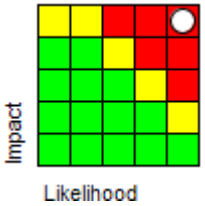
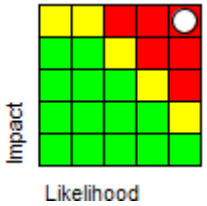
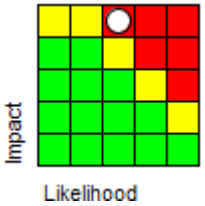
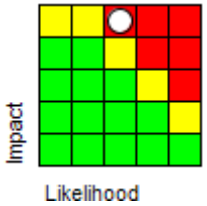
9.1 The report provides an update on the Council's corporate risks and how these are being managed by the Senior Leadership Team. See Appendix 1 for the latest version of the Council's Corporate Risk Register.

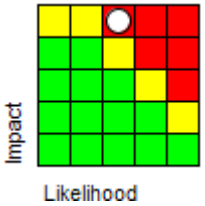
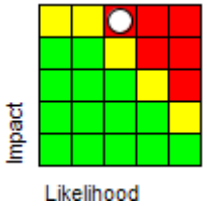
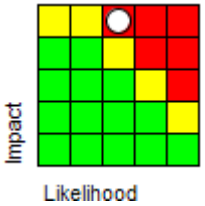
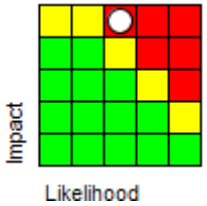
10 Other Considerations

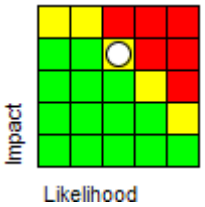
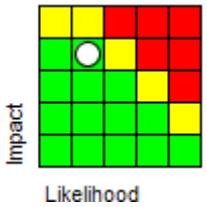
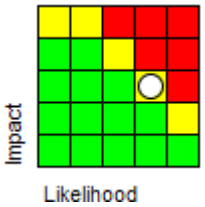
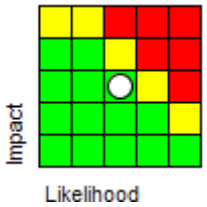
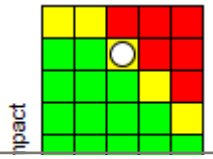
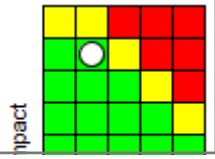
10.1 Risk management encompasses all risks within the organisation, including strategic, operational, and project/change risks. This includes consideration of Crime & Disorder; Human Rights; Equality & Diversity; and Sustainability as appropriate.

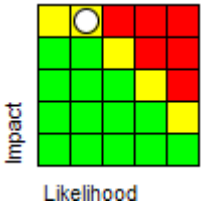
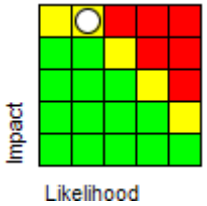
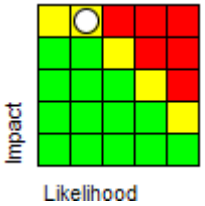
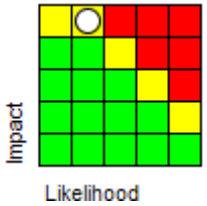
Appendix 1 Corporate Risk Report November 2019
Risks ordered by RAG not numerically

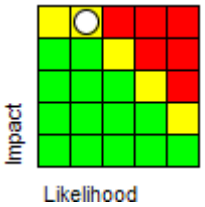
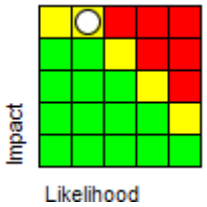
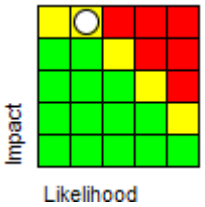
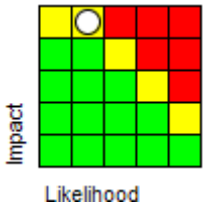
Generated on: 25 November 2019

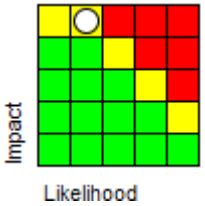
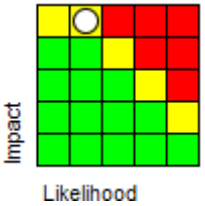
Risk Code & Description	Effect	Risk Owner	Current Risk Matrix	Control Action	Control Action Owner	Status	Target Risk Matrix	Quarterly Update
CRR30 Cause: WSCC have proposed some cuts to their budgets on the September 2018 forward plan. Risk: Increase in costs of homelessness, housing services, recycling and transport	Financial Service delivery in all services due to limited money	Glen Chipp		CRR.30.1 Work with other districts and voluntary organisations to seek ways to re-provide preventative services	Glen Chipp			November 2019 Update: Waste West Sussex County Council have confirmed that recycling credits will be withdrawn. It is likely that a £2m fund will be created to fund business cases that provide mutual benefits to both collection and disposal authorities. The loss of the recycling credits has been reflected in the MTFS. Housing Work continues to mitigate the impact of the Housing Related Support review. A number of services have received additional funding from District & Borough Councils to facilitate a continuation whilst others have ceased to deliver in the certain areas. Procurement for redesigned services envisaged for early 2020 with D&B'S being included as part of the tendering process.
				CRR.30.2 Provide evidence to county to inform their decision making	Glen Chipp			
				CRR.30.3 Task and finish group set up with representatives from across Districts and Boroughs to feed into process	Glen Chipp			
				CRR.30.4 Include on MTFS (Risk also relates to future cuts)	Glen Chipp			
				CRR.30.5 Services rated as amber are being redesigned with all District & Boroughs having a say in how these will be secured in the future	Glen Chipp			
CRR01b Financial Cause: The Council is reliant on Central Controlled Government funding (e.g. Business Rates). Risk: (ii) Funding from Government is less generous than assumed in the MTFS from 2021	Reductions in funding Adverse effect on morale Financial	Jane Eaton		CRR.01b.1 Continue to keep a watching brief	Dominic Bradley			November 2019 Update: Uncertainty beyond 2020, especially with regards to the localisation (75%) retention of business rates and changes from the fair funding review remains a significant area of concern. Government has consulted on both schemes. The Fair Funding

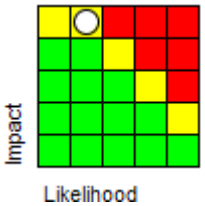
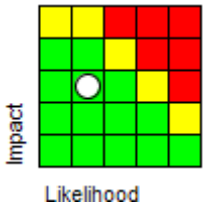
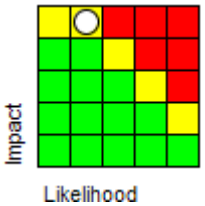
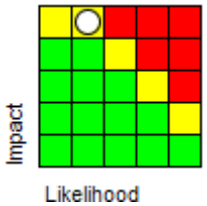
Risk Code & Description	Effect	Risk Owner	Current Risk Matrix	Control Action	Control Action Owner	Status	Target Risk Matrix	Quarterly Update
	Failure to achieve agreed objectives							consultation mentions potentially using excess Parking service income in the funding calculations. This will be reviewed as information and guidance on how the business rates scheme will work and results from the fair funding review are released. Due to Government's focus on Brexit in 2019, this will not be available until the 2021/22 budget. An updated MTFS was presented to Members during November 2019 which indicated near balanced budgets over the period if stout political decisions are made on Council Tax, garden waste and parking charges, alongside officer efficiencies, income generation and digital transformation.
CRR19 Cause: Uncertainty in the UK and World economy. The Government has spoken about an additional 5% reduction in local government funding, and further cuts in years to come. Risk: The impact on the financial markets and the pound could bring forward the next recession and cause a slowdown in the housing market. This may result in a reduction in planning fees; reduced car parking income; increased homelessness; and increased housing benefit claims.	Financial Service Delivery Compliance with Regulations	Jane Eaton		CRR.19.2 Monitor the external environment CRR.19.3 Monitor internal indicators, particularly income generation and respond appropriately to adverse trends	Dominic Bradley Dominic Bradley	 		November 2019 Update: The uncertain economic environment is being continually monitored and changes will be reported in any MTFS update and regular quarterly budget and performance monitoring to Overview and Scrutiny Committee. The Council is reviewing some areas of income generation activity, but ended 2018/19 with more income than the budget which contributed towards a surplus. HDC has published its Brexit plan and updates will be circulated to Members.
CRR32 Cause: Nationally, NHS Foundation Trusts (and some NHS Trusts) have applied for mandatory charitable relief on their business rates, on the basis that they should be treated as charities. Risk: Decrease in Rateable Value,	Reductions in funding Financial	Jane Eaton		CRR.32.1 Continue to keep a watching brief	Dominic Bradley			November 2019 Update: A High Court judicial review is being heard in November 2019 and is ongoing. One NHS Foundation Trust appeal in the district has been received and was included in the business rates

Risk Code & Description	Effect	Risk Owner	Current Risk Matrix	Control Action	Control Action Owner	Status	Target Risk Matrix	Quarterly Update
and potentially backdated refunds to 2010.								appeals provision at 31 March 2019. No separate provision has been created for appeals that have not yet been received.
CRR05 Governance Cause: Managers are responsible for ensuring that controls to mitigate risks are consistently applied. Risk: Officers are either unaware of expected controls or do not comply with control procedures.	Failure of business objectives Health & Safety Financial Service Delivery Compliance with Regulations Personal Privacy Infringement Reputation damage	Jane Eaton		CRR.05.1 Officer training CRR.05.3 All Service Managers required to sign an Assurance Statement. (By 30th June Annually) (Cyclical) CRR.05.4 "Cultural compliance" Internal Audits identify service based issues and help managers to resolve these.	Jane Eaton Jane Eaton Jane Eaton			November 2019 Update: Both 2019/20 cultural compliance audits received a less than satisfactory assurance from Internal Audit. Action plans are being developed to resolve the specific issues found. A further issue has arisen with regards to Trade Waste invoicing. Compliance with monthly financial forecasting across the council has remained high since the improvement in the summer.
CRR17 Cause: The External Auditors audit the HDC Benefits Grant Subsidy return to the Department for Work and Pensions (DWP) on an annual basis to identify errors. Risk: The Benefit Subsidy claim may be qualified and/or financial losses. HDC has a case load with a particularly high number of working people with many changes of circumstances.	Financial Service Delivery Compliance with regulations Reputation	Jane Eaton		CRR.17.1 Continuously monitor the level of quality control checking.	Beccy Salmon			November 2019 Update: This is an ongoing risk. The risk remains until Universal Credit comes in for all working age cases. Figures submitted for 2018/19 led to further 40+ checking as in previous years. The outcome of this and whether further risks have materialised will be known by the time of the Committee.
CRR31 Cause: The success of the election process is dependent upon adequate staffing, effective	Election Petition (challenge through the courts). Election would	Jane Eaton		CRR31.1 Review risks as part of project planning process prior to an election CRR31.2 Training of Internal & external staff	Sharon Evans Sharon Evans			November 2019 update: An experienced Elections Officer has been appointed.

Risk Code & Description	Effect	Risk Owner	Current Risk Matrix	Control Action	Control Action Owner	Status	Target Risk Matrix	Quarterly Update
equipment (including IT) and proper processes Risk: Unavailability of key officers, inadequate processes (including risk assessments and election project plan) leading to failure (including legal challenge).	need to be re-run - significant financial & resource implications. Results of election delayed and associated reputation risk			CRR31.3 Review the adequacy of insurance cover for Returning Officers at the start of election process; ensure adequate protection against an Election Petition	Sharon Evans			
CRR01c Financial Cause: The Council is reliant on Central Controlled Government funding (e.g. Business Rates). Risk: (iii) Decrease in Rateable Value due to several large buildings being redeveloped and coming off the RV list, including Piries Place, Park North and North Point. This causes the Council to fall below the business rates baseline, resulting in loss of funding.	Reductions in funding Financial	Jane Eaton		CRR.01c.1 Continue to keep a watching brief	Dominic Bradley			November 2019 Update: The 2017 Rateable Value list has fallen by £1.8m since 1 April 2017, although has remained relatively stable to date in 2019/20 with a £0.15m 'increase' in the year to date. This overall downward 'trend' remains a significant concern and risk to the Council's funding position should it continue.
CRR02 Managerial / Professional Cause: The Council has a legal obligation to protect personal data. The Information Commissioners powers are much more far reaching when they change in May 2018. Risk 1: Major data breach or leak of sensitive information to a third party. Risk 2: Risk of significant ICO fine for non-compliance with new General Data Protection Regulations (GDPR).	People and businesses come to harm and suffer loss. Complaints / claims / litigation Resources consumed in defending claims Financial losses Fines from regulators Adverse publicity Reputation damage	Jane Eaton		CRR.02.1 Develop appropriate processes & procedures which underpin the IT Security Policy	Andrea Curson / Sharon Evans			November 2019 Update: CRR.02.1 This work is ongoing and will be supported by the IT Security Officer now in post. CRR02.3 This work is ongoing and will be supported by the IT Security Officer now in post. CRR02.4 PSN Accreditation obtained on 8th November 2019 for the year.
				CRR.02.3 Provide a programme of Induction and at least annual training on Information Security to all staff.	Robert Laban			
				CRR.02.4 Annual PSN Accreditation	Andrea Curson			
				CRR.02.5 Representatives from each department meet every other month to maintain compliance, updates and training	Sharon Evans			

Risk Code & Description	Effect	Risk Owner	Current Risk Matrix	Control Action	Control Action Owner	Status	Target Risk Matrix	Quarterly Update
CRR03 Legal Cause: The Civil Contingencies Act places a legal obligation upon the Council, with partners, to assess the risk of, plan, and exercise for emergencies, as well as undertaking emergency and business continuity management. The Council is also responsible for warning and informing the public in relation to emergencies, and for advising local businesses. Risk: The Council is found to have failed to fulfil its obligations under the Act in the event of a civil emergency.	People and businesses come to harm and suffer loss Complaints / claims / litigation Resources consumed in defending claims Financial losses Censure by regulators Reputation damaged	Adam Chalmers		CRR.03.1 Update corporate business continuity plan and regular review.	Rob Jarvis			November 2019 Update: CRR.03.1: Corporate Business Continuity plan reviewed and updated 28/11/2019. Next review date is 28/11/2020 (or in line with any changes or a BC incident). CRR.03.2: Managers responsible for departmental BC plans have been reviewed and SLT provided with an update 12/11/19. CRR.03.5: Bitesize workshops are ongoing through 2019 and 2020 and some councillor awareness sessions will be scheduled in late 2019/2020.
				CRR.03.2 Update departmental business continuity plans and regular review.	Rob Jarvis			
				CRR.03.5 Bitesize workshops in 2017 and 2018 to address new procedures and processes and all SLT and heads of service will be invited to attend.	Rob Jarvis			
CRR06 Physical Cause: The Council is responsible for the health & safety of its clients, staff and other stakeholders, owns and maintains significant assets, and also has responsibility for H&S in some partner organisations where it does not have operational control. Risk: A health & safety failure occurs.	People come to harm Complaints/claims/ litigation Financial losses Censure by audit / inspection Reputation damage Adverse effect on morale Stress and absenteeism	Glen Chipp		CRR.06.2 Develop and implement a corporate inspection strategy (By 30/06/16).	Robert Laban / Health & Safety Officer			November 2019 Update: CRR.06.2: A self-inspections policy has been implemented and is being monitored by the H&S Forum. CRR.06.3 – Completed • H&S responsibilities are set out in the Corporate H&S Policy and H&S subject policies. • H&S Management Forum is responsible for implementing these policies and sharing best practice across the Council. • Team self-audits in place. • H&S Training matrix has been published. • E-learning courses for H&S key topics are accessible via Horsham LAB. CRR.06.4: The introduction of a central repository for risk assessments remains deferred until
				CRR.06.3 Clarity of responsibilities and implementation of a training programme	Robert Laban			
				CRR.06.4 Implement a central repository for risk assessments	Robert Laban / Health & Safety Officer			

Risk Code & Description	Effect	Risk Owner	Current Risk Matrix	Control Action	Control Action Owner	Status	Target Risk Matrix	Quarterly Update
								Technology One can be configured in this respect, or an alternative system can be developed/ purchased – assessments of suitability/ effective system is underway and is an agenda item for the H&S Management Forum until resolved.
CRR18 Technological Cause: Council services are increasingly reliant on IT systems at a time when there are greater opportunities for malicious attackers to exploit security weaknesses. Risk 1: A malicious attacker exploits a known or unknown security weakness to penetrate the Council's ICT systems. Risk 2: IT not working due to environmental problems: fire, flood, power cut	Loss of key systems- disruption to Council services. Cost of investigation and recovery of systems. Fraud/theft. Loss of the integrity of Council Records. Penalties from the ICO. Adverse media coverage.	Jane Eaton		CRR.18.1 Staff and Member Training	Claire Oliver / Robert Laban			November 2019 Update: Level of attack is great. Remediation ongoing. CRR.18.1 - IT Security Training has been rolled out to all staff and the IT Security Officer will be reviewing this training. CRR.18.2 – This work is ongoing. CRR.18.3 All work is ongoing. CRR.18.4 Patching of devices ongoing. CRR.18.5 PSN Accreditation
				CRR.18.2 Awareness of current threats	Andrea Curson			
				CRR.18.3 An effective ICT Service delivery team	Andrea Curson			
				CRR.18.4 Effective patching and updates to mitigate known vulnerabilities	Andrea Curson			
				CRR.18.5 Compliance with expected security standards. (PSN, PCI-DSS)	Andrea Curson			
				CRR.18.6 Effective policies in place which outline security requirements for users of ICT	Andrea Curson			
				CRR.18.7 Effective back-up and recovery processes in place for Council ICT systems.	Andrea Curson			
				CRR.18.8 Transferring the risks to the cloud provider	Andrea Curson			
				CRR.18.9 LGA Cyber Security review plan developed, approved internally and being carried out.	Andrea Curson			

Risk Code & Description	Effect	Risk Owner	Current Risk Matrix	Control Action	Control Action Owner	Status	Target Risk Matrix	Quarterly Update
CRR33 TO BE EXEMPTED Cause: Compensation claim received from L&Q (Landlord of adjacent buildings) in relation to new Piries Place car park works. Risk: Potential litigation action from L&Q in relation to Piries Place car park project. Larger sums being claimed than anticipated	Financial Reputation	Barbara Childs		CRR.33.1 Claim is being investigated by HDC Legal	Sharon Evans			November 2019 Update: Ongoing.
CRR34 Cause: Uncertainty in the UK and World economy. Instability and recent high profile failures, e.g. Carillion Risk: Key contractor failure	Financial	Jane Eaton		CRR.34.1 Regularly check accounts of key suppliers CRR.34.2 Check public liability insurance of key suppliers CRR.34.3 Ask for key suppliers' business continuity plans CRR.34.4 Consider whether the failure of a key supplier needs to go in service business continuity plan	Heads of Service Heads of Service Heads of Service Heads of Service			November 2019 Update: No change to uncertainty.

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Report to Audit Committee

19th December 2019

By the Director of Corporate Resources

INFORMATION REPORT

Not exempt

Annual Governance Statement – Review of Action Plan 2019/20

Executive Summary

The annual review of the Council's governance, risk management and internal control arrangements has been undertaken to support the production of the Annual Governance Statement for 2018/19. This review included information and assurance gathering processes to ensure that the published Annual Governance Statement is correct as well as a review of the Council's Governance framework against the best practice framework devised by CIPFA/SOLACE. The Annual Governance Statement was approved at the Audit Committee on 11th July 2019.

The aim of the review process is to ensure that the Council has effective governance, risk management and internal control processes in place to assist with accountability and the delivery of objectives. Additionally, the review process has identified any shortfalls in these arrangements to enable them to be addressed. These areas for improvement are listed in Appendix A and have been reviewed and updated to show the progress to date.

Recommendations

That the Committee is recommended:

i) To note the revised AGS Action Plan 2019/20.

Reasons for Recommendations

i) As part of good governance, it is important that the improvement actions are reviewed, progressed and completed.

Background Papers: Annual Governance Statement 2018/19

Consultation: The Senior Leadership Team and Monitoring Officer.

Wards affected: All

Contact: Julie McKenzie Project Assurance Manager, 01403-215306

Attachments:

Appendix A: AGS Action Plan 2019/20

Background Information

1 Introduction and Background

1.1 The Accounts and Audit (England) Regulations 2015 require the Council to review, at least annually, the effectiveness of its governance arrangements and publish an Annual Governance Statement.

1.2 Senior officers have been consulted and supporting documentation has been updated to reflect the current position.

2 Relevant Council Policy

The Audit Committee is responsible for approving the Annual Governance Statement in accordance with the Committee's terms of reference.

3 Details

3.1 The Annual Governance Statement - Action Plan 2019/20 is attached in Appendix A.

4 Next Steps

4.1 The Committee is asked to note the revised Annual Governance Statement Action Plan 2019/20 at the December meeting.

5 Outcome of Consultations

5.1 Key officers have been consulted when reviewing and updating the Annual Governance Statement Action Plan including the Senior Leadership Team and the Monitoring Officer.

6 Other Courses of Action Considered but Rejected

6.1 None.

7 Resource Consequences

7.1 There are no direct staffing consequences arising from this report.

8 Legal Consequences

8.1 Regulation 6 of The Accounts and Audit (England) Regulations 2015 requires that:-

6.—(1) A relevant authority must, each financial year—

(a) conduct a review of the effectiveness of the system of internal control required by regulation 3; and
(b) prepare an annual governance statement;

(2) If the relevant authority referred to in paragraph (1) is a Category 1 authority, following the review, it must—

(a) consider the findings of the review required by paragraph (1)(a)—

(i) by a committee; or
(ii) by members of the authority meeting as a whole; and

(b) approve the annual governance statement prepared in accordance with paragraph (1)(b) by resolution of—

(i) a committee; or
(ii) members of the authority meeting as a whole.

8.2 In 2016 CIPFA/SOLACE published a revised framework for Corporate Governance: "Delivering Good Governance in Local Government Framework". This framework provides a useful and practical update and follows seven core principles of good governance. The Framework urges local authorities to review and report on the effectiveness of the governance arrangements.

9 Risk Assessment

9.1 There are no risks associated with this report.

10 Other Considerations

10.1 This report has no effect on Crime & Disorder; Human Rights; Equality & Diversity or Sustainability.

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APPENDIX A:
ANNUAL GOVERNANCE STATEMENT ~ ACTION PLAN 2019/20 – SIX MONTH REVIEW

No.	Area for Improvement	Actions	Responsible Officer	Target Date
1	S151 and Monitoring Officer sign off of decision reports	Roll out of tracking and sign off through Modern.gov	Democratic Services Manager	31/03/20 COMPLETED
2	Revenues and Benefits disaster recovery	Move of all Horsham and Mid Sussex based revenues and benefits systems to Milton Keynes Council	Head of Revenues and Benefits (LGSS)	30/06/19 COMPLETED
3	Plan for major power outage in the District	Prepare a plan for dealing with this type of emergency.	Well-being/ Community Safety Manager	31/10/19 COMPLETED
4	Mandatory governance training courses	Ensure all mandated governance courses are completed by all staff. *Extended to 31/05/19 for Legal and Elections officers by CE* Identify the courses needed, annual refresh and implement a refresh programme, reminders to be issued 31/03/20	Heads of Service Head of HR & OD	31/05/19 COMPLETED 31/05/20 IN PROGRESS
5	Review Council Tax Reduction Scheme non-implementation in 2015	Report on the causes of the Governance Framework issue reported and improvements to the Audit Committee	Director of Corporate Resources	10/04/19 COMPLETED
6	Review of departmental GDPR compliance	Quarterly meetings with GDPR/FOI reps. All Heads of Service to review and update their GDPR Assurance Checklist. Checklist to be circulated January 2020.	All Heads of Service All Heads of Service	31/05/19 COMPLETED 31/03/20 IN PROGRESS

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Report to Audit Committee
18 December 2019
By the Director of Corporate Resources
INFORMATION REPORT

Not exempt

Treasury Management and Prudential Indicators mid-year report 2019/20

Executive Summary

This report covers treasury activity and prudential indicators for the first half of 2019/20. During the period the Council complied with its legislative and regulatory requirements and the statutory borrowing limit, the Authorised Limit, was not breached.

At 30 September 2019, the Council had no external debt (£4m at 31 March 2019) and its investments totalled £42.9m (£44.6m at 30 September 2018).

During the first half of 2019/20, the Council's cash balances were invested in accordance with the Council's treasury management strategy. Interest of £0.44m was earned on investments at an average return of 2.3% (2.1% full year 2018/19).

Recommendations

The Committee is recommended to:

i) Note the treasury management stewardship report at the mid-year 2019/20
ii) Note the mid-year prudential indicators for 2019/20

Reasons for Recommendations

i) This mid-year report is a requirement of the Council's reporting procedures
ii) This report meets the requirements of the relevant CIPFA Codes of Practice for Treasury Management and Prudential Indicators in Capital Finance.

Background Papers
"Treasury Management Strategy 2019-20" – Audit Committee 12 December 2018
"Budget 2019/20 and Medium Term Financial Strategy to 2022/23" – Cabinet 24 January 2019

Consultation: Arlingclose Limited. Council's Treasury management advisors

Wards affected: All

Contact: Julian Olszowka, Group Accountant, Technical 01403 215310

Background Information

1 Introduction

The purpose of this report

1.1 This report covers treasury management activity and prudential indicators for the first half of 2019/20. It meets the requirements of both the CIPFA Code of Practice on Treasury Management and the CIPFA Prudential Code for Capital Finance in Local Authorities. The Council is required to comply with both Codes through Regulations issued under the Local Government Act 2003. The Code recommends that Members are informed of Treasury Management activities at least twice a year.

Background

1.2 In line with the CIPFA Prudential Code for Capital Finance in Local Authorities the Council adopts prudential indicators for each financial year and reports on performance relative to those indicators. This requirement is designed to show that capital spending is prudent, affordable and sustainable and that treasury practices adequately manage risk. The original indicators for 2019/20 together with Capital Strategy were approved by Council on 13 February 2019. The Capital Strategy including the Treasury Management Strategy 2019/20 had been recommended for approval by this Committee on 12 December 2018.

1.3 The economic background to treasury management remains challenging with concerns over Brexit, indebtedness, productivity and growth weighing on the economy and financial system which has still not fully recovered from the 2008 financial crisis. Arlingclose Limited, the Council's treasury management advisors, have provided a commentary on the year so far in Appendix A.

Local Context

1.4 At the end of 2018/19 the Council's underlying need to borrow for capital purposes as measured by the Capital Financing Requirement (CFR) was £33.2m, while usable reserves and working capital which are the underlying resources available for investment were £65m. The Council had £4m of borrowing and £36.1m of investments reflecting its use of internal resources rather than borrowing in order to reduce risk and keep interest costs low.

1.5 The treasury management position at 30 September 2019 and the change during the period is show in table below

	31.3.19 Balance £m	**Movement £m**	**30.9.19 Balance £m**	**30.9.19 Rate %**
Long-term borrowing	0	0	0	
Short-term borrowing	4	-4	0	
Total borrowing	**4**	**-4**	**4**	
Long-term investments	16.8	2.8	19.6	3.8
Short-term investments	13.4	-2.0	11.4	1.3
Cash and cash equivalents	5.9	6.0	11.9	0.7
Total investments	**36.1**	**6.8**	**42.9**	**2.3**

2 Treasury management

Borrowing Activity

2.1 There is now no borrowing as the single £4m PWLB loan at 3.38% was repaid on 1st April 2019.

Investment Activity

2.2 The treasury management position at 30 September 2019 is shown below. This is the month end position but the daily position can vary as a large portion of income comes in at the beginning of month to be distributed to precepting authorities a few days later.

	31.3.19 Balance £m	Movement £m	30.9.19 Balance £m	30.9.19 Rate %
Call accounts	1.9	-1.5	0.4	0.4
Money Market Funds – call	4.0	7.5	11.5	0.7
Money Market Funds – cash plus or short bonds	9.4	0.0	9.4	1.2
Short-term deposits	4.0	-2.0	2.0	1.7
Pooled Funds - Property	5.0	-0.1	4.9	4.2
Pooled Funds – Multi-Asset	5.0	0.0	5.0	4.3
Pooled Funds – Equity	3.5	0.3	3.8	3.5
Pooled Funds – Bonds	3.3	2.6	5.9	2.9
Total Investments	**36.1**	**6.8**	**42.9**	**2.3**

2.3 Both the CIPFA Code and government guidance require the Authority to invest its funds prudently, and to have regard to the security and liquidity of its treasury investments before seeking the optimum rate of return, or yield. The Authority'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.

2.4 Investment income in the period was £0.44m which just exceeded the budget of £0.43m. The average return was 2.25% well over the adopted yield benchmark 7 day LIBID of 0.53% but slightly under budgeted figure of 2.35%. Average cash balances were more than those in the budget which compensates for the slightly lower yield meaning that the current forecast for the full year is that it will be at or slightly above the budget of £0.89m.

2.5 Given the risk and low returns from short-term unsecured bank investments, the council has diversified into more secure and/or higher yielding asset classes. Pooled funds comprising equity, bonds and property are a key part of the strategy and as can be seen from the table above are a significant contributor to overall income.

2.6 However, the pooled funds asset values can be volatile in the short term. At the end of the first half of the year the value of these investments was £200,000 above the

initial investment. However, it should be remembered that these investments are longer term so any snapshot of capital gain or loss should not be overemphasised.

Compliance

2.7 The Director of Corporate Resources reports that all treasury management activities undertaken during the first half of 2019/20 complied with the CIPFA Code of Practice and the Council's approved Treasury Management Strategy.

2.8 Security of capital has remained the Council's main investment objective. Key to this is the counterparty policy as set out in its treasury management strategy. Counterparty credit quality was assessed and monitored with reference to credit ratings, credit default swap prices, financial statements, information on potential government support and reports in the quality financial press.

Treasury Management Indicators

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

2.10 **Security benchmark** – The Council set a security benchmark rating of A, which is the average credit rating for the investment portfolio. The average rating was at above the benchmark at either A+ or AA- during the first half of the year.

2.11 **Liquidity benchmark** – The Council sets a benchmark to maintain a minimum of liquidity. The benchmark set was that £3m is available within a rolling three-month period without additional borrowing. The Director of Corporate Resources can report that liquidity arrangements were well within benchmark during the year to date with overnight cash alone not falling below £1m and a further £9m available within a week's notice.

Compliance with Prudential Indicators

2.12 The Council can confirm compliance with its Prudential Indicators for 2019/20, which were set out in December 2018 as part of the Council's Treasury Management Strategy.

Treasury Management Indicators

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

Interest rate risk indicator - Upper limit	Limit	Actual	Complied
One-year revenue impact of a 1% rise	£0.2m	£0.14m	✓
One-year revenue impact of a 1% fall	£0.2m	£0.14m	✓

2.14 **Principal sums invested for periods longer than 364 days** – The purpose of this indicator is to control the Council's exposure to the risk of incurring losses by

seeking early repayment of its long-term investments. There was no investments for more than 364 days so the Council was well within the indicator set:

	Original Indicator	Maximum Position
Maximum principal sums invested > 364 days	£12m	£0m

3 **Prudential Indicators 2019/20**

3.1 The Local Government Act 2003 requires the Council to have regard to CIPFA's Prudential Code for Capital Finance in Local Authorities (the Prudential Code) when determining how much it can afford to borrow. The objectives of the Prudential Code are to ensure that capital investment plans are affordable, prudent and sustainable. To demonstrate that the Council meets these objectives, the Prudential Code sets out the following indicators that must be set and monitored each year.

3.2 **The Council's Capital Expenditure and Financing 2019/20 -** This is one of the required prudential indicators and shows total capital expenditure for the year and how this is financed. The estimated indicator is shown below.

2019/20	Original Estimate £m	Current projection £000
Total capital expenditure	19.2	13.4
Resourced by:		
External Resources	4.7	3.7
Internal Resources	10.8	6.7
Debt	3.7	3.0
Total financing	19.2	13.4

3.3 The estimated capital spend in 2019/20 is projected as under the original budget with financing similarly lower than expected.

3.4 **The Council's overall borrowing need -** The Council's underlying need to borrow is termed the Capital Financing Requirement (CFR). It represents the accumulated net capital expenditure which has not been financed by revenue or other resources. Part of the Council's treasury activities is to address this borrowing need, either through borrowing from external bodies, or utilising temporary cash resources within the Council.

3.5 The Council is required to make an annual revenue charge, the Minimum Revenue Provision (MRP), to reduce the CFR – effectively a repayment of the borrowing need. The Council's 2019/20 MRP Policy was approved on 13 February 2019 within the 2019/20 Budget report.

3.6 The Council's CFR for the year is shown below, and represents a key prudential indicator. There is a decrease in the expected CFR is mainly due to the unfinanced capital spend being less than expected. No increase in long-term borrowing is projected in this financial year.

Capital Financing Requirement and External Debt Year end 2019/20	Original estimate £m	Current projection £m
CFR	36.4	35.3
External debt	0	0

3.7 External borrowing should not, except in the short term, exceed the total of CFR in the preceding year plus the estimates of any additional CFR for 2019/20 and next two financial years. No difficulties are envisaged for the current or future years in complying with this Prudential Indicator as no long-term borrowing is currently planned.

3.8 **Borrowing limits** - The Council approved these Prudential Indicators as part of the 2019/20 Budget report.

3.9 **Operational boundary for external debt:** The operational boundary is based on the Council's estimate of most likely, i.e. prudent, but not worst case scenario for external debt.

3.10 **Authorised limit for external debt:** The authorised limit is the affordable borrowing limit determined in compliance with the Local Government Act 2003. It is the maximum amount of debt that the Council can legally owe. The authorised limit provides headroom over and above the operational boundary for unusual cash movements.

	Limit	Actual	Met?
Operational boundary – borrowing	£0m	£0m	✓
Operational boundary – other long-term liability	£0m	£0m	✓
Operational boundary – TOTAL	£0m	£0m	✓
Authorised limit – borrowing	£15m	£0m	✓
Authorised limit – other long-term liability	£1m	£0m	✓
Authorised limit – TOTAL	£16m	£0m	✓

3.11 **The ratio of financing costs to net revenue stream -** This indicator identifies the trend in the cost of capital (financing costs net of interest and investment income) against the net revenue stream. The indicator for the year was 0% as investment income was almost exactly matching the financing costs. Based on current estimates the ratio is -0.4% as investments slightly exceed financing costs so the net financing costs are within the benchmark.

4 Non-Treasury Investments

4.1 The definition of investments in CIPFA's revised Treasury Management Code now covers all the financial assets of the Authority as well as other non-financial assets which the Authority holds primarily for financial return. This is replicated in MHCLG's Investment Guidance, in which the definition of investments is further broadened to also include all such assets held partially for financial return.

4.2 The Council has a significant directly owned property portfolio valued at £50.9m at the end of 2018/19. No new properties have been added to the portfolio in the first half of the year. The original investment strategy set £3.5m as the income figure from the property portfolio and the present forecast is £3.6m. There are a number of other indicators that were set for the year that cannot be definitively calculated until the end of the year when the accounts are closed and all relevant income and expenditure is accrued and central expenses are apportioned across all the Council's services. Some indicators can estimated as a snap shot from property records and the table below shows the original estimated indicators and the latest projections.

Indicator	Estimate	Latest
Average Vacancy levels	2%	0.3%
Tenant over 5%	5	5
Weighted Average Unexpired Lease Term (WAULT)	11yr	10yr
Bad debts written off	£10,000	£3,000

4.3 A number of indicators for the investment properties require the end of year value of the property. The value of the properties remains as it was at the end of 2018/19 as a revaluation only occurs at the end of the financial year. There has been evidence of a decrease in some property sector values in the past few months but there is no clear way to extrapolate to the Council's portfolio.

4.4 The Council has one small loan (£0.3m) to a community run leisure centre and this is performing as expected so the income should meet the estimate and no increase in the expectation of any credit loss is envisaged.

4.5 The July meeting of this Committee recommended a limit on investment in its subsidiaries for 2019/20 of £0.5m to allow the Council to invest in its housing company. It is expected that a £0.5m investment will be made in the second half of the year.

5 Staffing consequences

5.1 There are no direct staff resourcing consequences. However, the risks in the investment environment highlights the continuing need for staff training and staff will take advantage of courses run by its advisors Arlingclose Limited.

6 Financial consequences

6.1 Interest earned in 2019/20 is expected to be £18,000 above budget. MRP will be £37,000 under the budget. Minimal interest for short term cash flow purposes of £1,000 is expected to be paid out in the 2019/20 year.

7 Other considerations

7.1 There are no consequences of any action proposed in respect of Risk; Crime & Disorder; Human Rights; Equality & Diversity and Sustainability.

Appendix A

Economic background to the midpoint of 2019/20

Economic background: UK Consumer Price Inflation (CPIH) fell to 1.7% year/year in August 2019 from 2.0% in July, weaker than the consensus forecast of 1.9% and below the Bank of England's target. The most recent labour market data for the three months to July 2019 showed the unemployment rate edged back down to 3.8% while the employment rate remained at 76.1%, the joint highest since records began in 1971. Nominal annual wage growth measured by the 3-month average excluding bonuses was 3.8% and 4.0% including bonuses. Adjusting for inflation, real wages were up 1.9% excluding bonuses and 2.1% including.

The Quarterly National Accounts for Q2 GDP confirmed the UK economy contracted by 0.2% following the 0.5% gain in Q1 which was distorted by stockpiling ahead of an expected Brexit. Only the services sector registered an increase in growth, a very modest 0.1%, with both production and construction falling and the former registering its largest drop since Q4 2012. Business investment fell by 0.4% (revised from -0.5% in the first estimate) as Brexit uncertainties impacted on business planning and decision-making.

Politics, both home and abroad, continued to be a big driver of financial markets over the last quarter.

In the UK Boris Johnson won the Conservative Party leadership contest and was committed to leaving the EU on 31st October regardless of whether a deal was reached with the EU. However, Parliament passed a bill requiring him to seek a Brexit extension whcich extended Brexit uncertainty into the second half of the fiananveila year.

Globvally tensions continued between the US and China with no trade agreement in sight and both countries imposing further tariffs on each other's goods. The US Federal Reserve cut its target Federal Funds rates by 0.25% in September to a range of 1.75% - 2%, a pre-emptive move to maintain economic growth amid escalating concerns over the trade war and a weaker economic environment leading to more pronounced global slowdown. The euro area Purchasing Manager Indices (PMIs) pointed to a deepening slowdown in the Eurozone. These elevated concerns have caused key government yield curves to invert, something seen by many commentators as a predictor of a global recession. Market expectations are for further interest rate cuts from the Fed and in September the European Central Bank reduced its deposit rate to -0.5% and announced the recommencement of quantitative easing from 1st November.

The Bank of England maintained Bank Rate at 0.75% and in its August Inflation Report noted the deterioration in global activity and sentiment and confirmed that monetary policy decisions related to Brexit could be in either direction.

Financial markets: After rallying early in 2019, financial markets have been adopting a more risk-off approach in the following period as equities saw greater volatility and bonds rallied (prices up, yields down) in a flight to quality and anticipation of more monetary stimulus from central banks. The Dow Jones, FTSE 100 and FTSE 250 are broadly back at the same levels seen in March/April.

Gilt yields remained volatile over the period on the back of ongoing economic and political uncertainty. From a yield of 0.63% at the end of June, the 5-year benchmark gilt yield fell

to 0.32% by the end of September. There were falls in the 10-year and 20-year gilts over the same period, with the former dropping from 0.83% to 0.55% and the latter falling from 1.35% to 0.88%. 1-month, 3-month and 12-month LIBID (London Interbank Bid) rates averaged 0.65%, 0.75% and 1.00% respectively over the period.

Recent activity in the bond markets and PWLB interest rates highlight that weaker economic growth remains a global risk. The US yield curve remains inverted with 10-year Treasury yields lower than US 3-month bills. History has shown that a recession hasn't been far behind a yield curve inversion. Following the sale of 10-year Bunds at -0.24% in June, yields on German government securities continue to remain negative in the secondary market with 2 and 5-year securities currently both trading around -0.77%.

Credit background: Credit Default Swap (CDS) spreads rose and then fell again during the quarter, continuing to remain low in historical terms. After rising to almost 120bps in May, the spread on non-ringfenced bank NatWest Markets plc fell back to around 80bps by the end of September, while for the ringfenced entity, National Westminster Bank plc, the spread remained around 40bps. The other main UK banks, as yet not separated into ringfenced and non-ringfenced from a CDS perspective, traded between 34 and 76bps at the end of the period.

There were minimal credit rating changes during the period. Moody's upgraded The Co-operative Bank's long-term rating to B3 and Fitch upgraded Clydesdale Bank and Virgin Money to A-.

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Report to Audit Committee

18 December 2019

By the Director of Corporate Resources

DECISION REQUIRED

Not exempt

Horsham District Council

Capital Strategy 2020/21 incorporating Investment and Treasury Management Strategy

Executive Summary

This report is the second year's version of a report that was new last year. It was required by changes in CIPFA and the Ministry of Housing, Communities and Local Government (MHCLG) guidance. It combines an overview of how capital expenditure, capital financing, treasury and other investment activity contribute to the provision of local public services along with an overview of how associated risk is managed and the implications for future financial sustainability. The strategies set limits and indicators that embody the risk management approach that the Council believes to be prudent. The strategies are set against the mid-term financial strategy, the context of the UK economy and projected interest rates.

The report sets treasury investment criteria and limits which are largely unchanged with the exception of changes to the limits for pooled funds, Real Estate Investment Trusts (REITs), and Registered Providers detailed in Appendix B. The investment strategy in section 5 pulls together information on commercial property to explicitly show the Councils risk management approach in that area.

Recommendations

The Committee is asked to:

i) approve this Capital Strategy as an appropriate overarching strategy for the Council while leaving the full Council to approve the updated capital strategy that will accompany the 2020/21 budget to Council.

ii) recommend that the full Council approve the Treasury Management Strategy for 2020/21 and the associated limits and specific indicators included in section 4 and appendix B of this report.

iii) recommend that the full Council approve the Investment Strategy for 2020/21 and the associated limits and specific indicators included in section 5 and appendix C of this report.

Reasons for Recommendations

i) The Council is required to have regard to the Chartered Institute of Public Finance and Accountancy's Treasury Management in the Public Services: Code of Practice 2017 Edition (the CIPFA Code) and Prudential Code which requires the Council to approve a Capital strategy, Investment strategy and Treasury Management Strategy before the start of each financial year.

ii) The Ministry for Housing Communities and Local Government (MHCLG) issued revised guidance on local authority investments in 2017 that the Council is required to have regard to.

Background Paper
"Medium Term Financial Strategy 2020/21 to 2023/24" – Cabinet 28 November 2019

Consultation: Arlingclose Limited

Wards affected: All

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Background Information

1 Introduction

The purpose of this report

1.1 This report covers the requirements of Codes and guidance that the Council must, by statue, have regard to. Section 3 gives a high-level overview of:

- how capital expenditure, capital financing and treasury management activity contribute to the provision of local public services
- how associated risk is managed and;
- the implications for future financial sustainability.

1.2 The Treasury Management Strategy in section 4 covers the aspects of investments that this Committee has historically considered. It covers management of the Council's cash flows, borrowing and investments, and the associated risks. The investment strategy in section 5 is a requirement introduced last year and covers investments held for service purposes or for commercial profit which were not previously included in the Treasury Management Strategy.

1.3 The changes to guidance were designed to bring together areas which CIPFA and MHCLG consider should be regarded in the round. They were also a response to the increasing commercialisation of local government and especially the increasing investment in commercial property. The guidance requires the Capital and Investment Strategies to be approved by the full Council while the Treasury Management Strategy can now be approved by a subcommittee of the Council. However, here we follow the Council's existing Constitution that this Committee recommends the Treasury Management Strategy be approved by the full Council.

2 Background

Economic background

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

2.2 The forecast for the Bank Rate is that it remains at current levels in the medium term. For the purpose of the interest budget, any new investments are estimated to be on or about the Bank Rate.

2.3 The treasury management environment remains difficult with yields and quality counterparties still reduced in the aftermath of the financial crisis of 2008 with no return to pre-crisis rates in sight. Governments and regulators have put in place measures prompted by the crisis that restrict any government bail-out of individual financial institutions. This means an institution in difficulty may have to

use its own resources and its deposits to continue to operate, exposing any depositor's capital.

Statutory background

2.4 This report is part of the Council's legal obligation under the Local Government Act 2003 to have regard to both the CIPFA Code and the Ministry for Housing, Communities and Local Government (MHCLG) Guidance.

2.5 The regulatory background has been complicated by the revision by both CIPFA and MHCLG codes and guidance. Both CIPFA and the MHCLG state they do not seek to prescribe precisely how councils invest but they clearly have concerns that some councils are taking increasing commercial risks using borrowed money. This approach means that Members are asked to look at a more extensive strategy so that more of the risks that the Codes and guidance highlight are apparent to Members.

Relevant Council policy

2.6 The Council's constitution requires that the Council approve Prudential Code indicators and Treasury Management Strategy. The Investment Strategy covering commercial property has been split from the traditional Treasury Management Strategy here for ease of understanding as it deals with a different type of investment but it can be considered to be encompassed in the definition of the Treasury Management Strategy as used by the Constitution.

2.7 The existing strategies and Prudential indicators were approved by the Council on 13 February 2019 the former having been recommended for adoption by this Committee on 12 December 2018.

3 Capital Expenditure and Financing

3.1 Capital expenditure is where the Council spends money on assets, such as property or vehicles that will be used for more than one year. In local government this includes spending on assets owned by other bodies, and loans and grants to other bodies enabling them to buy assets. All capital expenditure must be financed, either from external sources (government grants and other contributions), the Council's own resources (revenue, reserves and capital receipts) or debt (borrowing or leasing).

3.2 Service managers bid annually in October to include projects in the Council's capital programme. Bids are collated by Finance who calculate the financing cost (which can be nil if the project is fully externally financed). The Senior Leadership Team appraises all bids based on a comparison of service priorities against financing costs and makes recommendations to the informal cabinet. The final capital programme is then presented to Cabinet in January and to Council in February each year.

3.3 The current projected capital programme and financing is shown below. It includes current estimates for capital bids for 2020/21 and beyond. The use of reserves is in line with the Medium Term Financial Strategy report to the Cabinet of 28 November 2019. It will be revised if necessary as the 2020/21 budget

process develops and the final figures appear alongside the Budget in February 2020 will constitute one of the prudential indicators required by the CIPFA Prudential Code. Capital expenditure for 2020/21 includes £3.5m due to a change in the accounting for leases. This gives rise to a notional borrowing from the lease provider.

£millions	**2018/19 Actual £000**	**2019/20 Estimate £000**	**2020/21 Estimate £000**	**2021/22 Estimate £000**	**2022/23 Estimate £000**
Projected Capital Expenditure	14.6	13.4	15.0	10.9	12.8
Financed by:					
External resources	3.5	3.7	5.5	6.8	9.1
Internal Resources *	7.4	6.7	6.0	4.1	3.7
Debt	3.7	3.0	3.5	0.0	0.0
Total Financing	14.6	13.4	15.0	10.9	12.8

* Includes use of New Homes Bonus

3.4 The term 'Debt' used above does not automatically lead to external borrowing as the Council may be able to use cash it holds in reserves and as working capital which is usually termed 'internal borrowing'. Over time all debt whether it be internal or external borrowing must be repaid, and this is therefore replaced over time by other financing, usually from revenue which is known as minimum revenue provision (MRP). The Council is required to make an annual MRP statement and this will be included in the Budget report in January 2020 and the methodology will be on the same basis as 2019/20. The current planned MRP payments are as follows:

£millions	**2018/19 actual**	**2019/20 forecast**	**2020/21 budget**	**2021/22 budget**	**2022/23 budget**
MRP	0.870	0.844	1.081	1.084	1.086

3.5 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 and any capital receipts used to replace debt. The CFR is expected to increase by £2.4m during 2020/21. The change in the accounting for leases introduced an increase of £3.2m so without this technical accounting change the CFR would have decreased. The Council's estimated CFR is projected as follows:

£millions	**31.3.2019 actual**	**31.3.2020 forecast**	**31.3.2021 budget**	**31.3.2022 budget**	**31.3.2023 budget**
CFR	33.2	35.3	37.7	36.6	35.5

3.6 **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. Repayments of capital grants, loans and investments also generate capital receipts. The Council projects capital receipts as follows:

£millions	2018/19 actual	2019/20 forecast	2020/21 estimate	2021/22 estimate	2022/23 estimate
Asset sales	1.2	1.1	2.9	1.6	0.8
Loans repaid	0.1	0.0	0.8	2.4	2.4
TOTAL	**1.3**	**1.1**	**3.7**	**4.0**	**3.2**

4 Treasury Management

4.1 Treasury management is concerned with keeping sufficient but not excessive cash available to meet the Council's spending needs, while managing the risks involved. Surplus cash is invested until required, while a shortage of cash will be met by borrowing, to avoid excessive credit balances or overdrafts in the bank current account. The Council is typically cash rich in the short-term as revenue income is received before it is spent, but cash poor in the long-term as capital expenditure is incurred before being financed. The revenue cash surpluses are offset against capital cash shortfalls to reduce overall borrowing. At the mid-year point the Council had no borrowing and £43m treasury investments at an average rate of 2.3%.

4.2 **Borrowing strategy**: The Council has no plans to borrow but could find itself in a position which calls for borrowing. In that circumstance the main objectives when borrowing would be to achieve a low but certain cost of finance while retaining flexibility. These objectives are often conflicting, and the Council therefore would seek to strike a balance between cheap short-term loans (currently available at around 0.8%) and long-term fixed rate loans where the future cost is known but higher (currently about 3.0%).

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

£millions	31.3.2019 actual	31.3.2020 forecast	31.3.2021 budget	31.3.2022 budget	31.3.2023 budget
Debt (incl. leases)	0	0	3.5	3.3	3.1
CFR	33.2	35.3	37.7	36.6	35.5

4.4 The table above demonstrates that the Council is relying on internal borrowing i.e. using reserves and other cash resources that it holds rather than borrow from external sources. From projections of the capital programme and use of reserves this strategy is seen as sustainable in the medium term although the Director of Corporate Resources will monitor the actual position against the projections in order to be ready to respond should external borrowing become advisable. In this the Council will use advice from its adviser as to the best course of action.

4.5 **Affordable borrowing limit**: Irrespective of plans to borrow or not the Council is legally obliged to set an affordable borrowing limit (also termed the authorised limit for external debt) each year. In line with statutory guidance, a lower "operational boundary" is also set as a warning level should debt approach the limit. The increase in lease figures from 2020/21 reflects the fact that the accounting treatment of leases changes from that year. Although no borrowing is planned, limits are set in case a need develops. Further details on borrowing are in appendix B.

£millions	2019/20 limit	2020/21 limit	2021/22 limit	2022/23 limit
Authorised limit – borrowing	15	15	15	15
Authorised limit – leases	1	6	6	6
Authorised limit – total external debt	16	21	21	21
Operational boundary – borrowing	0	0	0	0
Operational boundary – leases	0	4	4	4
Operational boundary – total external debt	0	4	4	4

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

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

	31.3.2019 actual	31.3.2020 forecast	31.3.2021 estimate	31.3.2022 estimate	31.3.2023 estimate
Near-term investments	19	11	14	13	8
Longer-term investments	17	19	20	20	20
TOTAL	**36**	**30**	**34**	**33**	**28**

4.8 The projections show cash balances at year-end, which is a cash low point, of about the £30m mark for the medium term. The major capital spends of the past few years at the Bridge and Piries Place car park will have finished and developers' contributions and New Homes Bonus flow in faster than they are spent. The New Homes Bonus projection used follows that in the Medium Term Financial Strategy reported to Cabinet on 28 November 2019. Further detail on treasury investments are in Appendix B including limits and indicators which the

Committee is asked to consider. The significant changes compared to last year's limits are an increase in limits on equity and bonds pooled funds from £15m to £18m, increase in limits on REITs from £2m to £5m, and an increase in limits for unrated Registered Providers from £2m over 1 year to £3m over 3 years. More detail on the justification is in Appendix B. It should be emphasised that these changes are to give the Council reasonable headroom and flexibility to operate until the end of the next financial year.

4.9 **Governance:** Decisions on treasury management investment and borrowing are made daily and are therefore delegated to the Director of Corporate Resources and staff, who must act in line with the Treasury Management Strategy as approved by the Council following this committee's scrutiny and recommendation. The Audit Committee receives a mid-year and full year report and is responsible for scrutinising treasury management decisions.

5 Investment Strategy (loans, shares and property)

5.1 This section is the disclosure newly required last year by CIPFA and MHCLG guidance. Both bodies have concerns over the increasing risks that they see in the sector as councils have become more commercial and made large commercial property purchases.

Investments for Service Purposes

5.2 The Council has the ability to make investments to assist local public services, including making loans to local service providers and buying shares and making loans to any Council subsidiaries that provide services. In light of the public service objective, the Council is willing to take more risk than with treasury investments. However it still plans for such investments to generate a profit after all costs to offset risk.

5.3 **Governance:** Decisions on service investments are made by the full Council after the relevant Head of Service has submitted a comprehensive analysis in consultation with the Director of Corporate Resources and must meet the criteria and limits. Most loans and shares are capital expenditure and will therefore also be approved as part of the capital programme in the Budget report or by full Council. Further details on service investments are in appendix C with a limit of £1.5m on the total exposure to loans for service purposes and £0.5m exposure permitted for shares being held.

Commercial Activities

5.4 With central government financial support for local public services declining, the Council invests in commercial property purely or mainly for financial gain. Total commercial investments are currently valued at £51m, with the largest being the Forum Retail Unit at £12m. These provide a net return after direct costs of just over 7% based on the last set of final accounts which value the assets at market value rather than historical value.

5.5 As financial return is the main objective, the Council recognises the higher risk on commercial investment compared with treasury investments. The principal risk exposures include individual vacancies, falls in market value, changes in the overall and local economy. Individual property risks are constantly monitored and

managed by the Head of Property. In order that commercial investments remain proportionate to the financial capacity of the Council, these are subject to an overall maximum investment limit which is set at £60m. Should income not meet expectations the Council holds at least £6m of general reserves available to balance the revenue budget in the short term while the Head of Property reviews the performance of the portfolio.

5.6 **Governance:** Decisions on new commercial investments are made by the Cabinet after recommendation from the Cabinet Advisory Sub-Committee (Property Investment) in line with the criteria and limits approved by the Council in this strategy. Property and most other commercial investments are also capital expenditure and purchases will therefore also be approved as part of the capital programme. Further details on commercial investments and limits on their use are in appendix C.

Other Liabilities

5.7 The Council has set aside £2.5m to cover risks of Business Rates Appeals. The Council is also at risk of having to pay for historic insurance claims but has not put aside any money because there is no reasonable assessment of the amount required.

5.8 **Governance:** Decisions on incurring new discretional liabilities are taken by the relevant Director whose directorate budget would cover the crystallisation of a liability. These would be discussed at the quarterly corporate risk management meeting and final decisions as to recognition taken by the Director of Corporate Resources. New liabilities exceeding £1m are reported to full Council for approval or notification as appropriate. Further details on liabilities are in note 18 of the 2018/19 statement of accounts.

Revenue Budget Implications

5.9 Although capital expenditure is not charged directly to the revenue budget, interest payable on loans and MRP are charged to revenue, offset by any investment income receivable. The net annual charge is known as financing costs; this is compared to the net revenue stream i.e. the amount funded from Council Tax, business rates and general government grants. Because the Council has no debt and significant investment income the financing costs are very low. Financing costs for 2020/21 and subsequent years includes a £0.2m increase due to a change in the accounting for leases.

	2018/19 actual	**2019/20 forecast**	**2020/21 budget**	**2021/22 budget**	**2022/23 budget**
Financing costs (£m)	0.0	0.0	0.3	0.3	0.3
Proportion of net revenue stream	0%	0%	2%	3%	3%

5.10 **Sustainability:** Due to the long-term nature of capital expenditure and financing, the revenue budget implications of expenditure incurred in the next few years will extend for up to 40 years into the future. The Director of Corporate Resources is satisfied that the proposed capital programme is prudent, affordable and

sustainable because the net budget demand on the Council and the risks in the programme have been reviewed and fall within the Council's tolerances.

Knowledge and Skills

5.11 The Council employs professionally qualified and experienced staff in senior positions with responsibility for making capital expenditure, borrowing and investment decisions. For example, the Director of Corporate Resources and S151 Officer is a qualified accountant with over 30 years' experience and the Head of Property is a fellow of RICS with over 30 years' of experience in commercial property. The Council will support junior staff to study towards relevant professional qualifications.

5.12 Where Council staff do not have the knowledge and skills required, use is made of external advisers that are specialists in their field. The Council currently employs Arlingclose Limited as treasury management advisers and for any significant property investment would use property consultants with specialist knowledge of the appropriate property sector. This approach ensues access to right knowledge and skills and can be more cost effective than employing such staff directly. The overarching requirement is that the Council has access to knowledge and skills commensurate with its risk appetite.

6 Other courses of action considered but rejected

6.1 The MHCLG Investment Guidance and the CIPFA Codes of Practice do not prescribe any particular strategies for local authorities to adopt. The above strategy represents an appropriate balance between risk management and cost effectiveness. Some alternative strategies, with their financial and risk management implications, are listed below:

Alternative	Impact on income and expenditure	Impact on risk management
Invest in a narrower range of counterparties and/or for shorter times	Interest income will be lower	Lower chance of losses from credit related defaults, but any such losses will be greater
Invest in a wider range of counterparties and/or for longer times	Interest income will be higher	Increased risk of losses from credit related defaults, but any such losses will be smaller
Borrow additional sums at long-term fixed interest rates using less internal funds	Debt interest costs will rise; this is unlikely to be offset by higher investment income	Higher investment balance leading to a higher impact in the event of a default; however long-term interest costs may be more certain
Invest more in service loans	Interest income will be higher and service benefits will accrue	Increased risk of losses from credit related defaults or service body being unable to pay loan and provide service
Reduce investment in property	Income will be lower	Lower chance of losses from non-paying tenants or falling property values.
Invest additional sums in property	income will be higher	Increased chance of losses from vacancies or falling property values. Reputational and regulatory risk if Council incurs large loss

7 Staffing consequences

7.1 There are no staffing consequences apart from the need for appropriate training.

8 Financial consequences

8 .1 The budgeted treasury investment income in 2020/21 is £0.93m (2019/20 £0.89m), which is equivalent to an average investment portfolio of £44m at an interest rate of 2.1%. The budget for debt interest paid in 2020/21 is £0.02m which is a contingency for possible short term borrowing. The budget for commercial property net income is £3.8m which is a yield of 7.3% from an investment portfolio of £53m.

9 Other considerations

9.1 Risks such as security of funds, liquidity, and interest rate risk are considered in the report. There are no consequences of any action proposed in respect of Crime & Disorder; Human Rights; Equality & Diversity and Sustainability.

Appendix A Economic background and interest rate forecast

Economic background

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

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

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

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

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

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

Credit outlook

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

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

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

Interest rate forecast:

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

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

A more detailed interest rate forecast provided by Arlingclose is shown below.

For the purpose of setting the budget, it has been assumed that new treasury management investments will be made at an average rate of 0.75%.

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

PWLB Certainty Rate (Maturity Loans) = Gilt yield + 1.80%

Appendix B Treasury Management Strategy

Present position and forecast

1 On 30 September 2019 the Council held no borrowing and £43m of investments at market value; broken down as follows:

	Principal £m	Interest Rate %
Call accounts	0.4	0.4
Money Market Funds – call	11.5	0.7
Money Market Funds – cash plus or short bonds	9.4	1.2
Short-term deposits	2.0	1.7
Pooled Funds - Property	4.9	4.2
Pooled Funds – Multi-Asset	5.0	4.3
Pooled Funds – Equity	3.8	3.5
Pooled Funds – Bonds	5.9	2.9
Net Investments	**42.9**	**2.3**

2 Taking the forecasts within the capital strategy, the balance sheet of the Council can be projected to estimate the amounts available for investments. An adjustment is made for the CFR that relates to leases which does not imply the need for a new external loan. Below is the current projected analysis of the balance sheet to illustrate the trajectory of the Council's funds.

All figures at year-end £m	**Actual 18/19**	**Estimate 19/20**	**Estimate 20/21**	**Estimate 21/22**	**Estimate 22/23**
CFR (incl leases)	33.2	35.3	37.7	36.6	35.5
Less Lease liabilities	0.0	0.0	(3.3)	(3.1)	(2.9)
Loans CFR	33.2	35.3	34.4	33.5	32.6
Less external borrowing	4.0	0	0	0	0
Internal borrowing	29.2	35.3	34.4	33.5	32.6
Useable reserves, receipts, contributions held	59.0	60.4	63.3	61.5	56.0
Working capital/other balances	6.3	4.9	4.9	5.0	5.0
Estimated Investments	36.1	30.0	33.8	33.0	28.4

3 The Council's strategy has been to maintain borrowing and investments below their underlying levels, sometimes known as internal borrowing. In spite of the continuation of this, the Council is projected to hold significant investment balances even at the end of the financial year which is the low point for cash.

Borrowing Strategy

4 As shown above the Council is not expecting to borrow long term funds although it may need short term borrowing if short term cash flow issues require it.

5 **Sources of borrowing:** The approved sources of long-term and short-term borrowing are:

- Public Works Loan Board and any successor body
- Any institution approved for investments (see below)
- Any other bank or building society authorised to operate in the UK
- UK public and private sector pension funds (except West Sussex County Council Pension Fund)
- Capital market bond investors
- UK Municipal Bond Agency and other special purpose companies created to enable joint local authority bond issues.

6 In addition, capital finance may be raised by the use of leases and hire purchase that are not borrowing, but may be classed as other debt liabilities.

7 The Council has previously raised its long-term borrowing from the PWLB, but it will investigate other sources of finance amongst the sources listed above, especially in view of the 1% increase in PWLB rates in October 2019.

8 **Municipal Bonds Agency:** UK Municipal Bonds Agency plc was established in 2014 by the Local Government Association as an alternative to the PWLB. It plans to issue bonds and lend the proceeds to local authorities. This will be a more complicated than the PWLB due to the need for the Council to provide some degree of guarantee to bond investors and the long lead times. Any decision to use the Agency will therefore be the subject of a separate report to full Council.

9 Short-term and variable rate loans leave the Council exposed to the risk of short-term interest rate rises and are therefore subject to the limit on the net exposure to variable interest rates in the treasury management indicators below.

Investment Strategy

10 The Council holds significant funds, representing income received in advance of expenditure plus balances and reserves held. In the past year, the Council's total investments have ranged between £31m and £56m and although the level of reserves is expected to reduce in the longer term, there will still be significant short to medium-term cash flow surpluses leading to larger sums being held than the core reserves of the Council would indicate. The current projections show year-end balances in the region of £30m for the next three years.

11 Both the CIPFA Code and the MHCLG Guidance require the Council to invest its funds prudently, and to have regard to the security and liquidity of its investments before seeking the highest rate of return, or yield. The Council's objective when investing money is to strike an appropriate balance between risk and return, minimising the risk of incurring losses from defaults and the risk of receiving

unsuitably low investment income. Where balances are expected to be invested for more than one year, the Council will aim to achieve a total return that is equal or higher than the prevailing rate of inflation, in order to maintain the spending power of the sum invested.

12 **Negative interest rates:** It is possible 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. In this event, security will be measured as receiving the contractually agreed amount at maturity, even though this may be less than the amount originally invested.

13 Given the increasing risk and very low returns from unsecured bank investments, the Council aims to further diversify into more secure and/or higher yielding asset classes during 2020/21. This diversification will continue the present strategy that has moved investment into pooled funds and other local authorities.

14 **Business models:** Under the IFRS9 standard, the accounting for certain investments depends on the Council's "business model" for managing them. The Council aims to achieve value from its internally managed treasury investments by a business model of collecting the contractual cash flows rather than buying and selling investments and therefore, where other criteria are also met, these investments will continue to be accounted for at amortised cost.

15 **Approved counterparties**: The Council may invest with any of the counterparty types in the table below; subject to the cash limits (per counterparty) and the time limits shown (changes from 19/20 limits are in bold):

Credit Rating	Banks Unsecured	Banks Secured	Government	Corporate	Registered Providers
AAA	*£2.5m 5 years*	*£4m 20 years*	*£4m 50 years*	*£2.5m 10 years*	*£4m 20 years*
AA+	*£2.5m 5 years*	*£4m 10 years*	*£4m 25 years*	*£2.5m 7 years*	*£4m 10 years*
AA	*£2.5m 4 years*	*£4m 5 years*	*£4m 15 years*	*£2.5m 5 years*	*£4m 10 years*
AA-	*£2.5m 3 years*	*£4m 4 years*	*£4m 10 years*	*£2.5m 4 years*	*£4m 10 years*
A+	*£2.5m 2 years*	*£4m 3 years*	*£4m 5 years*	*£2.5m 3 years*	*£4m 5 years*
A	*£2.5m 13 mons*	*£4m 2 years*	*£4m 5 years*	*£2.5m 2 years*	*£4m 5 years*
A-	*£2.5m 6 mons*	*£4m 13 months*	*£4m 5 years*	*£2.5m 1 year*	*£4m 5 years*
None	*£1m 6 months*	*n/a*	*n/a*	*£50,000 5 years*	***£3m 3 year***
UK Govt	*Central government £unlimited 50 years UK Local Authority £4m 10 years*				
Pooled funds and real estate investment trusts	*£5m per Fund or Trust*				

This table must be read in conjunction with the notes below.

16 **Credit Rating**: Investment limits are set with reference to the lowest published long-term credit rating from Fitch, Moody's or Standard & Poor's. Where available, the credit rating relevant to the specific investment or class of investment is used, otherwise the counterparty credit rating is used. However, investment decisions are never made solely based on credit ratings, and all other relevant factors including external advice will be taken into account.

17 **Banks Unsecured**: Accounts, deposits, certificates of deposit and senior unsecured bonds with banks and building societies, other than multilateral development banks. These investments are subject to the risk of credit loss via a bail-in should the regulator determine that the bank is failing or likely to fail. See below for arrangements relating to operational bank accounts.

18 **Banks Secured**: Covered bonds, reverse repurchase agreements and other collateralised arrangements with banks and building societies. These investments are secured on the bank's assets, which limits the potential losses in the unlikely event of insolvency, and means that they are exempt from bail-in. Where there is no investment specific credit rating, but the collateral upon which the investment is secured has a credit rating, the highest of the collateral credit rating and the counterparty credit rating will be used to determine cash and time limits. The combined secured and unsecured investments in any one bank will not exceed the cash limit for secured investments.

19 **Building Societies:** Although the regulation of building societies is no longer any different to that of banks the Council takes additional comfort from building societies' business model. The Council will therefore consider investing with unrated building societies where independent credit analysis shows them to be suitably creditworthy. A minimum asset size of £250m applies and limits of £1m per Society and £8m in total apply for unrated societies

20 **Government**: Loans, bonds and bills issued or guaranteed by national governments, regional and local authorities and multilateral development banks. These investments are not subject to bail-in, and there is an insignificant risk of insolvency. Investments with the UK Central Government may be made in unlimited amounts for up to 50 years and with a UK local government body up to £4m for up to 10 years. The Council is confident that as a sector local authorities are secure investments in the context of support from Central Government and the legal surcharging framework that guarantees debts will be paid. However, for any investment over six months the financial resilience of the relevant council will be assessed.

21 **Corporates**: Loans, bonds and commercial paper issued by companies other than banks and registered providers. These investments are exposed to the risk of the company going insolvent. Loans to unrated companies will only be made either

following an external credit assessment or to a maximum of £50,000 per company as part of a diversified pool in order to spread the risk widely.

22 **Registered Providers:** Loans and bonds issued by, guaranteed by or secured on the assets of Registered Providers of Social Housing, formerly known as Housing Associations. These bodies are tightly regulated by the Regulator of Social Housing and, as providers of public services; they retain the likelihood of receiving government support if needed.

23 **Change in Registered Providers Limit:** When discussing an investment option with the Council's treasury adviser the limits relating to unrated Registered Providers were reviewed. The Council previously limited unrated Registered Providers investments to £2m for one year. This was out of line with the advice on limits that the advisers thought were suitable for the Council's risk appetite. The Council's limit for the lowest rated Registered Providers was £4m over 5 years and the advice was that the change between a rated Registered Provider and unrated Registered Provider did not justify such a reduction in limits. Registered Providers do not automatically obtain ratings as their business model is itself not as risky as a typical private financial institution. Registered Providers' base business in social housing is to a great degree supported by benefits which are government funded. Housing demand is still strong so Registered Providers are regarded as intrinsically less risky. They are also regulated by the Regulator of Social Housing which gives a governance and viability rating. Historically when Registered Providers have got into difficulties the regulator has supported the merger of a troubled Registered Provider with a larger group. Against this context the limits for an unrated Registered Providers is raised to £3m over 3 years. If any investment is being considered officers will assess the individual Registered Provider with its adviser.

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

25 Bond, equity and property funds offer enhanced returns over the longer term, but are more volatile in the short term. These allow the Council to diversify into asset classes other than cash without the need to own and manage the underlying investments. Because these funds have no defined maturity date, but are available for withdrawal after a notice period, their performance and continued suitability in meeting the Council's investment objectives will be monitored regularly. These types of funds were introduced in 2016/17 and have provided increased yield

although their capital value has shown some volatility requiring continued monitoring.

26 **Change in Pooled Funds Limit:** This class of pooled funds are subject to their own specific limits. In view of the possible level of investments in the medium to longer term the overall limit has been increased to £18m to give the Council reasonable investment options.

27 **Real estate investment trusts(REIT):** Shares in companies that invest mainly in real estate and pay the majority of their rental income to investors in a similar manner to pooled property funds. As with property funds, REITs offer enhanced returns over the longer term, but are more volatile especially as the share price reflects changing demand for the shares as well as changes in the value of the underlying properties. This was a new category last year. It was added on the advice of the Council's advisers to give the Council greater options in investment in property should it require it. The Council will carry out detail appraisal and take advice before any possible investment.

28 **Change in Real estate investment trusts:** Last year the limit for these investments was £2m as they were new to the Council. A £2m investment was made in November 2019 with the Fundamentum REIT. This was appraised by the Council and its advisers and was viewed positively as it invests in supported social housing which is underpinned by income which was deemed to be secure and gave the Council diversification from many of the pooled fund investments which are in the commercial sector. The performance of this REIT will be monitored to inform any future investment but to give the Council headroom in case it wanted to further invest the limit for this category is raised to £5m

29 **Operational bank accounts:** The Council may incur exposure though its current accounts to any UK bank with credit ratings no lower than BBB- and with assets greater than £25 billion. These are not classed as investments, but still subject to the risk of a bank bail-in and balances will therefore be kept below £2.5m. The Bank of England has stated that in the event of failure, banks with assets greater than £25 billion are more likely to be bailed-in than made insolvent, increasing the chance of the Council maintaining operational continuity. The Council currently banks with NatWest rated A.

30 **Long Term investments**: Alongside pooled funds the Council may use long term investments when they are appropriately secure over the term of the investment. Currently the balance between security and yield is not thought to make this type of investment superior to pooled funds but there may be suitable investments so the Council sets a limit of £12m on the total long term (over a year) investments.

31 **Risk Assessment and Credit Ratings:** Credit ratings are monitored by the Council's treasury advisors, who will notify changes in ratings as they occur. Where

an entity has its credit rating downgraded so that it fails to meet the approved investment criteria then:

- no new investments will be made,
- any existing investments that can be ended at no cost will be, and
- full consideration will be given to the recall or sale of all other existing investments with the affected counterparty

32 Where a credit rating agency announces that a rating is on review for possible downgrade (also known as “rating watch negative” or “credit watch negative”) so that it may fall below the approved rating criteria, then no investments other than call investments will be made with that organisation until the outcome of the review is announced. This policy will not apply to negative outlooks, which indicate a long-term direction of travel rather than an imminent change of rating.

33 **Other Information on the Security of Investments**: The Council understands that credit ratings are good, but not perfect, predictors of investment default. Full regard will therefore be given to other available information on the credit quality of the organisations in which it invests, including credit default swap prices, financial statements and reports in the quality financial press. No investments will be made with an organisation if there are substantive doubts about its credit quality, even though it may meet the Council’s credit rating criteria.

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

35 **Investment limits**: The Council’s revenue reserves available to cover investment losses were in the region of £14m on 31 March 2019 but are set at a long term target of £6m. In order that no more than 2/3 of available reserves will be put at risk in the case of a single default, the maximum that will be lent to any one organisation (other than the UK Government) will be £4m. A group of banks under the same ownership will be treated as a single organisation for limit purposes. Limits will also be placed on fund managers, investments in brokers’ nominee accounts, foreign countries and industry sectors as below. Investments in pooled funds and multilateral development banks do not count against the limit for any single foreign country, since the risk is diversified over many countries. Where the limit has changed the new and old limits are shown

Category	Cash limit
Any single organisation, except the UK Central Government	£4m each
UK Central Government	Unlimited
Any group of organisations under the same ownership	£4m per group
Any group of pooled funds under the same management	£10m per manager
Money Market Funds	£30m in total
Property Invested Pooled Fund	£7m in total
Other Pooled Funds incl. Equity, Unrated Bond Funds, Diversified assets funds	£18m in total was £15m
Real estate investment trusts (New category in 2019/20)	£5m in total was £2m
Negotiable instruments held in a broker's nominee account	£20m per broker
Foreign countries	£10m per country
Registered Providers	£8m in total
Unsecured investments with Building Societies	£8m in total
Loans to unrated corporates	£2m in total

Cash flow management

36 The Council's officers maintain a detailed cash flow forecast for each coming year revising it as more information is available. This informs the short term investments such as those to cover precept payments. The forecast is compiled on a prudent basis, with receipts under-estimated and payments over-estimated to minimise the risk of the Council being forced to borrow on unfavourable terms to meet its financial commitments. Long term investment strategy is based on the Council's medium term financial strategy.

Treasury Management Indicators

37 **Security benchmark: average credit rating** The Council has adopted a voluntary measure of its exposure to credit risk by monitoring the value-weighted average credit rating of its investment portfolio. This is calculated by applying a score to each investment (AAA=1, AA+=2, etc.) and taking the arithmetic average, weighted by the size of each investment. Unrated investments are assigned a score based on their perceived risk. The benchmark for 2020/21 will be an average credit rating of A unchanged from last year.

38 **Liquidity benchmark:** The Council has adopted a voluntary measure of its exposure to liquidity risk by monitoring the amount of cash available to meet unexpected payments within a rolling three-month period, without additional borrowing. For 2020/21 the benchmark amount available will be £3m unchanged from 2019/20.

Interest rate exposures

39 This indicator is set to control the Council's exposure to interest rate risk. New CIPFA guidance has led to a change in this indicator which is now an upper limits on the one year revenue impact of a 1% rise or fall in interest rates. The impact of a change in interest rates is calculated on the assumption that maturing loans and investments will be replaced at current rates. The figures are the same as last year.

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

Maturity structure of borrowing

40 This indicator is set to control the Council's exposure to refinancing risk and is really most useful for councils with a portfolio of loans. The upper and lower limits on the maturity structure of fixed rate borrowing are shown below. The Council is not planning to borrow but will set limits to allow flexibility of term and maturity date for any new borrowing.

	Upper	Lower
Under 12 months	100%	0%
12 months and within 24 months	100%	0%
24 months and within five years	100%	0%
Five years and within 10 years	100%	0%
10 years and above	100%	0%

Principal sums invested for periods longer than a year

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

	2020/21	2021/22	2022/23
Limit on principal invested beyond year end	£12m	£10m	£8m

Other Treasury Management issues

42 **Financial Derivatives:** Local authorities have previously made use of financial derivatives embedded into loans and investments both to reduce interest rate risk (e.g. interest rate collars and forward deals) and to reduce costs or increase income at the expense of greater risk (e.g. LOBO loans and callable deposits). The general power of competence in Section 1 of the *Localism Act 2011* removes much of the uncertainty over local authorities' use of standalone financial derivatives (i.e. those that are not embedded into a loan or investment).

43 The Council will only use standalone financial derivatives (such as swaps, forwards, futures and options) where they can be clearly demonstrated to reduce the overall level of the financial risks that the Council is exposed to. Additional risks presented, such as credit exposure to derivative counterparties, will be taken into account when determining the overall level of risk. Embedded derivatives, including those present in pooled funds and forward starting transactions, will not be subject to this policy, although the risks they present will be managed in line with the overall treasury risk management strategy.

44 Financial derivative transactions may be arranged with any organisation that meets the approved investment criteria. The current value of any amount due from a derivative counterparty will count against the counterparty credit limit and the relevant foreign country limit.

45 **Markets in Financial Instruments Directive**: The Council has opted up to professional client status with its providers of financial services allowing it access to a greater range of services but without the greater regulatory protections afforded to individuals and small companies. The Director of Corporate Resources believes this to be the most appropriate status.

46 **Ethical Investment:** The investment fund management sector is increasing taking into account Environmental, Social and Governance (ESG) criteria to screen out investments or to guide their engagement with corporate bodies. Each of the Council's fund managers are reacting differently to this trend and the influence the Council can bring to bear is probably not great. However; the Council will work with its advisers to review the Council's opportunity to promote ESG factors without compromising security, liquidity and yield.

Appendix C Investment Strategy

1. This Investment Strategy was a new report for 2019/20, meeting the requirements of statutory guidance and focuses on the support of local public services by lending to or buying shares in other organisations or its own subsidiaries (service investments) and commercial property investment income.

Service Investments: Loans

2. The Council can lend money to local bodies or its subsidiaries to support local public services and stimulate local economic growth. Historically the Council has only done this in very limited circumstances where a significant service outcome is expected. At present only one £300,000 loan is outstanding with a community run leisure centre for it to develop a specific local service.

3. There is no intention to increase the use of loans to local bodies and they are expected to be infrequent. The Council will, however, be lending to a subsidiary in the guise of its housing company. The main risk when making service loans is that the borrower will be unable to repay the principal lent and/or the interest due. In order to limit this risk, and ensure that total exposure to service loans remains proportionate to the size of the Council, upper limits on the outstanding exposure has been set at £1.5m. This is the same limit as that recommended by this Committee at its July meeting when it was increased from £1m due to the advent of the Council's new housing companies.

4. Accounting standards require the Council to set aside loss allowance for loans, reflecting the likelihood of non-payment. The figures for loans in the Council's statement of accounts will be shown net of this loss allowance. However, the Council makes every reasonable effort to collect the full sum lent and has appropriate credit control arrangements in place to recover overdue repayments.

5. **Risk assessment**: The Council assesses the risk of loss before entering into service loans by assessing the counterparty's resilience, the service users' needs that the loan is designed to help meet and how these will evolve over time. During the life of the loan any change in original assumptions will be monitored. The Council will use external advisors if felt appropriate by the Director of Corporate Resources. All loans will be subject to contract agreed by Head of Legal. All new classes of loans must be approved by full Council and will be monitored by Director of Corporate Resources.

Service Investments: Shares

6. The Council does not currently invest in any shares. However, the setting up of a local housing company is in progress and the July meeting of this Committee recommended an increase of the limit for 2019/20 to £0.5m to allow the Council to invest in its subsidiary.

7. **Security:** One of the risks of investing in shares is that they potentially fall in value meaning that the initial outlay may not be recovered. In order to limit this risk upper limits on the sum invested in subsidiaries will be set at the lowest practical level if and when exposure is allowed.

8. **Risk assessment:** The Council would assess the risk of loss before entering into and whilst holding shares by going through an extensive process of risk analysis. The risk analysis will include an assessment of the market that the subsidiarity will be active in including the nature and level of competition, how the market/customer needs will evolve over time, the barriers to entry and exit and any ongoing investment requirements. The Council will use external advisors as thought appropriate by Director of Corporate Resources.

9. **Liquidity:** Although this type of investment is fundamentally illiquid, in order to limit this the Council, when it sets a limit in this area, will initially set out the maximum periods for which funds may prudently be committed and how the Council will ensure it stays within its stated investment limits. The life of the housing companies has not been explicitly set but the invested equity will be reviewed at a five-year interval.

10. **Non-specified Investments:** Shares are the only investment type that the Council has identified that meets the definition of a non-specified investment in the government guidance. The limits above on share investments are therefore also the Council's required upper limits on non-specified investments. The Council has not adopted any procedures for determining further categories of non-specified investment since none are likely to meet the definition.

Commercial Investments: Property

11. The Council invests in local commercial property in order to make a profit that will be spent on local public services. These include retail units, business centres, and commercial leisure facilities. They contributed £3.9m of income net of direct costs in 2018/19 and provide a significant revenue stream to support the Council's finances.

12. The table below lists the property by major category and by whether they are 'legacy' properties, which is taken as having been on the Council's books on 31st March 2007, and the acquisitions and developments since then. The reason for

the choice of 31st March 2007 is twofold: firstly, this was the date of the implementation of asset accounting under International financial reporting standard that required the Council to keep detail records of historic asset values and secondly it separates out the last decade where the recent purchases are reported. It is these more recent purchases which were made to provide commercial income to support the Council's budget as Central Government support reduced that is the main concern of the new guidance. For the recent purchases the cost records are available whereas the Council does not have comprehensive records of actual purchase costs so the 31st March 2007 values are used.

Property by type £millions	**Actual**	**31.3.2019 actual**		**31.3.2020 expected**	
	Purchase cost or 31st March 2007 value	**Gains or losses**	**Value in accounts**	**Gains or losses**	**Value in accounts**
Retail – legacy	2.7	1.9	4.6	1.9	4.6
Retail – Swan Walk	8.4	-5.5	2.9	-5.6	2.8
Light industrial - legacy	9.3	3.4	12.7	3.4	12.7
Healthcare – legacy	6.5	1.0	7.5	1	7.5
Office - legacy	1.0	0.5	1.5	0.5	1.5
Retail - recent	14.6	-0.1	14.5	-0.3	14.3
Light industrial – recent	4.1	-0.3	3.8	-0.3	3.8
Healthcare – recent	0.6	0.1	0.7	0.1	0.7
Education -recent	1.8	0.0	1.8	0.0	1.8
Leisure – recent*	1.5	-0.6	0.9	-0.6	0.9
Total	**50.5**	**0.4**	**50.9**	**0.1**	**50.6**

13. In the table above the Swan Walk Centre has been taken out of the legacy retail category as it has a significant effect and has its own distinct history. The loss in value is due to the movement of the valuation of the Council's equity share in Swan Walk from £8.4m in 2007 to a current value of £2.9m. A true separable purchase price for the Swan Walk equity share is not available as the Swan Walk development was a complex set of multiparty arrangements rather than a simple purchase.

14. **Security:** In accordance with government guidance, the Council considers a property investment to be secure if its accounting valuation is at or higher than its purchase cost including taxes and transaction costs.

15. The fair value assessment of the Council's investment property portfolio is slightly above the 'purchase' cost which means that the whole portfolio does provide 'security' in terms of the government guidance.

16. If we look only at the 'recent' property category the fair values are £0.9m below purchase price. This is distorted by the £0.6m reduction in the leisure category where the purchase of an investment asset had the side effect of increased

operational income which is not reflected in the investment property value. The Head of Property has considered the maintenance of the overall value of the portfolio bearing in mind it is normal for assets within the portfolio to perform differently depending on market conditions and concludes that the best course of action is to hold the assets for the long term as they are sound assets with dependable income streams.

17. The commercial properties are revalued each year-end by external valuers so the Council will each year consider whether the underlying assets provide security i.e. are not below their purchase cost. Should this be the case the Head of Property will consider whether his current course of action of holding the assets is appropriate and bring any alternative actions to Council in an update to the Investment Strategy for that year.

18. **Risk assessment:** The Council assesses the risk of loss before entering into and whilst holding property investments by :
    1) assessing the relevant market sector including the level of competition, the barriers to entry and exit and future market prospects;
    2) using advisors if thought appropriate by the Director of Corporate Resources;
    3) consulting Council's Cabinet Advisory Subcommittee (Property Investment)
    4) taking final comprehensive report on all new investments to Cabinet
    5) continually monitoring risk in the whole portfolio and any specific assets

19. **Liquidity:** Clearly property is relatively difficult to sell and convert to cash at short notice, and can take a considerable period to sell in certain market conditions. To ensure that the invested funds can be accessed when they are needed the Head of Property ensures that at least £5m of commercial property could be sold as a going concern within a six month period.

Loan Commitments and Financial Guarantees

20 Although not strictly counted as investments, since no money has exchanged hands yet, loan commitments and financial guarantees carry similar risks to the Council and are included here for completeness. The Council plans to provide loan commitments up to £6m to its Housing Company subsidiary. It does not plan to provide any guarantees in the foreseeable future.

Proportionality

21 The Council is dependent on profit generating investment activity to achieve a balanced revenue budget. The table below shows the extent to which the expenditure planned to meet the service delivery objectives is dependent on achieving the expected net profit from investments over the lifecycle of the Medium Term Financial Strategy. The 2018/19 figures was slightly distorted by backlog of income. Should the property portfolio fail to achieve the expected net profit, the Council has general reserves to cover the immediate shortfall in income and Head of Property would review the cause of any shortfall and identify any actions needed to ensure the income shortfall is remedied.

Proportionality of Investments £m	**2018/19 Actual**	**2019/20 Forecast**	**2020/21 Budget**	**2020/21 Budget**	**2021/22 Budget**
Gross service expenditure	33	33	33	33	34
Investment income	3.9	3.6	3.8	3.9	4.0
Proportion	12%	11%	12%	12%	12%

22 **Capacity, Skills and Culture**

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

- take informed decisions as to whether to enter into a specific investment;
- to assess individual assessments in the context of the strategic objectives and risk profile of the Council; and
- to enable them to understand how new decisions have changed the overall risk exposure of the Council.

The Council will ensure that the relevant officers and the Members of Audit Committee and Cabinet Advisory Subcommittee (Property Investment) have appropriate skills, providing training and advisor support where there is a skills gap.

23 **Commercial deals:** The Council will ensure that the Audit Committee, Cabinet Advisory Subcommittee (Property Investment), Cabinet, and officers negotiating commercial deals are aware of the core principles of the prudential framework and of the regulatory regime within which local authorities operate.

24 **Corporate governance:** Any investment decisions will be scrutinised by Senior Leadership Team, Cabinet Advisory Subcommittee (Property Investment), and Cabinet before final approval. The Overview and Scrutiny committee review all decisions made by the Cabinet. Although after the event the Committee can make any recommendations to the Council if it sees fit.

Investment Indicators

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

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

Total investment exposure £m	**31.03.2019 Actual**	**31.03.2020 Forecast**	**31.03.2020 Forecast**
Treasury management investments	36	30	34
Service investments: Loans	0.2	0.2	0.2
Service investments: Shares	0	0.5	0.5
Commercial investments: Property	50.9	50.6	53.5
TOTAL INVESTMENTS	87.1	81.3	88.2
Commitments to lend	0	6	6
Guarantees issued on loans	0	0	0
TOTAL EXPOSURE	87.1	87.3	94.2

27 **How investments are funded:** Government guidance is that these indicators should include how investments are funded. Since the Council does not have any borrowing the Council's investments are funded by usable reserves and income received in advance of expenditure.

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

Investments net rate of return	2018/19 Actual	2019/20 Forecast	2020/21 Forecast
Treasury management investments	2.1%	2.2%	2.2%
Service investments: Loans	3.0%	3.0%	3.0%
Service investments: Shares	0	0	0
Commercial investments: Property	7.6%	7.1%	7.3%
ALL INVESTMENTS	5.3%	5.3%	5.3%

29 **Other indicators:** The MHCLG guidance lists other indicators and the Council has selected the indicators below as appropriate.

Indicator	2018/19 Actual	2020/21 Forecast	2021/22 Forecast
Debt to net service expenditure ratio	34%	0%	0%
Commercial income to net service expenditure ratio	33%	31%	36%
Investment cover ratio – net income excl revaluation over interest expense	29	No debt	No debt
Benchmarking of returns – ratio of property income yield to IPD property yield index averaged over 5 year period	1.5	1.4	1.4
Income net of direct cost return target	7.6%	7.1%	7.3%
Operating overheads of property section attributable to commercial property as a proportion of net property income	6.4%	6.2%	5.5%
Average Vacancy levels	0.3%	1%	1%
Tenant over 5%	5	5	5
Weighted Average Unexpired Lease Term (WAULT)	10yr	9yr	9yr
Bad debts written off	£3,000	£10,000	£10,000

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By virtue of paragraph(s) 1, 2, 3, 4 of Part 1 of Schedule 12A
of the Local Government Act 1972.

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