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24 February 2020

Dear Councillor,

A meeting of **AUDIT COMMITTEE** will be held in the **COUNCIL CHAMBER** at these offices on **TUESDAY, 3RD MARCH, 2020 at 7.00 pm** when your attendance is requested.

Yours sincerely,  
KATHRYN HALL  
Chief Executive

**A G E N D A**

	<b>Pages</b>
1. To receive apologies for absence.	
2. To receive Declarations of Interest from Members in respect of any matter on the Agenda.	
3. To confirm the Minutes of the previous meeting held on 12 November 2019.	<b>3 - 6</b>
4. To consider any items that the Chairman agrees to take as urgent business.	
5. Internal Audit - Monitoring Report 21st February 2020.	<b>7 - 12</b>
6. Three Year Internal Audit Plan.	<b>13 - 20</b>
7. Treasury Management Counterparty Comparison.	<b>21 - 30</b>
8. Treasury Management Strategy Statement and Annual Investment Strategy 2020/21 to 2022/23.	<b>31 - 66</b>
9. External Audit Plan.	<b>67 - 106</b>
10. External Audit: Housing Benefit Assurance Report.	<b>107 - 122</b>

11. Questions pursuant to Council Procedure Rule 10.2 due notice of which has been given.

To: **Members of Audit Committee:** Councillors M Pulfer (Chair), R Cromie (Vice-Chair), A Boutrup, P Budgen, M Cornish, S Hicks and L Stockwell

# Agenda Item 3

## **Minutes of a meeting of Audit Committee held on Tuesday, 12th November, 2019 from 7.00 pm - 7.29 pm**

**Present:** M Pulfer (Chair)  
R Cromie (Vice-Chair)

P Budgen                    S Hicks  
M Cornish                   L Stockwell

**Absent:** Councillors A Boutrup

**1. TO RECEIVE APOLOGIES FOR ABSENCE.**

Apologies were received from Councillor Boutrup.

**2. TO RECEIVE DECLARATIONS OF INTEREST FROM MEMBERS IN RESPECT OF ANY MATTER ON THE AGENDA.**

None.

**3. TO CONFIRM THE MINUTES OF THE PREVIOUS MEETING HELD ON 10 SEPTEMBER 2019.**

Peter Stuart, Head of Corporate Resources advised the Chairman that he now had a copy of the letter from Ernst & Young which contained the questions Committee Members had requested at the previous meeting. The Minutes of the meeting of the Committee held on 10 September 2019 were agreed as a correct record and signed by the Chairman.

**4. TO CONSIDER ANY ITEMS THAT THE CHAIRMAN AGREES TO TAKE AS URGENT BUSINESS.**

None.

**5. REVIEW OF TREASURY MANAGEMENT STRATEGY ACTIVITY 1 APRIL - 30 SEPTEMBER 2019.**

Peter Stuart, Head of Corporate Resources introduced the report to update the Committee on Treasury Management Activity for the half year to 30 September 2019. He noted that all transactions were in order and the performance of the service has met the requirement of the Service Level Agreement with our shared service provider. He highlighted that for one day the account balance had been higher than usual as funds had arrived too late to place money in the market.

The Chairman suggested a review of the credit worthiness of building societies. The Head of Corporate Resources reminded the Audit Committee that they have been content to lend funds to building societies with assets of at least £1billion. He advised that this practise is not the same with all local authorities. If societies are not

credit rated some authorities will not lend to them and this reduces their ability to lend on the market. In response to a Member question the officer advised that the Council is careful in the selection of societies, and they will have minimum capital and mortgages assets of at least £1 billion. He suggested that the Committee could have more knowledge of the structure of building societies so they could see that the use of them was a prudent way forward for the Council's finances. He advised the Chairman that in conjunction with the shared service centre at Adur-Worthing, an appraisal of building societies will be undertaken to reassure the Committee. He noted that it will not be a lengthy piece of work. The Chairman thanked the Head of Resources and asked for the loan to capital ratios to be included.

A Member queried the profiling of capital risks and asked whether the Committee should be looking forward for a period longer than 6 months for financial protection.

The officer advised that this information will be provided in the report which is scheduled for the meeting in March 2020, and the report will look forward including the following year. He reminded the Members that the report presently before Members looks back and confirms that all activities have been completed as planned.

Several Members asked for more information on the investment of £20 million and asked about the effects and implications on next year's budget. The Chairman also asked whether receipts are built into next year's budget.

The officer reminded the Committee that it is difficult to accurately predict when receipts will be received. He confirmed that the Council do not spend money before the funds are actually received. Tom Clark, Head of Regulatory Services confirmed that a development site had been advertised for sale. The Head of Corporate Resources advised that the £20 million received will be from the sale of Hurst Farm, Haywards Heath. The Committee were advised that the sale of the land was on a deferred income basis and income will be received over the next two years. He noted that the Council had anticipated the funds to be received in one lump sum but developers prefer to pay over a longer time frame.

As there were no further questions the Chairman took Members to the recommendation in the report which was unanimously approved.

## **RESOLVED**

### **The Committee agreed to recommend to Council:**

- (i) that no new borrowing has been necessary in the 6 months to 30<sup>th</sup> September 2019 and the outstanding borrowing has reduced from £16.112m at 31 March 2019 to £10.185m.
- (ii) the increase in investments from £25.21m at 31 March 2019 to £31.88m at 30 September 2019 (both figures exclude the £6m investment in the CCLA Local Authorities' Property Fund).

## **6. INTERNAL AUDIT - MONITORING REPORT 31 OCTOBER 2019.**

Gillian Edwards, Audit and Risk Manager introduced the report to update the Committee on the progress of the 2019/20 Internal Audit Plan and to advice on progress made in implementing previously agreed recommendations. She noted that audits had been completed for Procurement Short Review, HR and Commercial

Properties. There were two high priority findings for this period. One relating to the HR audit and the very prescriptive process of pre-employment checks, where the document copies had not been signed and dated in the correct format. This has been discussed with the Business Unit Leader and the guidance will be followed; a follow up report will be received by the Committee in March 2020.

The Senior Auditor noted that the Procurement short review had highlighted that whilst all relevant contracts had been placed on the Contract Register, the e-form on the intranet had not been routinely completed for all purchase orders over £5,000. The Business Unit Leaders would remind staff of the need to comply with the Transparency Code 2015. She noted that a follow up report will be received by the Committee in March 2020.

The Committee were advised that during the audit for Commercial properties it was noted that the procedure notes were out of date and copies of tenant's insurance documents had not been received for some properties. She confirmed that all tenanted properties were insured.

The Senior Auditor noted that the updating of procedure notes for Housing Benefits to reflect the new structure and processes was still ongoing and should be completed by 31 March 2020. She advised that she had received assurances from the Business Unit Leader for Revenues and Benefits that the appropriate Academy access rights for all Housing Benefit staff have been reviewed. This will be confirmed in the forthcoming Housing Benefit audit in December 2019. She highlighted the audits that are currently planned or are in progress, and the team are on target to be substantially completed by 31 March 2020.

Following a Member's question the Senior Auditor confirmed that HR has to keep annotated copies of paper documents as part of the pre-employment checks. The Member suggested that these could be scanned and uploaded to the HR system.

In response to a Member's regarding the Contracts Register, the Head of Corporate Resources advised that enquiries would be made to investigate whether the register could be updated automatically when purchase orders are raised in excess of £5,000. He agreed to check if this is possible.

A Member asked how frequently Business Unit Leaders review their procedures as some issues seemed to appear fairly frequently in audits.

The Senior Auditor advised that the issue arose when the CenSus partnership was disaggregated and new procedures were necessary. She noted that Business Unit Leaders are reminded quarterly of their commitment to implement any recommendations from audits and they are currently working on them. She advised they had many issues to deal with redesignating roles and responsibilities and training new staff.

The Chairman asked for historical information on the CenSus Partnership.

The Head of Corporate Resources confirmed it had been a partnership to provide a joint revenue and benefit service between Adur, Horsham and Mid Sussex Districts Councils.

The partnership had been disaggregated after Adur District Council left in April 2018 and Horsham left in September 2018. He noted that Mid Sussex is now a stand-alone local authority providing a revenue and benefits service. The Council had to train many new recruits after staff left the joint partnership, and new local procedures

had to be written. He reminded the Chairman that Business Unit Leaders can be invited to attend Committee meetings.

As there were no further questions the Chairman took Members to the recommendation in the report which was unanimously approved.

**RESOLVED**

The Committee received and noted the report.

**7. COMMITTEE WORK PROGRAMME.**

Tom Clark, Head of Regulatory Services introduced the work programme and Members were asked to note the programme as set out at paragraph 5 of the report. He highlighted the Internal Audit Monitoring Report for the meeting in March 2020 and confirmed the Audit Planning Report will cover both internal and external audits.

A Member asked for a review on the range of risks at the next meeting.

The Head of Corporate Resources reminded the Committee that strategic risks are dealt with by the Cabinet and are scrutinised by the appropriate committee. He noted that the Audit Committee does not have a remit across the whole Council and the Treasury Management Strategy before the Committee in March will detail financial risks to the Council. He noted the addition in the Work Programme of the Building Society Appraisal Report.

**RESOLVED**

That the Committee Work Programme for 2019/20 be noted accordingly.

**8. QUESTIONS PURSUANT TO COUNCIL PROCEDURE RULE 10.2 DUE NOTICE OF WHICH HAS BEEN GIVEN.**

None.

The meeting finished at 7.29 pm

Chairman

# Agenda Item 5

## INTERNAL AUDIT – MONITORING REPORT 21<sup>st</sup> FEBRUARY 2020

REPORT OF: Audit and Risk Manager  
Contact Officer: Gillian Edwards  
Email: [gillian.edwards@midsussex.gov.uk](mailto:gillian.edwards@midsussex.gov.uk) Tel: 01444 477241  
Wards Affected: All MSDC Wards  
Key Decision: No  
Report to: Audit Committee  
3<sup>rd</sup> March 2020

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### Purpose of Report

1. The purpose of this report is twofold; to update the Committee on the progress of the 2019/2020 and 2021/2022 Internal Audit Plans and to report on the progress made in implementing previously agreed recommendations.

### Recommendation

2. The Committee is asked to receive this report.

### Background

3. Work Completed

Since the last report, as at 12<sup>th</sup> November 2020, the following reviews have been completed.

Audit Title	Audit Opinion
Payments	Satisfactory
Council Tax	Satisfactory
NNDR	Substantial
Sundry Debtors	Satisfactory

4. Work in Progress

The reviews in progress and other work that we have undertaken in the period are shown at Appendix A.

5. High priority findings in this period

We identified the following High priority findings in the period under review.

#### **Payments Audit 2019/2020**

##### Payment Made in Error

It was brought to our attention by the Head of Corporate Resources that 19 days after the implementation of the new T1 Financial Management System that a payment was made, in the sum of £68,000, whereas an invoice should have been raised in that sum.

This resulted in the recipient of the £68,000 notifying the Council that they had been paid in error and the monies were repaid.

We reviewed the controls in place to prevent this from happening again and are satisfied that the appropriate measures have been introduced.

However, we raised an issue in respect of the requirement for all BACS payments over £20,000 to be reviewed by the officer who approves the BACS payment run, to confirm that all such payments are supported by relevant documentation. It is considered that in the case of the £68,000 payment, this control was not adhered to.

We have discussed this with Management and it has been agreed that this will now be done in accordance with agreed procedures, with immediate effect.

### **Council Tax Audit 2019/2020**

During this review we identified two high priority findings as follows:

#### Identify Credit Balances and Agree Policy for Action to Clear

Credit balances can arise on Council Tax accounts for a number of reasons, for example because a property has been re-banded by the Valuation Office or a Council Tax payer overpays on their account.

We reviewed credit balances as at 11<sup>th</sup> November 2019, which totalled £1,669,641 and resided in 7,807 accounts. Some of these balances date back to 1993, where householders have left the area or are deceased, making clearance prolonged and difficult.

Two actions have been agreed by management to clear these balances being:

- Confirm the value of credit balances on all Council Tax accounts;
- Agree a process to deal with these balances, in particular, those that have arisen from a Valuation Office re-banding.

The implementation date for these actions is 31<sup>st</sup> May 2020 and we will report the outcome of this work at the next meeting of this Committee.

### **6. Follow Up Audits:**

We have undertaken these follow ups since the last Audit Committee.

#### **Housing Benefits – 31<sup>st</sup> January 2019**

High Priority findings – 1 –previously implemented

Medium priority findings – 3 with 1 previously implemented

The two outstanding medium priority findings that we identified related to the following:

- Procedure notes for the Housing Benefits section had not been updated to reflect the new structure and processes that are now in place – agreed *implementation date – ongoing*. Whilst a date for completion had not been set, this is an ongoing piece of work. The update as at 20<sup>th</sup> August 2019 was that the Housing Benefits section have mapped the processes but the procedures for the Housing Benefit section are still work in progress. The Housing Benefits section hoped to complete this work by 31<sup>st</sup> March 2020.

#### **Status of agreed action – Implemented**

- Whilst a review was being undertaken to confirm that access to the Housing Benefit system is appropriately restricted, this was not yet complete. *The agreed implementation date was 18<sup>th</sup> March 2019. The update as at 20<sup>th</sup> August 2019 was that this remained work in progress. The Housing Benefits section had removed Housing Needs access to Academy and were continuing to review all other access restricting it where appropriate. The Housing Benefit section hoped to complete this work by 31<sup>st</sup> March 2020.*

#### **Status of agreed action – Implemented**

#### **HR – 24<sup>th</sup> October 2019**

High Priority findings – 1

Medium Priority Findings - 0

- The high priority finding arose during testing to confirm that Home Office guidance was being followed in relation to new starters at the Council. Whilst most of the procedures were being followed in relation to checking right to work documentation, it was identified that the required wording in relation to the date that the check was made was absent. Action to rectify this weakness was agreed and implemented immediately. In order to confirm that this is now being performed satisfactorily, we reviewed a sample of new starters from 1<sup>st</sup> October 2019 – 31<sup>st</sup> January 2020. In all cases the correct wording was present.

#### **Status of agreed action - Implemented**

#### **Procurement – Contract Register – 4<sup>th</sup> November 2019**

High Priority findings – 1

Medium Priority Findings - 0

The Transparency Code 2015 requires that:

*Local authorities must publish details of every invitation to tender for contracts to provide goods and/or services with a value that exceeds £5,000. For each invitation, the following details must be published:*

- reference number
- title
- description of the goods and/or services sought
- start, end and review dates, and
- local authority department responsible

During this review we compared purchases identified from the Payments system to the Contract Register and found that whilst contracts were being recorded, a number of Purchase Orders in excess of £5,000 were not.

We contacted all Business Unit Leaders in January 2020 to ask that they remind their staff of the requirement to comply with the Transparency Code in these matters. Follow up work will be undertaken at the end of February 2020, to compare recent purchases to the Contract Register.

**Status of agreed action – a verbal update will be provided at the meeting to confirm whether there is an improvement in recording of relevant purchases.**

## **7. Work in Progress**

The reviews in progress and other work that has been undertaken in the period are shown at Appendix A.

All work has been planned and allocated to Audit staff and we are confident that the audit plan will be substantially complete by 31<sup>st</sup> March 2020.

### **Background Papers**

- Internal Audit reports relating to 2018/2019 and 2019/2020
- Working papers relating to 2018/2019 and 2019/2020

## Appendix A

### Internal Audit Plans 2018/2019 and 2019/2020

#### Progress Report as at 21<sup>st</sup> February 2020

Audit	Audit Plan Year	Audit Opinion-Assurance	Number of High Priority Findings	Comments
<b>A. Work Completed in the Current Period</b>				
Payments	2019/20	Satisfactory	1	
Council Tax	2019/20	Satisfactory	2	
NNDR	2019/20	Substantial		
Sundry Debtors	2019/20	Satisfactory		
<b>B. Work In Progress</b>				
Housing Benefits	2019/20			
Building Control	2019/20			
Treasury Management	2019/20			
Budgetary Control	2019/20			
Capital Accounting	2019/20			
Cash and Bank	2019/20			
FMS	2019/20			
<b>Follow Ups</b>				
Housing Benefits	2018/19			All agreed actions implemented
HR Review	2018/19			All agreed actions implemented
Procurement	2019/20			Verbal update to be provided

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# Agenda Item 6

## THREE YEAR INTERNAL AUDIT PLAN

Report from: Audit and Risk Manager  
Contact Officer: Gillian Edwards  
Email@ [gillian.edwards@midsussex.gov.uk](mailto:gillian.edwards@midsussex.gov.uk)  
Tel:~(01444) 477241  
Wards Affected: All  
Key Decision: No  
Date of Meeting – 3<sup>rd</sup> March 2020

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### 1. PURPOSE OF REPORT

To inform the Committee of the detailed work proposed for 2020/2021 and the overall Internal Audit Plan, for the three years 2020/2021, 2021/2022, and 2022/2023.

### 2. SUMMARY

- 2.1 The three year internal audit plan has been compiled to respond to the changes within the organisation, its structure and how its services are delivered, whilst also ensuring that key controls are effective.
- 2.2 The plan allows for examination of the main financial areas from a systems and ICT perspective, which is key to ensuring the Council's finances remain properly controlled, whilst also undertaking strategic and service based work each with a varying risk to the organisation.
- 2.3 The plan also includes some specific reviews from previous audit work, designed to ensure that agreed actions have been satisfactorily implemented and that the Council is being consistent in its approach year on year.
- 2.4 The plan continues to include coverage of specific key controls agreed with the External Auditor to support their year-end work as required.
- 2.5 It should be noted that the coverage in year 3 may be subject to amendment, based upon changing situations, risks identified, and priorities.

### 3. RECOMMENDATIONS

**The Committee is asked to comment on the detailed Internal Audit Plan for 2020/2021 (Appendix A) and the 3 Year Internal Audit Plan (Appendix B).**

### 4. INTRODUCTION AND BACKGROUND

- 4.1 The work of Internal Audit is managed through a risk-based planning process which this year comprises detailed one year and three year plans.
- 4.2 The purpose of this report is for the Committee to consider the proposed Internal Audit Plans.

## **5.0 INTERNAL AUDIT PLANS**

### **Preparation**

- 5.1 The preparation process for the detailed one year and three year plans included engagement with management, consideration of findings of previous audit work and the inclusion of fundamental systems, including the major financial systems.
- 5.2 The detailed plan for 2020/2021 is shown in Appendix A, with the three year plan in Appendix B.

### **Fundamental Systems**

- 5.3 These are the main financial systems and as such, adequate control is key to the proper operation of the Council's financial affairs. The External Auditor no longer relies upon the work of Internal Audit in formulating their audit opinion, and test the systems themselves to gain assurance. These systems are still examined annually by internal audit and a total of 99 days is allocated for this work in 2020/2021, which represents 41% of the total available audit days.

### **Computer Audit**

- 5.4 This category deals with examining the control of the Council's main computer systems and infrastructure. An ICT risk assessment is undertaken at the beginning of each financial year, to determine how the resources allocated to this area can be best utilised.

### **Risk Based and Corporate Audits**

- 5.5 This area relates to work requested and/or having been identified by Internal or External audit as a key risk to the Council.

### **Follow Ups**

- 5.6 It is important for the effectiveness of Internal Audit that there should be a process of following up previously agreed actions to ensure they are implemented satisfactorily and in a timely manner. A total of 10 days have been allocated for this work each year.

### **Contingency**

- 5.7 After consultation with the Head of Corporate Resources, the number of audit days have been increased from 236 last year, to 240 days to allow coverage of areas identified as being necessary to include comprehensive coverage of areas where it is deemed the risk is sufficient to require this. There is no time allocated to contingency at present, however, if any additional resources were required, they would be agreed with the Head of Corporate Resources, and provided by Crawley Borough Council.

## **Management and Planning**

- 5.8 In addition to undertaking the audits referred to above, Internal Audit also carry out a number of support and planning activities. These include liaison with the External Auditor to ensure the two functions complement each other and avoid duplication. In addition, they liaise with management to agree the audit programmes and scope, allocate appropriately skilled resources, provide guidance to management on internal issues and present to the Audit Committee.

## **Resources**

- 5.9 The Internal Audit Service for the forthcoming financial year has a total of 240 allocated to it, with 220 days per annum in years two and three. This will be kept under constant review and any changes will be discussed and agree with the Head of Corporate Resources. This work will be managed by Gillian Edwards, Audit and Risk Manager at Crawley Borough Council, as part of the shared service arrangement. Specialists, including computer auditors, will be brought in as required.

## **6.0 Risk Assessment**

- 6.1 This plan has been produced after engaging with stakeholders, consideration of the findings of Internal and External Audit and review of relevant documentation. There is scope for additional resources to be allocated to the plan, to cover unexpected eventualities and unforeseen risks, by agreement with the Head of Corporate Resources and the Audit and Risk Manager.

- 6.2 The three year plan is intended to focus on the strategic direction of the Council. Management Team are committed to Heads of Service taking responsibility for ensuring that controls are maintained within their areas of responsibility. If there are concerns over any issues, these can be discussed with Internal Audit for advice and there is sufficient flexibility in the plan to allow for this. Additionally, Heads of Service can ask Internal Audit to undertake examinations on a one off basis, subject to agreement by the Head of Corporate Resources.

## **7. Policy Context**

This report explains how the Internal Audit function will contribute to the work of the Council Internal Audit is a statutory function required under the Accounts and Audit Regulations 2015.

## **8. Financial Implications**

- 8.1 The detailed 2020/2021 Internal Audit Plan has been compiled to ensure it remains within the budget agreed with the Head of Corporate Resources.

## Appendix A

### Mid Sussex District Council Internal Audit Plan 2020/2021

	Systems	IT	Total	Comments
<b>Fundamentals</b>				
Housing Benefits	20		20	This work will ensure compliance
Council Tax	12		12	
NNDR	12		12	
Payroll	10		10	It will also include reviews to confirm
Income Collection (Cashiers)	8		8	
Treasury Management	5		5	
Payments (Creditors)	8		8	fundamental financial systems and
Sundry Debtors	8		8	
Capital Accounting & Asset Management	7		7	
Budgetary Control	4		4	operating in a satisfactory manner.
FMS	5		5	
Sub Total	<b>99</b>	<b>0</b>	<b>99</b>	
<b>Risk Based and Corporate</b>				
Payroll Post Implementation Review	10		10	
FMS Post Implementation Review	10		10	
Disabled Facility Grants	8		8	
Sub Total	<b>127</b>	<b>0</b>	<b>127</b>	
<b>Anti-Fraud Work</b>				
National Fraud Initiative Data Matching	30		30	
Fraud Awareness Training	3		3	
Sub Total	<b>160</b>		<b>160</b>	
<b>ICT Audits</b>				
Prioritisation of ICT Resources		10	10	
Cyber Security		10	10	
Sub Total	<b>160</b>	<b>20</b>	<b>180</b>	



	<b>Systems</b>	<b>IT</b>	<b>Total</b>	<b>Comments</b>
Follow Ups	10		10	
Contingency	10		10	
<b>Sub Total</b>	<b>180</b>	<b>20</b>	<b>200</b>	
<b><i>Management and Planning</i></b>				
Committees	10		10	
Operational Management	15		15	
Head of Audit Time	15		15	To include preparation of Head of Audit Annual Report
<b><i>Total Days</i></b>	<b>220</b>	<b>20</b>	<b>240</b>	

## Appendix B

### Mid Sussex District Council – 3 Year Internal Audit Plan

	2020/2021 Year 1	2021/2022 Year 2	2022/2023 Year 3
<b>Fundamentals</b>			
Housing Benefits	20	20	20
Council Tax	12	12	12
NNDR	12	12	12
Payroll	10	10	10
Income Collection (Cashiers)	8	8	8
Treasury Management	5	5	5
Payments (Creditors)	8	8	8
Sundry Debtors	8	8	8
Capital Accounting & Asset Management	7	7	7
Budgetary Control	4	4	4
FMS	5	5	5
<b>Risk Based and Corporate</b>			
Payroll Post Implementation Review	10		
FMS Post Implementation Review	10		
Disabled Facility Grants	8		
<b>Anti-Fraud Work</b>		30	30
National Fraud Initiative Data Matching	30		
Fraud Awareness Training	3		
<b>ICT Audits</b>		20	20
Prioritisation of ICT Resources	10		
Cyber Security	10		
<b>Follow Ups</b>		10	10
<b>Contingency</b>		21	21
<b>Management and Planning</b>			
Committees	10	10	10
Operational Management	15	15	15

Head of Audit Time	15	15	15
<b><i>Total Days</i></b>	<b>240</b>	<b>220</b>	<b>220</b>

# Agenda Item 7

## TREASURY MANAGEMENT COUNTERPARTY COMPARISON

REPORT OF: Head of Corporate Resources  
Contact Officer: Peter Stuart, Head of Corporate Resources  
Email: [Peter.Stuart@midsussex.gov.uk](mailto:Peter.Stuart@midsussex.gov.uk) Tel: 01444 477315  
Wards Affected: All  
Key Decision No

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### 1. Purpose of Report

To inform the Committee of some comparative data between banks and building societies to be considered in assembling a Treasury Management Strategy.

### 2. Recommendations

The Audit Committee is recommended to note the data.

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### 3 Background

- 3.1 Attached at Annex 1 is a report commissioned by the Building Societies Association which analyses the relative performance of UK banks and building societies.
- 3.2 Authored by the City University, London it examines a range of measures to show the differences between building societies as a group and the banking sector. While the comparison is not entirely valid .(which the paper admits) the comparison 'lower risk and better capitalised' sets out the 2014 data which shows that 'building societies are, on average, less risky than banks'.
- 3.3 The Head of Corporate Resources is endeavouring to bring some more recent information before the committee for the meeting. It is appreciated that this needs to be accessible and easy to assimilate..

### 4 Financial implications

- 4.1 There are no financial implications arising from this report. .

### 5 Equalities implications

- 5.1 The report raises no implications of this nature.

### 6 Risk analysis

- 6.1 No material risks arise from this report

### Background Papers

None

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# An analysis of the relative performance of UK banks and building societies

Cass Business School,  
City University London

September 2015





**Building Societies Association**

We fulfil two key roles. We provide our members, all 44 building societies and two credit unions, with information to help them run their businesses. We also represent their interests to audiences including regulators, the government and parliament, the Bank of England, the media and the general public.

Our members have total assets of over £330 billion, and account for approximately 20% of each of the UK mortgage and savings markets. It's estimated that more than a third of the UK population has a financial service relationship with a building society.

## Cass Business School, City University London

Cass Business School, which is part of City University London, delivers innovative, relevant and forward-looking education, consultancy and research.

Cass is located in the heart of one of the world's leading financial centres. It has strong links to both the City of London and its corporate, financial and professional service firms, as well as to the thriving entrepreneurial hub of Tech City – located close to the School.

# Foreword



Dr Barbara Casu  
Reader in Banking and  
Director of the Centre  
for Banking Research,  
Cass Business School,  
City University London

This research examines the performance of UK building societies, relative to banks, over the last 15 years. The impact of the financial crisis is clear, and the financial services industry continues to undergo a deep transformation which affects all industry participants.

Building societies have recovered well from the financial turmoil and they appear less risky than banks on a variety of measures. Their recent performance should put them in good stead to face the challenges driven by regulatory pressure and reform.

We are aware that assessing customer-owned building societies against standard bank performance metrics is unlikely to be entirely appropriate. However, we believe that this analysis will be informative for policymakers when weighing up what the future shape of the banking sector should be, as it helps to demonstrate the differences between types of organisations competing in the market.

The main findings are summarised below, and the full report can be found on [www.cassknowledge.com](http://www.cassknowledge.com)

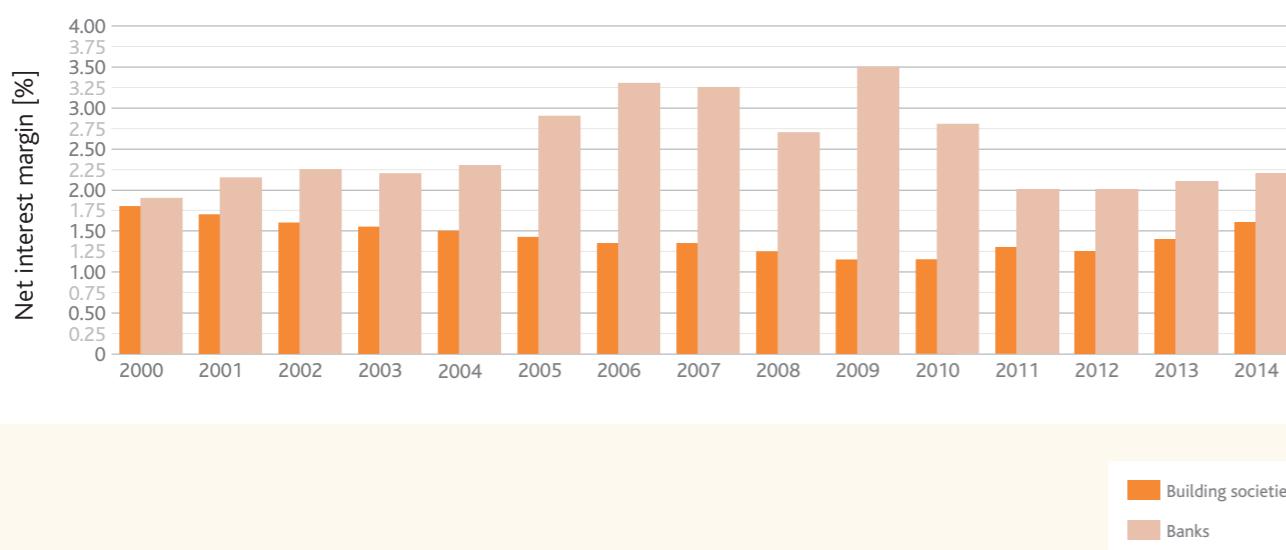
# A better deal for consumers

The net interest margin measures the ability of managers to perform banks' primary intermediation function by managing assets and liabilities as to maximise the spread between the interest income earned on assets and the interest costs of liabilities.

Building societies will typically have a lower net interest margin than banks, as they tend to offer higher saving rates and/or lower mortgage rates to their

customers, as a way to provide value rather than maximising returns to shareholders.

As the chart illustrates, building societies do seem to offer customers a better deal by consistently maintaining lower net interest margins compared to banks.



“ Building societies typically have a lower net interest margin than banks, as they tend to offer higher saving rates and/or lower mortgage rates.

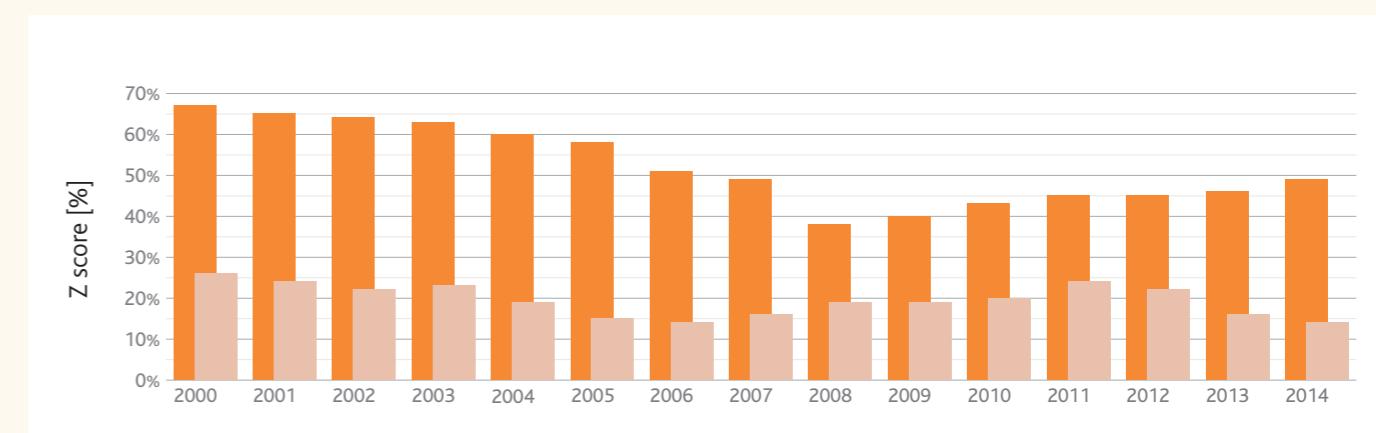
# Lower risk and better capitalised

Building societies are, on average, better capitalised than banks as shown by their 2014 core equity tier 1 capital ratios.

An increasingly popular measure of bank stability is the z-score, a measure of the distance from insolvency for a given institution which combines profitability, capitalisation and volatility of returns.

A higher z-score indicates that a bank is more stable, or less likely to become bankrupt. Thus, a higher z-score value indicates a lower probability of failure.

The results show that the z-scores for building societies are significantly higher than those of banks over the sample period, indicating that building societies are, on average, less risky than banks.



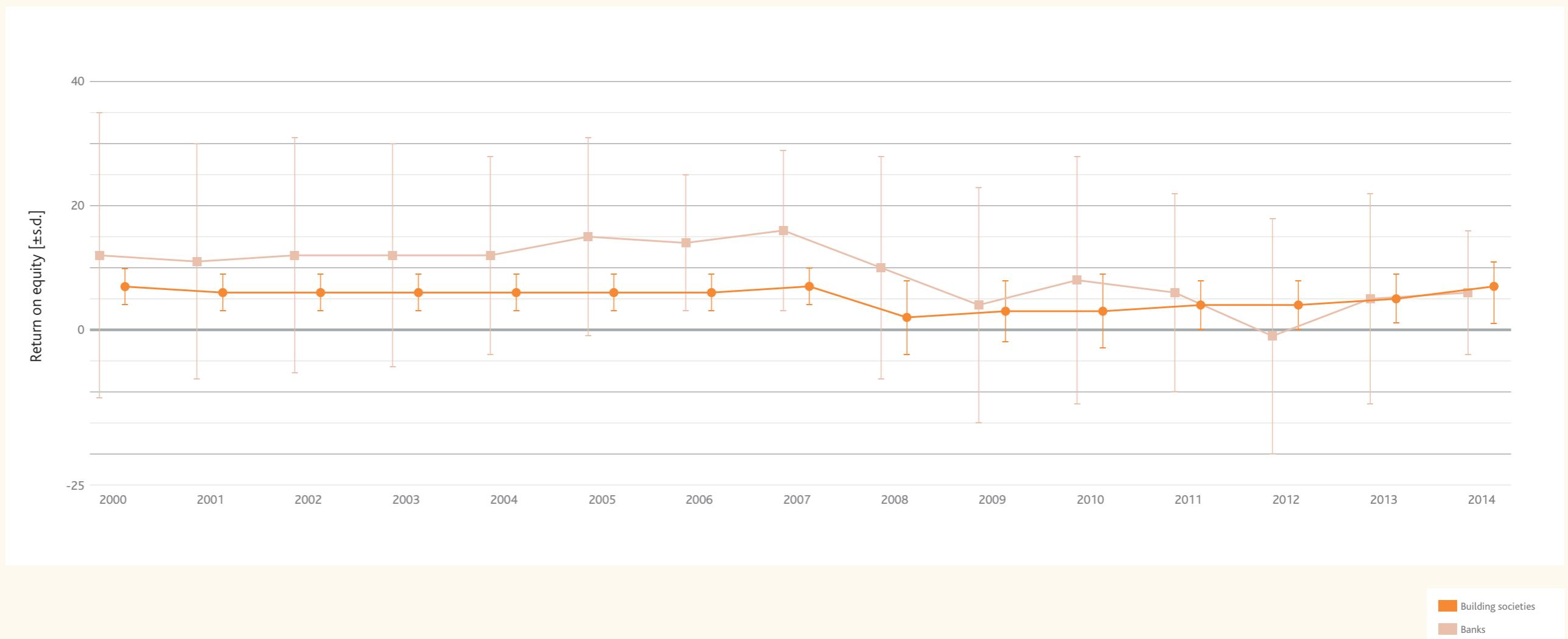
Building societies  
Banks

# More stable earnings

As building societies do not seek to maximise profits they can be expected to typically record lower returns, as measured by returns on equity or assets. However, it is also important to consider the composition and volatility of those earnings.

While the average ROE is higher for banks than for building societies, at least pre-crisis, the volatility of returns is also higher (as indicated by the standard deviation of returns, captured by the vertical bars in the chart).

Although lower on average, building societies' returns are more stable and, notwithstanding a dip in 2008, recover faster than those of banks.



“ Although lower on average, building societies' returns are more stable and, notwithstanding a dip in 2008, recover faster than those of banks.

# Efficient operations

The cost to income (C/I) ratio is a quick test of efficiency that reflects non-interest costs as a proportion of income.

Building societies' C/I ratios are not, on average, higher than those of banks, with the sector displaying good levels of efficiency with ratios around 60% on average during the sample period. Overall, building societies are just as efficient as banks.



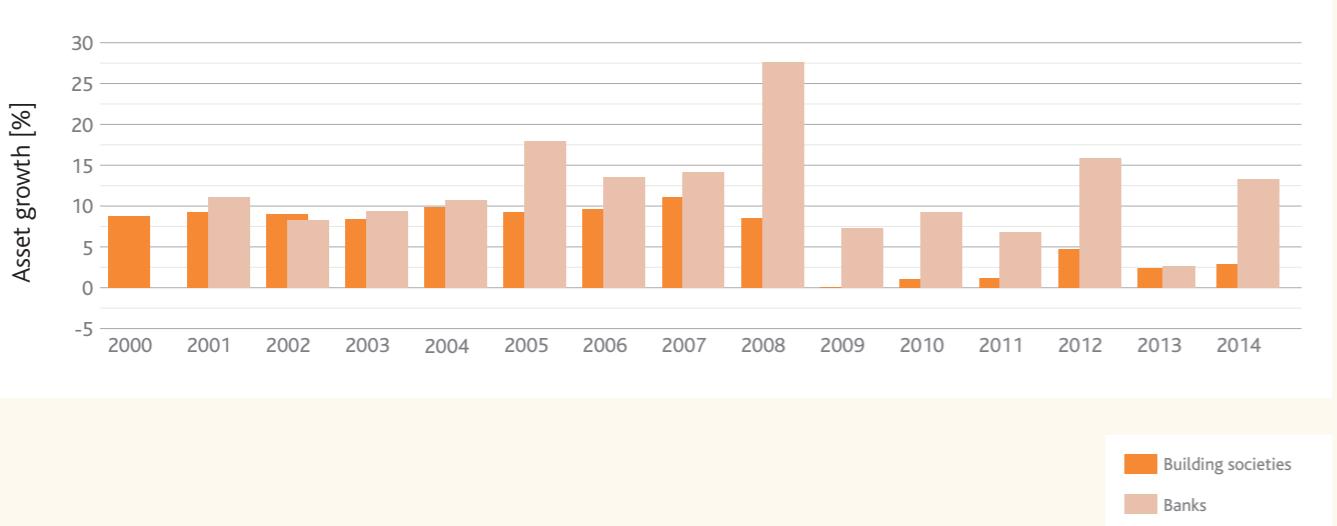
Building societies  
Banks

# More stable asset growth

The chart illustrates the asset growth (year on year) of banks and building societies over the sample period. Although growth has been positive for both groups, banks outperformed building societies in the run up to the financial crisis.

During the recession years, building societies' lending was limited. The sector, however, seems to have recovered from the financial turmoil faster than their major banking counterparts; asset growth has been on average positive since 2010, although at lower rates than in the pre-crisis period.

Building societies have more stable asset growth than banks. Fast asset and lending growth are often considered as indicators of increased risk-taking in the financial sector. In particular, banks with high rates of loan growth in the pre-crisis period reported a more significant drop in their performance during the crisis.



Source for data in charts: Bankscope; SNL Financial, Building Societies Association (BSA) and author's calculations.

View the full research at [www.cassknowledge.com](http://www.cassknowledge.com)

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# Agenda Item 8

## TREASURY MANAGEMENT STRATEGY STATEMENT AND ANNUAL INVESTMENT STRATEGY 2020/21 TO 2022/23

REPORT OF: Head of Corporate Resources  
Contact Officer: Peter Stuart  
Email: [peter.stuart@midsussex.gov.uk](mailto:peter.stuart@midsussex.gov.uk) Tel: 01444 477315  
Wards Affected: All  
Key Decision: No  
Report to: Audit Committee, 3 March 2020

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### Purpose of Report

1. This report sets out the Council's investment and borrowing strategy for the forthcoming three years and reports the counterparty list with which investments may be made. It also sets out the Prudential Limits that provide the parameters for approved future lending and borrowing, including the incidental cost of so doing.

### Summary

2. The purchase of the Orchard Shopping Centre head lease in November 2016 necessitated borrowing of £22m from other Local Authorities. £15m has already been repaid, using the cash flow generated by matured fixed term deposits. £2m will be repaid in November 2020 and the final £5m in November 2021.
3. Lending is restricted to the same counterparties and within the same limits as in the previous strategy approved in March 2019 except for the following amendments:
4. Halifax and HBOS have been removed as they are no longer on the suggested credit list supplied by Link Asset Services.
5. The limit for investment in the Local Authorities' Property Fund has been amended from "the higher of £4m or 25% of funds" to "the higher of £6m or 25% of funds" to accommodate the current investment of £6m. Investments in property funds are less liquid than cash investments and it would not be appropriate to withdraw funds in order to meet the 25% limit if, for example, liquid investments were used for a significant property purchase, resulting in a breach of the 25% limit.
6. The Council will give consideration to the use of "green" and "ethical" investments where appropriate.

### Recommendations

7. **The Committee is recommended to propose that Council agree:**
  - (i) the proposed Treasury Management Strategy Statement (TMSS) for 2020/21 and the following two years,
  - (ii) the Annual Investment Strategy (AIS) and the Minimum Revenue Provision Statement (MRP) as contained in Sections 4 and 2.3 respectively of the report;
  - (iii) the Prudential Indicators contained within this report.

## **Background**

8. The Council applies and upholds the Chartered Institute of Public Finance and Accountancy's Code of Practice for Treasury Management in Public Services (the "CIPFA TM Code"). CIPFA has defined Treasury Management as:

*"the management of the organisation's borrowing, investments and cash flows, its banking, money market and capital market transactions; the effective control of the risks associated with those activities; and the pursuit of optimum performance consistent with those risks."*
9. The Code requires local authorities to produce an annual Treasury Management Strategy Statement (TMSS), which documents the Council's approach to capital financing and investments for the forthcoming financial year (2020/21) and the following two years. This report fulfils that requirement.
10. In producing the TMSS, The Local Government Act 2003 (the Act) and supporting regulations require the Council to 'have regard to' the CIPFA Prudential Code and the CIPFA Treasury Management Code of Practice to set Prudential and Treasury Indicators for the next three years. The indicators are established to ensure that the Council's capital investment plans are affordable, prudent and sustainable.
11. Additionally, the Act and its subsequent Investment Guidance require the Council to set out its treasury management strategy for borrowing, and to prepare an Annual Investment Strategy (AIS). The Council's borrowing position is reported in Section 3, with arrangements for making Minimum Revenue Provision (MRP) for repayment of debt explained in Section 2.3. The AIS is contained in Section 4 of this report, and describes the Council's policies for managing its investments, and for giving priority to the security and liquidity of those investments.
12. Statute requires that the AIS, MRP Statement, and Prudential Indicators are approved by full Council before the start of the new financial year.

## **Policy Context**

13. Providing transparency and approval of the strategies contained in this report is an important part of the Council's statutory role. Treasury Management has become increasingly topical given the nature of the world's financial markets in recent years, and Members are expected to have a basic understanding of how the Council uses its reserves and cash flows which are in the stewardship of the Head of Corporate Resources.

## **Other Options Considered**

14. None – this report is statutorily required.

## **Financial Implications**

15. This report has no quantifiable financial implications. Interest payable and interest receivable arising from treasury management operations, and annual revenue provisions for repayment of debt, form part of the revenue budget but are not required to support the provision of services.

## **Risk Management Implications**

16. This report has no specific implications for the risk profile of the Authority.

## **Equality and Customer Service Implications**

17. None.

## **Background Papers**

**Treasury Management Strategy Statement & Annual Investment Strategy 2019/20 to 2021/22 (March 2019)**

**Annual Review of Treasury Management 2018-19 (July 2019)**

**Review of Treasury Management Activity 1 April – 30 September 2019 (Nov. 2019)**

**Treasury Management in the Public Services: Code of Practice and Cross Sectoral Guidance Notes (CIPFA)**

**The Prudential Code for Capital Finance in Local Authorities (CIPFA, December 2017)**

**MHCLG Investment Guidance (Revised for April 2018) and MRP Guidance**

**Link Asset Services report template (January 2020)**

# Treasury Management Strategy Statement & Annual Investment 2020/21 to 2022/23

## INTRODUCTION

### Background

1. The Council is required to operate a balanced budget, which broadly means that cash raised during the year will meet cash expenditure. Part of the treasury management operation is to ensure that this cash flow is adequately planned, with cash being available when it is needed. Surplus monies are invested in low risk counterparties or instruments commensurate with the Council's low risk appetite, providing adequate liquidity initially before considering investment return.
2. The second main function of the treasury management service is the funding of the Council's capital plans. These capital plans provide a guide to the borrowing need of the Council, essentially the longer term cash flow planning, to ensure that the Council can meet its capital spending obligations. This management of longer term cash may involve arranging long or short term loans, or using longer term cash flow surpluses. On occasion, when it is prudent and economic, any debt previously drawn may be restructured to meet Council risk or cost objectives.
3. The contribution the treasury management function makes to the authority is critical, as the balance of debt and investment operations ensure liquidity or the ability to meet spending commitments as they fall due, either on day-to-day revenue or for larger capital projects. The treasury operations will see a balance of the interest costs of debt and the investment income arising from cash deposits affecting the available budget. Since cash balances generally result from reserves and balances, it is paramount to ensure adequate security of the sums invested, as a loss of principal will in effect result in a loss to the General Fund Balance.
4. Whilst any commercial initiatives or loans to third parties will impact on the treasury function, these activities are generally classed as non-treasury activities, (arising usually from capital expenditure), and are separate from the day to day treasury management activities.

### Reporting requirements

#### Capital Strategy

5. The CIPFA revised 2017 Prudential and Treasury Management Codes require all local authorities to prepare a capital strategy report which will provide the following:
  - a high-level long term overview of how capital expenditure, capital financing and treasury management activity contribute to the provision of services
  - an overview of how the associated risk is managed
  - the implications for future financial sustainability
6. The aim of this capital strategy is to ensure that all elected members on the full council fully understand the overall long-term policy objectives and resulting capital strategy requirements, governance procedures and risk appetite.

#### Treasury Management reporting

7. The Council is required to receive and approve, as a minimum, three main reports each year, which incorporate a variety of policies, estimates and actuals:
  - (a) **Prudential and treasury indicators and treasury strategy (this report) - the first, and most important report covers:**
    - the capital plans (including prudential indicators);

- a minimum revenue provision (MRP) policy (how residual capital expenditure is charged to revenue over time);
- the treasury management strategy (how the investments and borrowings are to be organised) including treasury indicators; and
- an investment strategy (the parameters on how investments are to be managed).

The approval of the Treasury Management Strategy and Annual Investment Strategy is the function of the Council, however the Head of Corporate Resources shall also report to the Audit Committee on treasury management activity performance as follows:

- (b) **A mid year treasury management report** – This will update Members with the progress of the capital position, amending prudential indicators as necessary, and whether any policies require revision. The report will be submitted as soon after 30 September as practically possible.
- (c) **An annual treasury report** – This provides details of a selection of actual prudential and treasury indicators and actual treasury operations compared to the estimates within the strategy. The report will be submitted no later than 30 September after the financial year end.
8. **Scrutiny** - The above reports are required to be adequately scrutinised before being recommended to the Council. This role is undertaken by the Audit Committee, which may make recommendations regarding any aspects of treasury management policy and practices it considers appropriate in fulfilment of its scrutiny role. Such recommendations, as may be made shall be incorporated within the above named reports and submitted to meetings of the Council for consideration at the next available opportunity.
9. The Council's Scheme of Delegations is set out in Appendix E.

### **Treasury Management Strategy for 2020/21**

10. The strategy for 2020/21 covers two main areas:
  - (a) **Capital issues**
    - the capital expenditure plans and the associated prudential indicators;
    - the minimum revenue provision (MRP) policy.
  - (b) **Treasury management issues**
    - the current treasury position;
    - treasury indicators which limit the treasury risk and activities of the Council;
    - prospects for interest rates;
    - the borrowing strategy;
    - policy on borrowing in advance of need;
    - debt rescheduling;
    - the investment strategy;
    - creditworthiness policy; and
    - policy on use of external service providers.
11. These elements cover the requirements of the Local Government Act 2003, the CIPFA Prudential Code, MHCLG MRP Guidance, the CIPFA Treasury Management Code and MHCLG Investment Guidance.

## **Training**

12. The CIPFA Code requires the responsible officer to ensure that Members with responsibility for treasury management receive adequate training. This especially applies to Members responsible for scrutiny. Training was supplied by Link Asset Services on the 2<sup>nd</sup> July 2019 and during 2020/21 appropriate mandatory treasury management training will be provided to the Audit Committee. The training needs of the treasury management officers at Adur District Council, who provide the shared treasury service to Mid Sussex District Council, are periodically reviewed. Officers attend courses provided by appropriate trainers such as CIPFA and Link Asset Services.

## **External Service Providers**

13. The Council obtains treasury management services under a Shared Services Arrangement (SSA) from the in-house treasury management team formed out of the partnership working between Adur District and Worthing Borough Councils. The operation for all three Councils' treasury management is based at Worthing Town Hall, utilising similar banking arrangements. The SSA is provided under a Service Level Agreement (SLA) that commenced in October 2019 and which defines the respective roles of the client and provider authorities for a period of three years.
14. The SSA uses Link Asset Services as its external treasury management advisors. The Council recognises that there is value in employing external providers of treasury management services in order to acquire access to specialist skills and resources.
15. In making this arrangement the Council recognises that responsibility for treasury management decisions remains with the organisation at all times and will ensure that reliance beyond the terms and arrangements specified in the SLA is not placed upon the shared service providers. The Council will ensure that the terms of the appointment of the shared services providers, and the methods by which their value will be assessed, are properly agreed and documented and subjected to regular review.

## **THE CAPITAL PRUDENTIAL INDICATORS 2020/21 – 2022/23**

16. The Council's capital expenditure plans are the key driver of treasury management activity. The output of the capital expenditure plans is reflected in the Prudential Indicators, which are designed to assist Members' overview and confirm capital expenditure plans.

### **Capital expenditure**

17. This Prudential Indicator is a summary of the Council's capital expenditure plans, both those agreed previously, and those forming part of this budget cycle. The figures exclude other long term liabilities, such as leasing arrangements which already include borrowing instruments. Members are asked to approve the capital expenditure forecasts:

<b>Capital expenditure £m</b>	<b>2018/19 Actual</b>	<b>2019/20 Estimate</b>	<b>2020/21 Estimate</b>	<b>2021/22 Estimate</b>	<b>2022/23 Estimate</b>
General Fund	24.626	6.253	2.232	1.989	0.161

18. The table below summarises the above capital expenditure plans and how these plans are being financed by capital or revenue resources. Any shortfall of resources results in a funding borrowing need.

Financing of capital expenditure £m	2018/19 Actual	2019/20 Estimate	2020/21 Estimate	2021/22 Estimate	2022/23 Estimate
Capital receipts	1.269	0.058	10.472	10.050	10.050
Capital grants, Contributions & S106 receipts	4.827	2.307	1.512	1.583	0.000
General Reserves, Specific Reserves & Revenue Contributions	15.939	3.888	0.248	0.356	0.111
Net financing need for the year	2.591	0.000	(10.000)	(10.000)	(10.000)

#### The Council's borrowing need (the Capital Financing Requirement)

19. The second prudential indicator is the Council's Capital Financing Requirement (CFR). The CFR is simply the total historic outstanding capital expenditure which has not yet been paid for from either revenue or capital resources. It is essentially a measure of the Council's indebtedness and so its underlying borrowing need. Any capital expenditure above, which has not immediately been paid for through a revenue or capital resource, will increase the CFR. The CFR does not increase indefinitely, as the minimum revenue provision (MRP) is a statutory annual revenue charge which broadly reduces the indebtedness in line with each asset's life and so charges the economic consumption of capital assets as they are used.
20. The CFR includes any other long term liabilities (e.g. finance leases). Whilst these increase the CFR, and therefore the Council's borrowing requirement, these types of scheme include a borrowing facility and so the Council is not required to separately borrow for these schemes. The Council currently has one finance lease taken out in 2018 and ending in 2028.
21. The Council is asked to approve the CFR projections below:

Capital Financing Requirement £m	2018/19 Actual	2019/20 Estimate	2020/21 Estimate	2021/22 Estimate	2022/23 Estimate
Total CFR at 31/03	27.948	27.438	16.916	6.382	(4.615)
Movement in CFR	2.591	(0.510)	(10.522)	(10.534)	(10.547)
<b>Movement in CFR represented by:</b>					
Net financing need for the year (above)	3.089	0.000	(10.000)	(10.000)	(10.000)
Less MRP and other financing movements	(0.498)	(0.510)	(0.522)	(0.534)	(0.547)
<b>Movement in CFR</b>	<b>2.591</b>	<b>(0.510)</b>	<b>(10.522)</b>	<b>(10.534)</b>	<b>(10.547)</b>

### **Minimum revenue provision (MRP) policy statement**

22. The Council is required to pay off an element of the accumulated General Fund capital spend each year (the CFR) through a revenue charge (the minimum revenue provision - MRP), although it is also allowed to undertake additional voluntary payments if required (voluntary revenue provision - VRP).
23. MHCLG regulations have been issued which require the full Council to approve an MRP Statement in advance of each year. A variety of options is provided to councils, so long as there is a prudent provision. The Council is recommended to approve the following MRP Statement:
24. The Council's policy for MRP relating to unfunded capital expenditure is to provide for MRP on an annuity basis over the life of the loans (except as detailed below for the Orchard Shopping Centre). As an annuity is a fixed annual sum comprising interest and principal, the MRP for repayment of debt will increase each year over the asset life as the proportion of interest calculated on the principal outstanding reduces as the debt is repaid.
25. The purchase of the Orchard Shopping Centre head lease in November 2016 increased the Capital Financing Requirement. However, as the Council is forecasting possible capital receipts of over £30m, MRP will only be provided on the balance of nearly £5m. This will be done on a level basis of £100,000 per year.
26. Repayments included in finance leases are applied as MRP.

### **BORROWING**

27. The capital expenditure plans set out in Section 2 provide details of the service activity of the Council. The treasury management function ensures that the Council's cash is organised in accordance with the relevant professional codes, so that sufficient cash is available to meet the service activity and the Council's capital strategy. This will involve both the organisation of the cash flow and, where capital plans require, the organisation of appropriate borrowing facilities. The strategy covers the relevant treasury / prudential indicators, the current and projected debt positions and the annual investment strategy.

## Current portfolio position

28. The overall treasury management portfolio as at 31 March 2019 and for the position as at 31 December 2019 are shown below for both borrowing and investments.

	Principal at 31.03.19 £m	Actual 31.03.2019 %	Principal at 31.12.19 £m	Actual 31.12.2019 %
<b>External Borrowing</b>				
PWLB	(0.571)	4%	(0.505)	5%
Other Borrowing	(13.000)	79%	(7.000)	69%
Finance lease	(2.818)	17%	(2.610)	26%
<b>TOTAL BORROWING</b>	<b>(16.389)</b>	100%	<b>(10.115)</b>	100%
<b>Treasury Investments:</b>				
Local Authority Property Fund	5.942	19%	5.942	13%
<b>In-house:</b>				
Banks	6.010	19%	7.001	16%
Building societies - unrated	9.000	29%	17.000	38%
Building societies - rated	4.000	13%	7.000	16%
Local authorities	1.000	3%	0.000	0%
Money market funds	5.200	17%	7.735	17%
<b>TOTAL INVESTMENTS</b>	<b>31.152</b>	100%	<b>44.678</b>	100%
<b>NET INVESTMENTS</b>	<b>14.763</b>		<b>34.563</b>	

29. The Council's forward projections for borrowing are summarised below. The table shows the actual external debt, against the underlying capital borrowing need (the Capital Financing Requirement - CFR), highlighting any over or under borrowing.

External Debt £m	2018/19 Actual	2019/20 Estimate	2020/21 Estimate	2021/22 Estimate	2022/23 Estimate
Debt at 1 April	12.698	13.571	7.437	5.298	0.152
Expected change in Debt	0.873	(6.134)	(2.139)	(5.146)	(0.152)
Other long-term liabilities (OLTL)	0.000	2.818	2.541	2.258	1.970
Expected change in OLTL	2.818	(0.277)	(0.283)	(0.288)	(0.294)
Actual gross debt at 31 March	16.389	9.978	7.556	2.122	1.676
The Capital Financing Requirement	27.948	27.438	16.916	6.382	(4.615)
Under/(over) borrowing	11.559	17.460	9.360	4.260	(1.676)

30. The Council's debt comprises one loan from the Public Works Loan Board (PWLB), which matures on 1 March 2023 and 2 loans with other local authorities, totalling £7m, which mature in November 2020 (£2m) and November 2021 (£5m), which were arranged to fund the purchase of the Orchard Shopping Centre head lease. The local authority loans are at rates lower than those that were available from the PWLB, ranging from 1.0% to 1.1% (average rate), and they will be repaid using capital receipts and maturing investments. The "other long term liability" is in respect of capital assets acquired by finance leases.

31. Within the range of Prudential Indicators there are a number of key indicators to ensure that the Council operates its activities within well-defined limits. One of these is that the Council needs to ensure that its gross debt does not, except in the short term, exceed the total of the CFR in the preceding year plus the estimates of any additional CFR for 2020/21 and the following two financial years. This allows some flexibility for limited early borrowing for future years, but ensures that borrowing is not undertaken for revenue or speculative purposes.
32. The Head of Corporate Resources reports that the Council complied with this Prudential Indicator in the current year. The respective timings of capital receipts and repayment of debt result in a projected over borrowing position in 2022/23. However this is due to the Council's ability to fund its capital expenditure from grants and other resources and is not an indication of imprudent borrowing. In addition, both the CFR and the outstanding debt are small relative to the size of the Council's budget. This view takes into account current commitments, existing plans, and the proposals in this report.

#### Treasury Indicators: limits to borrowing activity

33. **The operational boundary** - This is the limit which external debt is not normally expected to exceed. In most cases, this would be a similar figure to the CFR, but may be lower or higher depending on the levels of actual debt and the ability to fund under-borrowing by other cash resources.

Operational Boundary	2019/20	2020/21	2021/22	2022/23
	£m	£m	£m	£m
Debt	£28.0m	£28.0m	£28.0m	£28.0m
Other long term liabilities	£4.0m	£4.0m	£4.0m	£4.0m
<b>Total</b>	<b>£32.0m</b>	<b>£32.0m</b>	<b>£32.0m</b>	<b>£32.0m</b>

34. **The authorised limit for external debt** – This is a key Prudential Indicator and represents a control on the maximum level of borrowing. This represents a legal limit beyond which external debt is prohibited, and this limit needs to be set or revised by the full Council. It reflects the level of external debt which, while not desired, could be afforded in the short term, but is not sustainable in the longer term.

- (i) The Council is asked to approve the authorised limit:

Authorised Limit	2019/20	2020/21	2021/22	2022/23
	£m	£m	£m	£m
Debt	£30.0m	£30.0m	£30.0m	£30.0m
Other long term liabilities	£4.0m	£4.0m	£4.0m	£4.0m
<b>Total</b>	<b>£34.0m</b>	<b>£34.0m</b>	<b>£34.0m</b>	<b>£34.0m</b>

- (ii) This is the statutory limit determined under section 3 (1) of the Local Government Act 2003. The Government retains an option to control either the total of all councils' plans, or those of a specific council, although this power has not yet been exercised.

35. The Head of Corporate Resources has delegated authority, within the total limit for any individual year, to effect movement between the separately agreed limits for borrowing and other long term liabilities. Decisions will be based on the outcome of financial option appraisals and best value considerations. Any movement between these separate limits will be reported to the next meeting of the Council at the earliest opportunity.

## Prospects for interest rates and the economy

36. This section contains a commentary for the economic outlook provided by the Council's shared service provider's treasury management consultants, Link Asset Services . This includes a central view of forecast interest rates as follows:

Link Asset Services Interest Rate View														
	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	Mar-23
Bank Rate View	0.75	0.75	0.75	0.75	0.75	1.00	1.00	1.00	1.00	1.00	1.25	1.25	1.25	1.25
3 Month LIBID	0.70	0.70	0.70	0.80	0.90	1.00	1.00	1.00	1.10	1.20	1.30	1.30	1.30	1.30
6 Month LIBID	0.80	0.80	0.80	0.90	1.00	1.10	1.10	1.20	1.30	1.40	1.50	1.50	1.50	1.50
12 Month LIBID	1.00	1.00	1.00	1.10	1.20	1.30	1.30	1.40	1.50	1.60	1.70	1.70	1.70	1.70
5yr PWLB Rate	2.30	2.40	2.40	2.50	2.50	2.60	2.70	2.80	2.90	2.90	3.00	3.10	3.20	3.20
10yr PWLB Rate	2.60	2.70	2.70	2.70	2.80	2.90	3.00	3.10	3.20	3.20	3.30	3.30	3.40	3.50
25yr PWLB Rate	3.20	3.30	3.40	3.40	3.50	3.60	3.70	3.70	3.80	3.90	4.00	4.00	4.10	4.10
50yr PWLB Rate	3.10	3.20	3.30	3.30	3.40	3.50	3.60	3.60	3.70	3.80	3.90	3.90	4.00	4.00

37. The above forecasts have been based on an assumption that there is an agreed deal on Brexit, including agreement on the terms of trade between the UK and EU, at some point in time. The result of the general election has removed much uncertainty around this major assumption. However, it does not remove uncertainty around whether agreement can be reached with the EU on a trade deal within the short time to December 2020, as the prime minister has pledged.
38. It has been little surprise that the Monetary Policy Committee (MPC) left Bank Rate unchanged at 0.75% so far due to the ongoing uncertainty over Brexit and the outcome of the general election. In its meeting on 7 November, the MPC became more dovish due to increased concerns over the outlook for the domestic economy if Brexit uncertainties were to become more entrenched, and for weak global economic growth: if those uncertainties were to materialise, then the MPC were likely to cut Bank Rate. However, if they were both to dissipate, then rates would need to rise at a "gradual pace and to a limited extent". Brexit uncertainty has had a dampening effect on UK GDP growth in 2019, especially around mid-year. There is still some residual risk that the MPC could cut Bank Rate as the UK economy is still likely to only grow weakly in 2020 due to continuing uncertainty over whether there could effectively be a no deal Brexit in December 2020 if agreement on a trade deal is not reached with the EU. Until that major uncertainty is removed, or the period for agreeing a deal is extended, it is unlikely that the MPC would raise Bank Rate.
39. **Bond yields / PWLB rates** There has been much speculation during 2019 that the bond market has gone into a bubble, as evidenced by high bond prices and remarkably low yields. However, given the context that there have been heightened expectations that the US was heading for a recession in 2020, and a general background of a downturn in world economic growth, together with inflation generally at low levels in most countries and expected to remain subdued, conditions are ripe for low bond yields. While inflation targeting by the major central banks has been successful over the last thirty years in lowering inflation expectations, the real equilibrium rate for central rates has fallen considerably due to the high level of borrowing by consumers: this means that central banks do not need to raise rates as much now to have a major impact on consumer spending, inflation, etc. This has pulled down the overall level of interest rates and bond yields in financial markets over the last thirty years. We have therefore seen over the last year, many bond yields up to ten years in the Eurozone actually turn negative. In addition, there has, at times, been an inversion of bond yields in the US whereby ten-year yields have fallen below shorter-term yields. In the past, this has been a precursor of a recession. The other side of this coin is that bond prices are elevated, as investors would be expected to be moving out of riskier assets i.e. shares, in anticipation of a downturn in corporate earnings and so selling out of equities. However, stock markets are also currently at high levels as some investors have focused on chasing returns in the context of dismal ultra-low interest rates on cash deposits.

- 40. During the first half of 2019-20 to 30 September, gilt yields plunged and caused a near halving of longer term PWLB rates to completely unprecedented historic low levels. (See paragraph 3.7 for comments on the increase in the PWLB rates margin over gilt yields of 100bps introduced on 9 October 2019.) There is though, an expectation that financial markets have gone too far in their fears about the degree of the downturn in US and world growth. If, as expected, the US only suffers a mild downturn in growth, bond markets in the US are likely to sell off and that would be expected to put upward pressure on bond yields, not only in the US, but also in the UK due to a correlation between US treasuries and UK gilts; at various times this correlation has been strong but at other times weak. However, forecasting the timing of this, and how strong the correlation is likely to be, is very difficult to forecast with any degree of confidence. Changes in UK Bank Rate will also impact on gilt yields.
- 41. One potential danger that may be lurking in investor minds is that Japan has become mired in a twenty-year bog of failing to get economic growth and inflation up off the floor, despite a combination of massive monetary and fiscal stimulus by both the central bank and government. Investors could be fretting that this condition might become contagious to other western economies.
- 42. Another danger is that unconventional monetary policy post 2008, (ultra-low interest rates plus quantitative easing), may end up doing more harm than good through prolonged use. Low interest rates have encouraged a debt-fuelled boom that now makes it harder for central banks to raise interest rates. Negative interest rates could damage the profitability of commercial banks and so impair their ability to lend and / or push them into riskier lending. Banks could also end up holding large amounts of their government's bonds and so create a potential doom loop. (A doom loop would occur where the credit rating of the debt of a nation was downgraded which would cause bond prices to fall, causing losses on debt portfolios held by banks and insurers, so reducing their capital and forcing them to sell bonds – which, in turn, would cause further falls in their prices etc.). In addition, the financial viability of pension funds could be damaged by low yields on holdings of bonds.
- 43. The overall longer run future trend is for gilt yields, and consequently PWLB rates, to rise, albeit gently. From time to time, gilt yields, and therefore PWLB rates, can be subject to exceptional levels of volatility due to geo-political, sovereign debt crisis, emerging market developments and sharp changes in investor sentiment. Such volatility could occur at any time during the forecast period.
- 44. In addition, PWLB rates are subject to ad hoc decisions by H.M. Treasury to change the margin over gilt yields charged in PWLB rates: such changes could be up or down. It is not clear that if gilt yields were to rise back up again by over 100bps within the next year or so, whether H M Treasury would remove the extra 100 bps margin implemented on 9 October 2019.
- 45. Economic and interest rate forecasting remains difficult with so many influences weighing on UK gilt yields and PWLB rates. The above forecasts, (and MPC decisions), will be liable to further amendment depending on how economic data and developments in financial markets transpire over the next year. Geopolitical developments, especially in the EU, could also have a major impact. Forecasts for average investment earnings beyond the three-year time horizon will be heavily dependent on economic and political developments.

### **Investment and borrowing rates**

- 46. Investment returns are likely to remain low during 2020/21 with little increase in the following two years. However, if major progress was made with an agreed Brexit, then there is upside potential for earnings.

47. Borrowing interest rates were on a major falling trend during the first half of 2019-20 but then jumped up by 100 bps on 9 October 2019. The policy of avoiding new borrowing by running down spare cash balances has served local authorities well over the last few years. However, the unexpected increase of 100 bps in PWLB rates requires a major rethink of local authority treasury management strategy and risk management. Now that the gap between longer term borrowing rates and investment rates has materially widened, and in the long term Bank Rate is not expected to rise above 2.5%, it is unlikely that this authority will do any further longer term borrowing for the next three years, or until such time as the extra 100 bps margin is removed
48. If this authority is not able to avoid borrowing to finance new capital expenditure, there will be a cost of carry, (the difference between higher borrowing costs and lower investment returns), to any new short or medium-term borrowing that causes a temporary increase in cash balances as this position will, most likely, incur a revenue cost.

### **Borrowing strategy**

49. The Council is currently maintaining an under-borrowed position. This means that the capital borrowing need (the Capital Financing Requirement), has not been fully funded with loan debt as cash supporting the Council's reserves, balances and cash flow has been used as a temporary measure. This strategy is prudent as investment returns are low and counterparty risk is still an issue that needs to be considered.
50. Against this background and the risks within the economic forecast, caution will be adopted with the 2020/21 treasury operations. The Head of Corporate Resources will monitor interest rates in financial markets and adopt a pragmatic approach to changing circumstances:
  - (i) if it was felt that there is a significant risk of a sharp FALL in borrowing rates, (e.g. due to a marked increase of risks around relapse into recession or of risks of deflation), then borrowing will be postponed.
  - (ii) if it was felt that there is a significant risk of a much sharper RISE in borrowing rates than that currently forecast, perhaps arising from an acceleration in the rate of increase in central rates in the USA and UK, an increase in world economic activity, or a sudden increase in inflation risks, then the portfolio position will be re-appraised. Most likely, fixed rate funding will be drawn whilst interest rates are lower than they are projected to be in the next few years.

Any decisions will be reported to the appropriate decision making body at the next available opportunity.

### **Policy on borrowing in advance of need**

51. The Council will not borrow more than or in advance of its needs purely in order to profit from the investment of the extra sums borrowed. Any decision to borrow in advance will be within forward approved Capital Financing Requirement estimates, and will be considered carefully to ensure that value for money can be demonstrated and that the Council can ensure the security of such funds. Risks associated with any borrowing in advance activity will be subject to prior appraisal and subsequent reporting through the mid-year or annual reporting mechanism

### **Debt rescheduling**

52. The Council has one loan from the Public Works Loan Board, repaid by fixed annuities over the life of the loan. As it would not be possible to prematurely repay the existing loan without incurring a premium charge for early settlement, there is currently no intention to redeem the loan early. The loans for the purchase of the Orchard Shopping Centre head lease will be repaid within 2 years and are at competitively low interest rates.

53. Any rescheduling will be reported to the Council at the earliest meeting following its action.

### **New financial institutions as a source of borrowing and / or types of borrowing**

54. Following the decision by the PWLB on 9 October 2019 to increase their margin over gilt yields by 100 bps to 180 basis points on loans lent to local authorities, if any borrowing becomes necessary, consideration will also need to be given to sourcing funding at cheaper rates from the following:

Local authorities (primarily shorter dated maturities)

Financial institutions (primarily insurance companies and pension funds but also some banks, out of spot or forward dates)

Municipal Bonds Agency

55. The degree which any of these options proves cheaper than PWLB Certainty Rate is still evolving at the time of writing but our advisors will keep us informed.

## **ANNUAL INVESTMENT STRATEGY**

### **Investment policy – management of risk**

56. The Council's investment policy has regard to the following: -

- MHCLG's Guidance on Local Government Investments ("the Guidance")
- CIPFA Treasury Management in Public Services Code of Practice and Cross Sectoral Guidance Notes 2017 ("the Code")
- CIPFA Treasury Management Guidance Notes 2018

57. The Council's investment priorities will be security first, portfolio liquidity second and then yield, (return).

58. The Head of Corporate Resources, under delegated powers, will undertake through the Shared Service Arrangement the most appropriate form of investments in keeping with the investment objectives, income and risk management requirements, and Prudential Indicators. As conditions in the financial markets remain uncertain, the proposed maximum limits for Specified and Unspecified Investments for 2020/21 are the same as for 2019/20.

59. Investment instruments identified for use in the financial year are listed in Appendices C and D under the 'specified' and 'non-specified' investments categories. Counterparty limits will be as set through the Council's treasury management practices.

60. The above guidance from the MHCLG and CIPFA place a high priority on the management of risk. This authority has adopted a prudent approach to managing risk and defines its risk appetite by the following means: -

- (i) Minimum acceptable credit criteria are applied in order to generate a list of highly creditworthy counterparties. This also enables diversification and thus avoidance of concentration risk. The key ratings used to monitor counterparties are the short term and long-term ratings.
- (ii) Other information: ratings will not be the sole determinant of the quality of an institution; it is important to continually assess and monitor the financial sector on both a micro and macro basis and in relation to the economic and political environments in which institutions operate. The assessment will also take account of information that reflects the opinion of the markets. To achieve this consideration the Council will engage with its advisors to maintain a monitor on market pricing such as "credit default swaps" and overlay that information on top of the credit ratings.

- (iii) Other information sources used will include the financial press, share price and other such information pertaining to the financial sector in order to establish the most robust scrutiny process on the suitability of potential investment counterparties.
  - (iv) This authority has defined the list of types of investment instruments that the treasury management team is authorised to use. There are two lists in Appendices C and D under the categories of 'specified' and 'non-specified' investments.
    - **Specified investments** are those with a high level of credit quality and subject to a maturity limit of one year.
    - **Non-specified investments** are those with less high credit quality, may be for periods in excess of one year, and/or are more complex instruments which require greater consideration by members and officers before being authorised for use. Once an investment is classed as non-specified, it remains non-specified all the way through to maturity i.e. an 18 month deposit would still be non-specified even if it has only 11 months left until maturity.
  - (v) Lending limits, (amounts and maturity), for each counterparty are set out in Appendices C and D.
  - (vi) This authority will set a limit for the amount of its investments which are invested for longer than 365 days, (see paragraph 4.8).
  - (vii) Investments will only be placed with counterparties from countries with a specified minimum sovereign rating, (see paragraph 4.5). The UK is excluded from this limit because it will be necessary to invest in UK banks and other institutions even if the sovereign rating is cut.
  - (viii) Through the shared service, this authority has access to external consultants, to provide expert advice on how to optimise an appropriate balance of security, liquidity and yield, given the risk appetite of this authority in the context of the expected level of cash balances and need for liquidity throughout the year.
  - (ix) All investments will be denominated in sterling.
  - (x) As a result of the change in accounting standards for 2019/20 under IFRS 9, this authority will consider the implications of investment instruments which could result in an adverse movement in the value of the amount invested and resultant charges at the end of the year to the General Fund. (In November 2018, the Ministry of Housing, Communities and Local Government, [MHCLG], concluded a consultation for a temporary override to allow English local authorities time to adjust their portfolio of all pooled investments by announcing a statutory override to delay implementation of IFRS 9 for five years commencing from 1.4.18. Consequently any fluctuations in the value of the Council's investment in the Local Authorities' Property Fund will not be taken through the general fund for the period of the override).
61. However, this authority will also pursue **value for money** in treasury management and will monitor the yield from investment income against appropriate benchmarks for investment performance, (see paragraph 4.14). Regular monitoring of investment performance will be carried out during the year.

#### **Changes in risk management policy from last year**

62. The above criteria are unchanged from last year other than as set out in the Summary at the beginning of the report.

## **Creditworthiness policy**

63. The primary principle governing the Council's investment criteria through the Shared Services Arrangement (SSA) is the security of its investments, although the yield or return on the investment is also a key consideration. After this main principle, the SSA will ensure that:
  - It maintains a policy covering both the categories of investment types it will invest in, criteria for choosing investment counterparties with adequate security, and monitoring their security. This is set out in the specified and non-specified investment sections in Appendices C and D; and
  - It has sufficient liquidity in its investments. For this purpose it will set out procedures for determining the maximum periods for which funds may prudently be committed. These procedures also apply to the Council's Prudential Indicators covering the maximum principal sums invested.
64. The SSA will maintain a counterparty list in compliance with the criteria in the Appendices and will revise the criteria and submit them to Council for approval as necessary. These criteria are separate to that which determines which types of investment instrument are either specified or non-specified as it provides an overall pool of counterparties considered high quality which the Council may use, rather than defining what types of investment instruments are to be used.
65. Credit rating information is supplied to the SSA by Link Asset Services, our treasury advisors, on all active counterparties that comply with the criteria below. Any counterparty failing to meet the criteria would be omitted from the counterparty (dealing) list. Any rating changes, rating Watches (notification of a likely change), rating Outlooks (notification of the longer term bias outside the central rating view) are provided to the SSA almost immediately after they occur and this information is considered before dealing. For instance, a negative rating Watch applying to a counterparty at the minimum Council criteria will be suspended from use, with all others being reviewed in light of market conditions.

## **Use of additional information other than credit ratings**

66. Additional requirements under the Code require the Council to supplement credit rating information. Whilst the above criteria rely primarily on the application of credit ratings to provide a pool of appropriate counterparties for officers to use, additional operational market information will be applied before making any specific investment decision from the agreed pool of counterparties. This additional market information will be applied to compare the relative security of differing investment opportunities.
67. The officers of the shared service recognise that ratings should not be the sole determinant of the quality of an institution and that it is important to continually assess and monitor the financial sector on both a micro and macro basis and in relation to the economic and political environments in which institutions operate. The assessment will also take account of information that reflects the opinion of the markets, the government support for banks, and the credit ratings of that government support. Accordingly, the shared service will exercise discretion to deviate from Link's suggested durational bands – for example the Council approves the use of Building Societies as set out in the Appendices.

## **The Council's Minimum Investment Creditworthiness Criteria**

68. The minimum credit ratings criteria used by the Council generally will be a short term rating (Fitch or equivalents) of F1, and long term rating A-. There may be occasions when the counterparty ratings from one or more of the three Ratings Agencies are marginally lower than the minimum requirements of F1 Short term, A- Long term (or equivalent). Where this arises, the counterparties to which the ratings apply may still be used with discretion, but in these instances consideration will be given to the whole range of topical market information available, not just ratings.
69. The Council includes **Building Societies** with asset size in excess of £1 billion in the specified investments. It is recognised that they may carry a lower credit rating than the Council's other counterparties, or no rating, therefore the lending limits for the building societies shall be £4m each for the top 3 and £3m for the others.

## **UK banks – ring fencing**

70. The largest UK banks, (those with more than £25bn of retail / Small and Medium-sized Enterprise (SME) deposits), are required, by UK law, to separate core retail banking services from their investment and international banking activities by 1st January 2019. This is known as "ring-fencing". Whilst smaller banks with less than £25bn in deposits are exempt, they can choose to opt up. Several banks are very close to the threshold already and so may come into scope in the future regardless.
71. Ring-fencing is a regulatory initiative created in response to the global financial crisis. It mandates the separation of retail and SME deposits from investment banking, in order to improve the resilience and resolvability of banks by changing their structure. In general, simpler activities offered from within a ring-fenced bank, (RFB), will be focused on lower risk, day-to-day core transactions, whilst more complex and "riskier" activities are required to be housed in a separate entity, a non-ring-fenced bank, (NRFB). This is intended to ensure that an entity's core activities are not adversely affected by the acts or omissions of other members of its group.
72. While the structure of the banks included within this process may have changed, the fundamentals of credit assessment have not. The Council will continue to assess the new-formed entities in the same way that they do others and those with sufficiently high ratings, (and any other metrics considered), will be considered for investment purposes.

## **Country Limits and Proposed Monitoring Arrangements**

73. Due care will be taken to consider the country, group and sector exposure of the Council's investments. The SSA has determined that it will only use approved counterparties from countries (other than the UK) with a minimum sovereign credit rating of AA- from Fitch Ratings (or equivalent from other agencies if Fitch does not provide one). The list of countries that qualify using these credit criteria as at the date of this report is reflected in the counterparty approved lending list shown at Appendix C. This list will be added to, or deducted from, by officers should ratings change, in accordance with this policy. No more than 25% of investments shall be placed in non-UK financial institutions for more than 7 days.

## **Investment strategy**

74. **In-house funds** - Investments will be made with reference to the core balance and cash flow requirements and the outlook for short-term interest rates (i.e. rates for investments up to 12 months). Greater returns are usually obtainable by investing for longer periods. While most cash balances are required in order to manage the ups and downs of cash flow, where cash sums can be identified that could be invested for longer periods, the value to be obtained from longer term investments will be carefully assessed. For cash flow balances, the shared service will seek to use notice accounts, money market funds and short-dated deposits to benefit from the compounding of interest
- If it is thought that Bank Rate is likely to rise significantly within the time horizon being considered, then consideration will be given to keeping most investments as being short term or variable.
  - Conversely, if it is thought that Bank Rate is likely to fall within that time period, consideration will be given to locking in higher rates currently obtainable, for longer periods.
75. The Head of Corporate Resources, through the shared service, will undertake the most appropriate form of investments in keeping with the investment objectives, income and risk management requirements and Prudential Indicators. Decisions taken on the core investment portfolio will be reported to the meetings of the Audit Committee and the Council in accordance with the reporting arrangements. The Council's shared service will research the range of "green" and "ethical" investments that is developing.

## **Investment returns expectations**

76. On the assumption that the UK and EU agree a Brexit deal including the terms of trade by the end of 2020 or soon after, then Bank Rate is forecast to increase only slowly over the next few years, to reach 1.25% by quarter 1 2023. Bank Rate forecasts are:

Q1 2021	:	0.75%
Q1 2022	:	1.00%
Q1 2023	:	1.25%

77. The suggested budgeted investment earnings rates for returns on investments placed for periods up to about three months during each financial year are as follows:

2019/20	:	0.75%
2020/21	:	0.75%
2021/22	:	1.00%
2022/23	:	1.25%
2023/24	:	1.50%
2024/25	:	1.75%
Later years	:	2.25%

- The overall balance of risks to economic growth in the UK is probably relatively even due to the weight of all the uncertainties over post-Brexit trade arrangements and the impact of an expansionary government spending policy (as expected in the Budget on the 11<sup>th</sup> March).
- The balance of risks to increases or decreases in Bank Rate and shorter term PWLB rates are also broadly even.

## Funds available for investment

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

Investments	2019/20 Estimate	2020/21 Estimate	2021/22 Estimate	2022/23 Estimate
Balance at 1 April	£m	£m	£m	£m
Capital Expenditure	31.152	31.000	39.895	48.182
Grants, capital receipts & other new funds	(6.253)	(2.232)	(1.989)	(0.161)
Loan repayments/adjustments	2.365	13.127	15.276	11.298
Balance at 31 March	3.736	(2.000)	(5.000)	0.000
	31.000	39.895	48.182	59.319

## Investment treasury indicator and limit - principal funds invested for greater than 365 days

79. These limits are set with regard to the Council's liquidity requirements and to reduce the need for early sale of an investment, and are based on the availability of funds after each year-end.
80. The Council is asked to approve the treasury indicator limit: -

Maximum proportion of principal sums invested > 365 days	2020/21	2021/22	2022/23
Principal sums invested > 365 days	50%	50%	50%

81. In any sustained period of significant stress in the financial markets, the default position is for investments to be placed with The Debt Management Account Deposit Facility of the Debt Management Office (DMO) of the UK central government. The rates of interest are below equivalent money market rates, however, the returns are an acceptable trade-off for the guarantee that the Council's capital is secure.
82. The Council's proposed investment activity for placing cash deposits in 2019/20 will be to use:
- AAA-rated Money Market Funds with a Constant Net Asset Value (CNAV) or a Low Volatility Net Asset Value (LVNAV) under the new money market fund regulations
  - other local authorities, parish councils etc.
  - bank business reserve accounts and term deposits. These are primarily restricted to UK institutions that are rated at least A- long term.
  - Building Societies with asset size in excess of £1 billion

## Other Options for Longer Term Investments

83. To provide the Council with options to enhance returns above those available for short term durations, it is proposed to retain the option to use the following for longer term investments, as an alternative to cash deposits:
- a) **Supranational bonds** greater than 1 year to maturity

- b) **Gilt edged securities** with a maturity of greater than one year. These are Government bonds and so provide the highest security of interest and the repayment of principal on maturity. Similar to category (a) above, the value of the bond may rise or fall before maturity and losses may accrue if the bond is sold before maturity.
- c) **Building Societies** not meeting the basic security requirements under the specified investments, but on the list in Appendix C (b). The operation of some building societies does not require a credit rating, although in every other respect the security of the society would match similarly sized societies with ratings.
- d) Any **bank** that has a minimum long term credit rating of A- for deposits with a maturity of greater than one year (including forward deals in excess of one year from inception to repayment).
- e) Any **non-rated subsidiary** of a credit rated institution included in the specified investment category. These institutions will be included as an investment category subject to a guarantee from the parent company, and exposure up to the limit applicable to the parent.
- g) **Property Investment Funds** for example the Local Authorities' Property Fund. The Councils will consult the Treasury Management Advisors and undertake appropriate due diligence before investment of this type is undertaken. Some of these funds are deemed capital expenditure – the Councils will seek guidance on the status of any fund considered for investment.
- h) Other **local authorities**, parish councils etc.
- i) Other investments listed in Appendices C and D - the Council will seek further advice on the appropriateness and associated risks with investments in these other categories as and when an opportunity presents itself.

The **accounting treatment** may differ from the underlying cash transactions arising from investment decisions made by the Council. To ensure that the Council is protected from any adverse revenue impact, which may arise from these differences, the accounting implications of new transactions will be reviewed before they are undertaken.

The Council will not transact in any investment that may be deemed to constitute capital expenditure (e.g. Share Capital, or pooled investment funds other than Money Market Funds), without the resource implications being approved as part of the consideration of the Capital Programme or other appropriate Committee report.

**Investment risk benchmarking** – The shared service will subscribe to Link's Investment Benchmarking Club to review the investment performance and risk of the portfolios.

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

#### **External fund managers**

The Council does not use external fund managers, but reserves the option to do so in future should this be deemed to be appropriate. Should consideration be given to exercising this option in the future, the relevant Committee will be advised of the reasons for doing so and the Council requested to consider whether it wishes to proceed with the selection and appointment of external fund managers.

**The monitoring of investment counterparties** – The credit rating of counterparties will be monitored regularly. The shared service receives credit rating information (changes, rating watches and rating outlooks) from Link Asset Services as and when ratings change, and counterparties are checked promptly. On occasion ratings may be downgraded when an investment has already

been made. The criteria used are such that a minor downgrading should not affect the full receipt of the principal and interest. Any counterparty failing to meet the criteria will be removed from the list immediately by the shared service, and if required, new counterparties which meet the criteria will be added to the list.

Officers of the shared service met in January with representatives of the Local Authorities' Property Fund for a presentation on the activity and outlook of the Fund to supplement the regular reports and dividend statements.

## Appendix A

### THE CAPITAL PRUDENTIAL AND TREASURY INDICATORS 2020/21 – 2022/23

- 1.1 The Council's capital expenditure plans are the key driver of treasury management activity. The output of the capital expenditure plans is reflected in the Prudential Indicators, which are designed to assist Members' overview and confirm capital expenditure plans.

Capital expenditure	2018/19 Actual	2019/20 Estimate	2020/21 Estimate	2021/22 Estimate	2022/23 Estimate
	£m	£m	£m	£m	£m
General Fund	24.626	6.253	2.232	1.989	0.161

1.2 **Affordability Prudential Indicators**

The previous sections cover the overall capital and control of borrowing Prudential Indicators, but within this framework Prudential Indicators are required to assess the affordability of the capital investment plans. These provide an indication of the impact of the capital investment plans on the Council's overall finances. The Council is asked to approve the following indicators:

#### Ratio of financing costs to net revenue stream

This indicator identifies the trend in the cost of capital (borrowing and other long term obligation costs net of investment income) against the net revenue stream.

	2018/19 Actual	2019/20 Estimate	2020/21 Estimate	2021/22 Estimate	2022/23 Estimate
	%	%	%	%	%
Ratio	0.50%	0.58%	0.39%	-1.04%	-3.07%

The estimates of financing costs include current commitments and the proposals in this budget report.

1.3 **Maturity structure of borrowing**

These gross limits are set to reduce the Council's exposure to large fixed rate sums falling due for refinancing, and are required for upper and lower limits. However as the Council currently has only two significant loans, the upper limits need to be set very high. The Council does not have any variable rate borrowing.

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

Maturity structure of fixed interest rate borrowing 2020/21		
	Lower	Upper
Under 12 months	0%	50%
12 months to 2 years	0%	70%
2 years to 5 years	0%	80%
5 years to 10 years	0%	80%
Over 10 years	0%	60%

## **TREASURY MANAGEMENT PRACTICE (TMP1) – CREDIT AND COUNTERPARTY RISK MANAGEMENT**

The MHCLG issued Investment Guidance in 2018, and this forms the structure of the Council's policy below. These guidelines do not apply to either trust funds or pension funds which operate under a different regulatory regime.

The key intention of the Guidance is to maintain the current requirement for councils to invest prudently, and that priority is given to security and liquidity before yield. In order to facilitate this objective the guidance requires this Council to have regard to the CIPFA publication Treasury Management in the Public Services: Code of Practice and Cross-Sectoral Guidance Notes, which will apply to all investment activity. In accordance with the Code, the Council will comply with the treasury management practices (TMPs). This part, TMP 1(1), covering investment counterparty policy requires approval each year.

**Annual investment strategy** - The key requirements of both the Code and the investment guidance are to set an annual investment strategy, as part of the annual treasury strategy for the following year, covering the identification and approval of the following:

- The strategy guidelines for choosing and placing investments, particularly non-specified investments.
- The principles to be used to determine the maximum periods for which funds can be committed.
- Specified investments that the Council will use. These are high security (i.e. high credit rating, although this is defined by the Council, and no guidelines are given), and high liquidity investments in sterling and with a maturity of no more than a year.
- Non-specified investments, clarifying the greater risk implications, identifying the general types of investment that may be used and a limit to the overall amount of various categories that can be held at any time.

**Strategy guidelines** – The main strategy guidelines are contained in the body of the treasury strategy statement.

### **SPECIFIED AND NON SPECIFIED INVESTMENTS**

Specified Investments will be those that meet the criteria in the MHCLG Guidance, i.e. the investment

- is sterling denominated
- has a maximum maturity of 1 year or where the Council has the right to be repaid within 12 months
- meets the “high” credit criteria as determined by the Council or is made with the UK government or is made with a local authority in England, Wales and Scotland.
- the making of which is not defined as capital expenditure under section 25(1)(d) in SI 2003 No 3146 (i.e. the investment is not loan capital or share capital in a body corporate).

These are considered low risk assets where the possibility of loss of principal or investment income is small.

**“Specified” Investments identified for the Council’s use are:**

- The UK Government such as the Debt Management Account deposit facility
- Deposits with UK local authorities
- Deposits with banks and building societies
- \*Certificates of deposit with banks and building societies
- \*Gilts : (bonds issued by the UK government)
- \*Bonds issued by multilateral development banks
- Pooled investment vehicles such as AAA Money Market Funds with a Constant Net Asset Value (Constant NAV) or appropriate Low Volatility Net Asset Value (LVNAV) that have been awarded an AAA rating by Standard and Poor’s, Moody’s and/or Fitch rating agencies.
- Other Money Market Funds and Collective Investment Schemes— i.e. credit rated funds which meet the definition of a collective investment scheme as defined in SI 2004 No 534 and SI 2007 No 573.  
\* Investments in these instruments will be on advice from the Shared Service’s treasury advisor.

For credit rated counterparties, the minimum criteria, excepting for the Council’s own banker and the specified building societies, (see below) will be the short-term / long-term ratings assigned by various agencies which may include Moody’s Investors Services, Standard and Poor’s, Fitch Ratings, being:

Long-term investments (over 365 days): minimum: A- (Fitch) or equivalent  
Or

Short-term investments (365 days or less): minimum: F1 (Fitch) or equivalent

For all investments the Shared Service will also take into account information on corporate developments of, and market sentiment towards, investment counterparties.

If the Council’s own banker (currently Lloyds Bank) falls beneath the specified criteria, it will still be used for transactional purposes.

Within these bodies, and in accordance with the Code, the Council has set additional criteria to set the time and amount of monies which will be invested in these bodies, as detailed below.

**APPROVED INVESTMENT INSTITUTIONS****Specified Investments identified for use by the Council**

New specified investments will be made within the following limits:

## (a) Banks

Major U.K. and European Banks and their wholly-owned subsidiaries meeting the Council's approved investment criteria. RFB refers to Ring Fenced Bank – the separate core retail banking service.

Counterparty	Group	Maximum Sum	Maximum Period *
1 HSBC UK Bank PLC (RFB)	N/A	£4m	5 years
2 The Royal Bank of Scotland Group:	£5m		
The Royal Bank of Scotland PLC (RFB)		£4m	5 years
National Westminster Bank PLC (RFB)		£4m	5 years
3 Lloyds Group::	£5m		
Lloyds Bank PLC (RFB)		£4m	5 years
Bank of Scotland PLC (RFB)		£4m	5 years
4 Barclays Bank UK PLC (RFB)	N/A	£4m	5 years
5 Santander UK PLC	N/A	£4m	5 years
6 Clydesdale Bank PLC	N/A	£4m	5 years
7 Handelsbanken PLC	N/A	£4m	1 year
8 Goldman Sachs International Bank	N/A	£4m	5 years
9 Close Brothers Ltd	N/A	£4m	5 years

\*Specified investments are for a maximum period of 1 year, the maximum limits shown in this column are for non-specified investments with these institutions.

(b) Building Societies

Building Societies (Assets in excess of £1 billion):

Rank	Name of Counterparty	Individual	
		Sum	Period*
1	Nationwide	£4m	3 years
2	Coventry	£4m	3 years
3	Yorkshire	£4m	3 years
4	Skipton	£3m	3 years
5	Leeds	£3m	3 years
6	Principality	£3m	3 years
7	West Bromwich	£3m	3 years
8	Nottingham	£3m	3 years
9	Newcastle	£3m	3 years
10	Cumberland	£3m	3 years
11	National Counties	£3m	3 years
12	Progressive	£3m	3 years
13	Cambridge	£3m	3 years
14	Newbury	£3m	3 years
15	Monmouthshire	£3m	3 years
16	Leek United	£3m	3 years
17	Saffron	£3m	3 years

\*Specified investments are for a maximum period of 1 year, the maximum limits shown in this column are for non-specified investments with these institutions.

(c) Money Market Funds

Counterparty	Sum	For Short Term Operational Cash Flow Purposes
Invesco Aim – Sterling	£3m	
Blackrock Institutional Sterling Liquidity Fund	£3m	
Goldman Sachs Sterling Liquidity Reserve Fund	£3m	
Fidelity Institutional Cash Fund plc – Sterling	£3m	
CCLA Public Sector Deposit Fund	£3m	
JP Morgan GBP Liquidity LVNAV Fund	£3m	
Federated Short-Term Sterling Prime Liquidity Fund	£3m	

The limit for investing in any one Money Market Fund is £3 million. Total investments in Money Market Funds shall not exceed the higher of £9m or 25% of the total investment portfolio, for more than one week at any one time.

(d) Local Authorities

All the following local authorities mentioned in the Regulations

Schedule Part II Ref	Details	Individual	
		Sum	Period*
1	County Councils (England and Wales)	£3m	5 years
2	District Councils in England and Wales (including Borough, City, Metropolitan Borough Councils and Unitary Councils)	£3m	5 years
3	London Borough Councils	£3m	5 years
4	The Common Council of the City of London	£3m	5 years
5	The Council for the Isles of Scilly	£3m	5 years
7	Combined Police Authorities	£3m	5 years
16	Regional, Islands, or District Councils in Scotland	£3m	5 years
17	Joint boards under s.235 (1) of LG (Scotland) Act 1973	£3m	5 years
28	District Councils in Northern Ireland	£3m	5 years
29	Police Authorities (now Police and Crime Commissioners) under s.3 Police Act 1964 as substituted by s.2 Police & Magistrates Courts Act 1994	£3m	5 years

\*Specified investments are for a maximum period of 1 year, the maximum limits shown in this column are for non-specified investments with these institutions.

## APPENDIX D

### NON-SPECIFIED INVESTMENTS DETERMINED FOR USE BY THE COUNCIL

Having considered the rationale and risk associated with Non-Specified Investments, the following have been determined for the Council's use.

	In-house use	Use by Fund Managers	Maximum Maturity	Maximum % of portfolio or £m	Capital Expenditure?
<ul style="list-style-type: none"> <li>• Deposits with banks and building societies and Local Authorities</li> <li>• Certificates of deposit with banks and building societies</li> </ul>	√ √	√	5 years	The higher of £10m or 50% of funds	No
<b>Gilts and Bonds:</b> <ul style="list-style-type: none"> <li>• Gilts</li> <li>• Bonds issued by multilateral development banks</li> <li>• Bonds issued by financial institutions guaranteed by the UK government</li> <li>• Sterling denominated bonds by non-UK sovereign governments</li> </ul>	√ √ √ √ (on advice from treasury advisor)	√ √ √ √	5 years	The higher of £3m or 25% of funds	No
Money Market Funds and Collective Investment Schemes (pooled funds which meet the definition of a collective investment scheme as defined in SI 2004 No. 534 and SI 2007, No. 573), but which are not credit rated.	√ (on advice from treasury advisor)	√	These funds do not have a defined maturity date.	The higher of £9m or 25% of funds	No
Government guaranteed bonds and debt instruments (e.g. floating rate notes) issued by corporate bodies	√ (on advice from treasury advisor)	√	5 years	The higher of £2m or 10% of funds	Subject to test
Property Funds approved by HM Treasury and operated by managers regulated by the Financial Conduct Authority – specifically the Local Authorities' Property Fund	√	√	These funds do not have a defined maturity date.	The higher of £6m or 25% of funds	No
Non-guaranteed bonds and debt instruments (e.g. floating rate notes) issued by corporate bodies	√ (on advice from treasury advisor)	√	5 years	The higher of £2m or 10% of funds	Subject to test
Collective Investment Schemes (pooled funds) which do not meet the definition of collective investment schemes in SI 2004 No. 534 or SI 2007, No. 573.	√ (on advice from treasury advisor)	√	These funds do not have a defined maturity date	The higher of £2m or 20% of funds	Subject to test

In determining the period to maturity of an investment, the investment is regarded as commencing on the date of the commitment of the investment rather than the date on which funds are paid over to the counterparty.

The Council will seek further advice on the appropriateness and associated risks with investments in these categories.

### **Accounting treatment of investments**

The accounting treatment may differ from the underlying cash transactions arising from investment decisions made by this Council. To ensure that the Council is protected from any adverse revenue impact, which may arise from these differences, we will review the accounting implications of new transactions before they are undertaken.

## **APPENDIX E**

### **TREASURY MANAGEMENT SCHEME OF DELEGATION**

#### **(i) Full Council**

- approval of annual treasury management strategy and Annual Investment Strategy
- approval of MRP Statement
- approval of/amendments to the organisation's adopted clauses, treasury management policy statement and treasury management practices
- budget consideration and approval
- approval of the division of responsibilities

#### **(ii) Audit Committee**

Receiving and reviewing the following, and making recommendations to the Cabinet

- regular monitoring reports on compliance with the Treasury Management Strategy, practices and procedures.
- receiving and reviewing regular monitoring reports and acting on recommendations

#### **(iii) The S151 (responsible) officer**

- recommending clauses, treasury management policy/practices for approval, reviewing the same regularly, and monitoring compliance
- submitting regular treasury management policy reports
- submitting budgets and budget variations
- receiving and reviewing management information reports
- reviewing the performance of the treasury management function
- ensuring the adequacy of treasury management resources and skills, and the effective division of responsibilities within the treasury management function
- ensuring the adequacy of internal audit, and liaising with external audit
- approving the selection of external service providers and agreeing terms of appointment.

## **APPENDIX F**

## ECONOMIC BACKGROUND

**UK. Brexit.** 2019 was a year of upheaval on the political front as Theresa May resigned as Prime Minister to be replaced by Boris Johnson on a platform of the UK leaving the EU on 31 October 2019, with or without a deal. However, MPs blocked leaving on that date and the EU agreed an extension to 31 January 2020. In late October, MPs approved an outline of a Brexit deal to enable the UK to leave the EU on 31 January. The Conservative Government gained a large overall majority in the **general election** on 12 December; this ensured that the UK left the EU on 31 January. However, there will still be much uncertainty as the detail of a comprehensive trade deal will need to be negotiated by the current end of the transition period in December 2020, which the Prime Minister has pledged he will not extend. This could prove to be an unrealistically short timetable for such major negotiations that leaves open three possibilities; a partial agreement on many areas of agreement and then continuing negotiations to deal with the residual areas, the need for the target date to be put back, probably two years, or, a no deal Brexit in December 2020.

**GDP growth took** a big hit from both political and Brexit uncertainty during 2019; quarter three 2019 surprised on the upside by coming in at +0.4% q/q, +1.1% y/y. However, the peak of Brexit uncertainty during the final quarter appears to have suppressed quarterly growth to probably around zero. The forward-looking surveys in January have indicated that there could be a significant recovery of growth now that much uncertainty has gone. Nevertheless, economic growth may only come in at about 1% in 2020, pending the outcome of negotiations on a trade deal. Provided there is a satisfactory resolution of those negotiations, which are in both the EU's and UK's interest, then growth should strengthen further in 2021.

At its 30 January meeting, the Monetary Policy Committee held Bank Rate unchanged at 0.75%. The vote was again split 7-2, with two votes for a cut to 0.50%. The financial markets had been predicting a 50:50 chance of a rate cut at the time of the meeting. Admittedly, there had been plenty of downbeat UK economic news in December and January which showed that all the political uncertainty leading up to the general election, together with uncertainty over where Brexit would be going after the election, had depressed economic growth in quarter 4. In addition, three members of the MPC had made speeches in January which were distinctly on the dovish side, flagging up their concerns over weak growth and low inflation; as there were two other members of the MPC who voted for a rate cut in November, five would be a majority at the January MPC meeting if those three followed through on their concerns.

However, that downbeat news was backward looking; more recent economic statistics and forward-looking business surveys, have all pointed in the direction of a robust bounce in economic activity and a recovery of confidence after the decisive result of the general election removed political and immediate Brexit uncertainty. In addition, the September spending round increases in expenditure will start kicking in from April 2020, while the Budget in March is widely expected to include a substantial fiscal boost by further increases in expenditure, especially on infrastructure. The Bank of England cut its forecasts for growth from 1.2% to 0.8% for 2020, and from 1.8% to 1.4% for 2021. However, these forecasts could not include any allowance for the predicted fiscal boost in the March Budget. Overall, the MPC clearly decided to focus on the more recent forward-looking news than the earlier downbeat news.

The quarterly Monetary Policy Report did, though, flag up that there was still a risk of a Bank Rate cut; "Policy may need to reinforce the expected recovery in UK GDP growth should the more positive signals from recent indicators of global and domestic activity not be sustained or should indicators of domestic prices remain relatively weak." Obviously, if trade negotiations with the EU failed to make satisfactory progress, this could dampen confidence and growth. On the other hand, there was also a warning in the other direction, that if growth were to pick up strongly, as suggested by recent business surveys, then "some modest tightening" of policy might be needed further ahead. It was therefore notable that the Bank had dropped its phrase that tightening would be "limited and gradual", a long-standing piece of forward guidance; this gives the MPC more room to raise Bank Rate more quickly if growth was to surge and, in turn, lead to a surge in inflation above the 2% target rate.

As for **inflation** itself, CPI has been hovering around the Bank of England's target of 2% during 2019, but fell again in both October and November to a three-year low of 1.5% and then even further to 1.3% in December. It is likely to remain close to or under 2% over the next two years and so, it does not pose any immediate concern to the MPC at the current time. However, if there was a hard or no deal Brexit, inflation could rise towards 4%, primarily because of imported inflation on the back of a weakening pound.

With regard to the **labour market**, growth in numbers employed has been quite resilient through 2019 until the three months to September, where it fell by 58,000. However, there was an encouraging pick up again in the three months to October to growth of 24,000 and then a stunning increase of 208,000 in the three months to November. The unemployment rate held steady at a 44-year low of 3.8% on the Independent Labour Organisation measure. Wage inflation has been steadily falling from a high point of 3.9% in July to 3.4% in November (3-month average regular pay, excluding bonuses). This meant that in real terms, (i.e. wage rates higher than CPI inflation), earnings grew by about 2.1%. As the UK economy is very much services sector driven, an increase in household spending power is likely to feed through into providing some support to the overall rate of economic growth in the coming months. The other message from the fall in wage growth is that employers are beginning to find it easier to hire suitable staff, indicating that supply pressure in the labour market is easing.

**Coronavirus.** The recent Coronavirus outbreak could cause disruption to the economies of affected nations. The Chinese economy is now very much bigger than it was at the time of the SARS outbreak in 2003 and far more integrated into world supply chains. However, a temporary dip in Chinese growth could lead to a catch up of lost production in following quarters with minimal net overall effect over a period of a year. However, no one knows quite how big an impact this virus will have around the world; hopefully, the efforts of the WHO and the Chinese authorities will ensure that the current level of infection does not multiply greatly.

**USA.** After growth of 2.9% y/y in 2018 fuelled by President Trump's massive easing of fiscal policy, growth has weakened in 2019. After a strong start in quarter 1 at 3.1%, (annualised rate), it fell to 2.0% in quarter 2 and then 2.1% in quarters 3 and 4. This left the rate for 2019 as a whole at 2.3%, a slowdown from 2018 but not the precursor of a recession which financial markets had been fearing earlier in the year. Forward indicators are currently indicating that growth is likely to strengthen somewhat moving forward into 2020.

**The Fed** finished its series of increases in rates to 2.25 – 2.50% in December 2018. In July 2019, it cut rates by 0.25% as a 'midterm adjustment'. It also ended its programme of quantitative tightening in August 2019, (reducing its holdings of treasuries etc.). It then cut rates by 0.25% again in September and by another 0.25% in its October meeting to 1.50 – 1.75%. It left rates unchanged at its December meeting. Rates were again left unchanged at its end of January meeting although it had been thought that as the yield curve on Treasuries had been close to inverting again, (with 10 year yields nearly falling below 2 year yields - this is often viewed as being a potential indicator of impending recession), that the Fed could have cut rates, especially in view of the threat posed by the coronavirus. However, it acknowledged that coronavirus was a threat of economic disruption but was not serious at the current time for the USA. In addition, the phase 1 trade deal with China is supportive of growth. The Fed though, does have an issue that despite reasonably strong growth rates, its inflation rate has stubbornly refused to rise to its preferred core inflation target of 2%; it came in at 1.6% in December. It is therefore unlikely to be raising rates in the near term. It is also committed to reviewing its approach to monetary policy by midyear 2020; this may include a move to inflation targeting becoming an average figure of 2% so as to allow more flexibility for inflation to under and over shoot.

**"The NEW NORMAL."** The Fed chairman has given an overview of the current big picture of the economy by summing it up as **A NEW NORMAL OF LOW INTEREST RATES, LOW INFLATION AND PROBABLY LOWER GROWTH.** This is indeed an affliction that has mired Japan for the last two decades despite strenuous efforts to stimulate growth and inflation by copious amounts of fiscal stimulus and cutting rates to zero. China and the EU are currently facing the same difficulty to trying to get inflation and growth up. Our own MPC may well have growing concerns and one MPC member specifically warned on the potential for a low inflation trap in January.

It is also worth noting that no less than a quarter of total world sovereign debt is now yielding negative returns.

**EUROZONE.** Growth has been slowing from +1.8 % during 2018 to nearly half of that in 2019. Growth was +0.4% q/q in quarter 1, +0.2% q/q in quarters 2 and 3; it then fell to +0.1% in quarter 4 for a total overall growth rate of only 1.0% in 2019. Recovery from quarter 4 is expected to be slow and gradual. German GDP growth has been struggling to stay in positive territory in 2019 and grew by only 0.6% in 2019, with quarter 4 potentially being a negative number. Germany would be particularly vulnerable to a no deal Brexit depressing exports further and if President Trump imposes tariffs on EU produced cars.

The European Central Bank (ECB) ended its programme of quantitative easing purchases of debt in December 2018, which then meant that the central banks in the US, UK and EU had all ended the phase of post financial crisis expansion of liquidity supporting world financial markets by quantitative easing purchases of debt. However, the downturn in EZ growth in the second half of 2018 and in 2019, together with inflation falling well under the upper limit of its target range of 0 to 2%, (but it aims to keep it near to 2%), has prompted the ECB to take new measures to stimulate growth. At its March 2019 meeting, it said that it expected to leave interest rates at their present levels "at least through to the end of 2019", but that was of little help to boosting growth in the near term. Consequently, it announced a **third round of TLTROs**; this provides banks with cheap borrowing every three months from September 2019 until March 2021 that means that, although they would have only a two-year maturity, the Bank was making funds available until 2023, two years later than under its previous policy. As with the last round, the new TLTROs will include an incentive to encourage bank lending, and they will be capped at 30% of a bank's eligible loans. However, since then, the downturn in EZ and world growth has gathered momentum; at its meeting on 12 September, it cut its deposit rate further into negative territory, from -0.4% to -0.5%, and announced a **resumption of quantitative easing purchases of debt for an unlimited period**. At its October meeting it said these purchases would start in November at €20bn per month - a relatively small amount compared to the previous buying programme. It also increased the maturity of the third round of TLTROs from two to three years. However, it is doubtful whether this loosening of monetary policy will have much impact on growth and, unsurprisingly, the ECB stated that governments would need to help stimulate growth by 'growth friendly' fiscal policy. There have been no changes in rates or monetary policy since October. In January, the ECB warned that the economic outlook was 'tilted to the downside' and repeated previous requests for governments to do more to stimulate growth by increasing national spending. The new President of the ECB, Christine Lagarde who took over in December, also stated that a year long review of monetary policy, including the price stability target, would be conducted by the ECB. On the political front, Austria, Spain and Italy have been in the throes of **forming coalition governments** with some unlikely combinations of parties i.e. this raises questions around their likely endurance. The most recent results of German state elections has put further pressure on the frail German CDU/SDP coalition government and on the current leadership of the CDU.

**CHINA.** Economic growth has been weakening over successive years, despite repeated rounds of central bank stimulus; medium term risks are increasing. Major progress still needs to be made to eliminate excess industrial capacity and the stock of unsold property, and to address the level of non-performing loans in the banking and shadow banking systems. In addition, there still needs to be a greater switch from investment in industrial capacity, property construction and infrastructure to consumer goods production.

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

**WORLD GROWTH.** Until recent years, world growth has been boosted by increasing **globalisation** i.e. countries specialising in producing goods and commodities in which they have an economic advantage and which they then trade with the rest of the world. This has boosted worldwide productivity and growth, and, by lowering costs, has also depressed inflation. However, the rise of China as an economic superpower over the last thirty years, which now accounts for nearly 20% of

total world GDP, has unbalanced the world economy. The Chinese government has targeted achieving major world positions in specific key sectors and products, especially high tech areas and production of rare earth minerals used in high tech products. It is achieving this by massive financial support, (i.e. subsidies), to state owned firms, government directions to other firms, technology theft, restrictions on market access by foreign firms and informal targets for the domestic market share of Chinese producers in the selected sectors. This is regarded as being unfair competition that is putting western firms at an unfair disadvantage or even putting some out of business. It is also regarded with suspicion on the political front as China is an authoritarian country that is not averse to using economic and military power for political advantage. The current trade war between the US and China therefore needs to be seen against that backdrop. It is, therefore, likely that we are heading into a period where there will be a **reversal of world globalisation and a decoupling of western countries** from dependence on China to supply products. This is likely to produce a backdrop in the coming years of weak global growth and so weak inflation. **Central banks are, therefore, likely to come under more pressure to support growth by looser monetary policy measures and this will militate against central banks increasing interest rates.**

The trade war between the US and China is a major concern to **financial markets** due to the synchronised general weakening of growth in the major economies of the world, compounded by fears that there could even be a recession looming up in the US, though this is probably overblown. These concerns resulted in **government bond yields** in the developed world falling significantly during 2019. If there were a major worldwide downturn in growth, central banks in most of the major economies will have limited ammunition available, in terms of monetary policy measures, when rates are already very low in most countries, (apart from the US). There are also concerns about how much distortion of financial markets has already occurred with the current levels of quantitative easing purchases of debt by central banks and the use of negative central bank rates in some countries.

## INTEREST RATE FORECASTS

The interest rate forecasts provided by Link Asset Services in paragraph 3.3 are **predicated on an assumption of an agreement being reached on Brexit between the UK and the EU**. On this basis, while GDP growth is likely to be subdued in 2019 and 2020 due to all the uncertainties around Brexit depressing consumer and business confidence, an agreement on the detailed terms of a trade deal is likely to lead to a boost to the rate of growth in subsequent years. This could, in turn, increase inflationary pressures in the economy and so cause the Bank of England to resume a series of gentle increases in Bank Rate. Just how fast, and how far, those increases will occur and rise to, will be data dependent. The forecasts in this report assume a modest recovery in the rate and timing of stronger growth and in the corresponding response by the Bank in raising rates.

- In the event of an **orderly non-agreement exit in December 2020**, it is likely that the Bank of England would take action to cut Bank Rate from 0.75% in order to help economic growth deal with the adverse effects of this situation. This is also likely to cause short to medium term gilt yields to fall.
- If there were a **disorderly Brexit**, then any cut in Bank Rate would be likely to last for a longer period and also depress short and medium gilt yields correspondingly. Quantitative easing could also be restarted by the Bank of England. It is also possible that the government could act to protect economic growth by implementing fiscal stimulus.

## The balance of risks to the UK

- The overall balance of risks to economic growth in the UK is probably relatively even due to the weight of all the uncertainties over post-Brexit trade arrangements and the impact of an expansionary government spending policy (as expected in the Budget on 11th March).
- The balance of risks to increases or decreases in Bank Rate and shorter term PWLB rates are also broadly even.

One risk that is both an upside and downside risk, is that all central banks are now working in very different economic conditions than before the 2008 financial crash as there has been a major increase in consumer and other debt due to the exceptionally low levels of borrowing rates that have prevailed since 2008. This means that the neutral rate of interest in an economy, (i.e. the rate that is neither expansionary nor deflationary), is difficult to determine definitively in this new environment, although central banks have made statements that they expect it to be much lower than before 2008. Central banks could therefore either over or under do increases in central interest rates.

**Downside risks to current forecasts for UK gilt yields and PWLB rates currently include:**

- **Post Brexit trade negotiations** – if it were to cause significant economic disruption and a major downturn in the rate of growth.
- **Bank of England** takes action too quickly, or too far, over the next three years to raise Bank Rate and causes UK economic growth, and increases in inflation, to be weaker than we currently anticipate.
- A resurgence of the **Eurozone sovereign debt crisis**. In 2018, Italy was a major concern due to having a populist coalition government which made a lot of anti-austerity and anti-EU noise. However, in September 2019 there was a major change in the coalition governing Italy which has brought to power a much more EU friendly government; this has eased the pressure on Italian bonds. Only time will tell whether this new coalition based on an unlikely alliance of two very different parties will endure.
- Weak capitalisation of some **European banks**, particularly Italian banks.
- **German minority government**. In the German general election of September 2017, Angela Merkel's CDU party was left in a vulnerable minority position dependent on the fractious support of the SPD party, as a result of the rise in popularity of the anti-immigration AfD party. The CDU has done badly in recent state elections but the SPD has done particularly badly and this has raised a major question mark over continuing to support the CDU. Angela Merkel has stepped down from being the CDU party leader but she intends to remain as Chancellor until 2021.
- **Other minority EU governments**. Austria, Finland, Sweden, Spain, Portugal, Netherlands and Belgium also have vulnerable minority governments dependent on coalitions which could prove fragile.
- **Austria, the Czech Republic, Poland and Hungary** now form a strongly anti-immigration bloc within the EU. There has also been rising anti-immigration sentiment in Germany and France.
- In October 2019, the IMF issued a report on the World Economic Outlook which flagged up a synchronised slowdown in world growth. However, it also flagged up that there was **potential for a rerun of the 2008 financial crisis**, but this time centred on the huge debt binge accumulated by corporations during the decade of low interest rates. This now means that there are corporates who would be unable to cover basic interest costs on **some \$19trn of corporate debt in major western economies**, if world growth was to dip further than just a minor cooling. This debt is mainly held by the shadow banking sector i.e. pension funds, insurers, hedge funds, asset managers etc., who, when there is \$15trn of corporate and government debt now yielding negative interest rates, have been searching for higher returns in riskier assets. Much of this debt is only marginally above investment grade so any rating downgrade could force some holders into a fire sale, which would then depress prices further and so set off a spiral down. The IMF's answer is to suggest imposing higher capital charges on lending to corporates and for central banks to regulate the investment operations of the shadow banking sector. In October 2019, the deputy Governor of the Bank of England also flagged up the dangers of banks and the shadow banking sector lending to corporates, especially highly leveraged corporates, which had risen back up to near pre-2008 levels.
- **Geopolitical risks**, for example in North Korea, but also in Europe and the Middle East, which could lead to increasing safe haven flows.

### **Upside risks to current forecasts for UK gilt yields and PWLB rates**

- **Brexit** – if a comprehensive agreement on a trade deal was reached that removed all threats of economic and political disruption between the EU and the UK.
- The **Bank of England is too slow** in its pace and strength of increases in Bank Rate and, therefore, allows inflationary pressures to build up too strongly within the UK economy, which then necessitates a later rapid series of increases in Bank Rate faster than we currently expect.
- **UK inflation**, whether domestically generated or imported, returning to sustained significantly higher levels causing an increase in the inflation premium inherent to gilt yields.

# Agenda Item 9

## EXTERNAL AUDIT PLAN

REPORT OF: Head of Corporate Resources  
Contact Officer: Peter Stuart, Head of Corporate Resources  
Email: [Peter.Stuart@midsussex.gov.uk](mailto:Peter.Stuart@midsussex.gov.uk) Tel: 01444 477315  
Wards Affected: All  
Key Decision No

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### 1. Purpose of Report

To inform the Committee of the External Auditor's Audit Plan.

### 2. Recommendations

The Audit Committee is recommended to note the 2019/20 Audit Plan;

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### 3 Background

- 3.1 Attached at Annex 1 is the Audit Plan which outlines the work and the emphasis to be given to our audit for this financial year.
- 3.2 Members will note that there are a number of risks flagged in the report although the majority of these are generic. One specific risk particular to Mid Sussex is the change in Financial Management System mid year which will bring minor challenges when assembling the Financial Statements for 2019/20.
- 3.3 The Audit Director will be able to elucidate on any points raised including the approach to auditing two financial systems.

### 4 Financial implications

- 4.1 There are no financial implications arising from this report. .

### 5 Equalities implications

- 5.1 The report raises no implications of this nature.

### 6 Risk analysis

- 6.1 No material risks arise from this report

### Background Papers

None

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# **Mid Sussex District Council**

## **Audit planning report**

Year ended 31 March 2020

January 2020



Mid Sussex District Council  
Oaklands Road  
Haywards Heath  
West Sussex  
RH16 1SS

March 2020



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 3rd March 2020 as well as understand whether there are other matters which you consider may influence our audit.

Yours faithfully

Kevin Suter

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 PSA 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 Mid Sussex 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 Mid Sussex 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 Mid Sussex 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
New Ledger System	Significant risk	Increase in risk and focus	<p>The Council introduced its new Technology One financial management system with effect from 02 September 2019. It put in place measures to migrate data on 2019/20 transactions and balances from the old to the new financial management system. The Council's 2019/20 financial statements will be prepared using data taken from the new general ledger at the end of the financial year.</p> <p>To ensure the production of materially accurate and complete 2019/20 financial statements, it is essential that the Council is assured over the completeness and accuracy of financial data to its new general ledger.</p>
Misstatements due to fraud or error	Fraud risk	No change in risk or focus	<p>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.</p>
Risk of incorrect capitalisation of revenue expenditure	Fraud risk	No change in risk or focus	<p>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.</p> <p>We believe the risk of manipulation is most likely to manifest in the incorrect capitalisation of revenue expenditure, as there is an incentive to reduce expenditure which is funded from Council Tax.</p>
Valuation of Land and Buildings/ Investment properties	Inherent risk	No change in risk or focus	<p>The value of Property, Plant and Equipment (PPE) and Investment Properties (IP) represents significant balances in the Council's accounts and is subject to valuation changes and impairment reviews. Management is required to make material judgements about key assumptions and apply estimation techniques to calculate the year-end balances recorded in the balance sheet.</p>

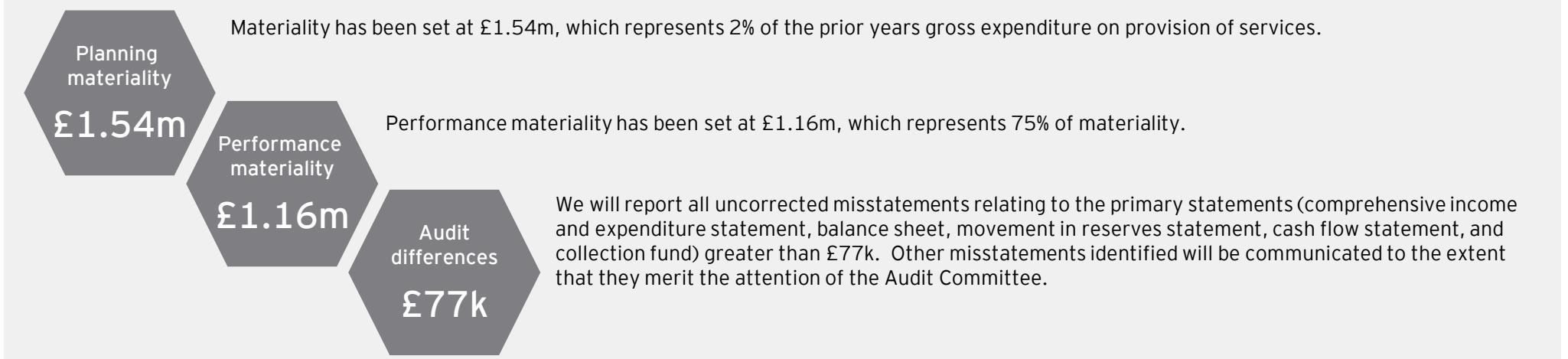


# Overview of our 2019/20 audit strategy

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
Pension Liability Valuation	Inherent risk	No change in risk or focus	<p>The Council's pension fund liability 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 Hymans Robertson.</p> <p>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.</p>
IFRS 16 Leases	Inherent risk	New accounting standard	IFRS 16 (leases) applies from 1 April 2020. The Council needs to put in place arrangements to implement the new standard for the 2020/21 financial year, and to make necessary disclosures for forthcoming changes in accounting standards in its 2019/20 statement of accounts.

## Materiality





# 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 Mid Sussex District Council give a true and fair view of the financial position as at 31 March 2020 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 MSDC audit, we will discuss these with management as to the impact on the scale fee.

## Audit team changes



**Jack Dunkley, Manager**

- Jack is a Manager within the UK&I Assurance practice, with over five years experience of LG audits. He will be the key contact for your Finance Team.
- He is a member of The Institute of Chartered Accountants in England and Wales (ICAEW).



## 02 Audit risks





## 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.

New financial ledger system	<b>What is the risk?</b>	<b>What will we do?</b>
	<p>The Council introduced its new Technology One financial management system with effect from 02 September 2019. It put in place measures to migrate data on 2019/20 transactions and balances from the old to the new financial management system. The Council's 2019/20 financial statements will be prepared using data taken from the new general ledger at the end of the financial year.</p> <p>To ensure the production of materially accurate and complete 2019/20 financial statements, it is essential that the Council is assured over the completeness and accuracy of financial data to its new general ledger.</p>	<p>We will:</p> <ul style="list-style-type: none"><li>▶ meet with officers to discuss and understand the process for implementing the new financial management system.</li><li>▶ review the actions taken by the Council to ensure the complete and accurate migration of financial data to the new general ledger. This will include reviewing the effectiveness of reconciliation processes. We will undertake our own testing on the completeness and accuracy of data migration as necessary.</li><li>▶ have regard to the findings of any work by Internal Audit in 2019/20 in relation to the new ledger system.</li><li>▶ review how data from the new system maps to the statement of accounts, as part of our understanding of the accounts production process for 2019/20.</li></ul>



## 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.

Misstatements due to fraud or error *	What is the risk?	What will we do?
	<p>The financial statements as a whole are not free of material misstatements whether caused by fraud or error.</p> <p>As identified in ISA (UK and Ireland) 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 otherwise appear to be operating effectively.</p> <p>We identify and respond to this fraud risk on every audit engagement.</p>	<p>We will undertake our standard procedures to address fraud risk, which include:</p> <ul style="list-style-type: none"><li>➤ Inquiring of management about risks of fraud and the controls put in place to address those risks.</li><li>➤ Understanding the oversight given by those charged with governance of management's processes over fraud.</li><li>➤ Considering the effectiveness of management's controls designed to address the risk of fraud.</li><li>➤ Performing mandatory procedures regardless of specifically identified fraud risks, including:<ul style="list-style-type: none"><li>➤ testing of journal entries and other adjustments in the preparation of the financial statements.</li><li>➤ Review accounting estimates for evidence of management bias.</li><li>➤ Evaluate the business rationale for significant unusual transactions.</li></ul></li></ul>



## 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.

Risk of incorrect capitalisation of revenue expenditure*	What is the risk?	What will we do?
<p><b>Financial statement impact</b></p> <p>Misstatements that occur in relation to the risk of fraud in revenue and expenditure recognition could affect the income and expenditure accounts. We are focussing our testing on capital additions.</p>	<p>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.</p> <p>We believe the risk of manipulation is most likely to manifest in the incorrect capitalisation of revenue expenditure, as there is an incentive to reduce expenditure in the general fund which is funded from Council Tax.</p> <p>This could then result in funding of that expenditure, that should properly be defined as revenue, through inappropriate sources such as capital receipts, capital grants, or borrowing</p>	<p>We will:</p> <ul style="list-style-type: none"><li>▶ Test PPE additions to ensure that the expenditure incurred and capitalised is clearly capital in nature.</li><li>▶ Test REFCUS, if material, to ensure that it is appropriate for the revenue expenditure incurred to be financed from ring fenced capital resources.</li><li>▶ Seek to identify and understand the basis for any significant journals transferring expenditure from revenue to capital codes within the general ledger.</li></ul>



## Audit risks

### 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.

What is the risk/area of focus?	What will we do?
<p><b>Valuation of Land and Buildings/Investment Properties</b></p> <p>The fair value of Property, Plant and Equipment (PPE) and Investment Properties (IP) represent significant balances in the Council's accounts and is subject to valuation changes and impairment reviews.</p> <p>Management is required to make material judgements about key assumptions and apply estimation techniques to calculate the year-end balances recorded in the balance sheet.</p>	<p>We will:</p> <ul style="list-style-type: none"><li>▶ Consider the work performed by the Council's valuers (Wilks, Head &amp; Eve), including the adequacy of the scope of the work performed, their professional capabilities and the results of their work;</li><li>▶ Challenge the assumptions used by the Council's valuer by reference to external evidence and our EY valuation specialists as necessary - for example, significant or unusual movements in valuation, difficult to value specialist assets, or investments in areas of the economy under stress such as retail;</li><li>▶ Sample testing key asset information used by the valuers in performing their valuation (e.g. building areas to support valuations based on price per square metre);</li><li>▶ 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, and annually for IP. We also consider if there are any specific changes to assets that have occurred and that these have been communicated to the valuer;</li><li>▶ Review assets not subject to valuation in 2019/20 to confirm that the remaining asset base is not materially misstated;</li><li>▶ Consider changes to useful economic lives as a result of the most recent valuation; and</li><li>▶ Test accounting entries have been correctly processed in the financial statements.</li></ul>



## Audit risks

### 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.

What is the risk/area of focus?	What will we do?
<p><b>Pension Liability Valuation</b></p> <p>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.</p> <p>The Council's pension fund deficit is a material estimated balance and the Code requires that this liability be disclosed on the Council's balance sheet.</p> <p>The information disclosed is based on the IAS 19 report issued to the Council by the actuary.</p> <p>Accounting for this scheme involves significant estimation and judgement and therefore management engages an actuary to undertake the calculations on their behalf. ISAs (UK) 500 and 540 require us to undertake procedures on the use of management experts and the assumptions underlying fair value estimates.</p>	<p>We will:</p> <ul style="list-style-type: none"><li>▶ Obtain assurances over the information supplied to the actuary in relation to the Council;</li><li>▶ Assess the work of the Pension Fund actuary including the assumptions they have used by relying on the work of PWC - Consulting Actuaries commissioned by the National Audit Office for all Local Government sector auditors, and considering any relevant reviews by the EY actuarial team; and</li><li>▶ Review and test the accounting entries and disclosures made within the Council's financial statements in relation to IAS19.</li><li>▶ Where outturn information is available at the time we undertake our work after production of the Council's draft financial statements (for example the year-end actual valuation of pension fund assets), we will use this to inform our assessment of the accuracy of estimated information included in the financial statements and whether any adjustments are required.</li></ul>



## Audit risks

### 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.

What is the risk/area of focus?	What will we do?
<p><u>IFRS 16 Leases</u></p> <p>This new accounting standard is applicable for local authority accounts from the 2020/21 financial year and will change:</p> <ul style="list-style-type: none"><li>▶ How operating leases are recognised (as lessee); and</li><li>▶ The disclosure requirements for operating leases (as lessee).</li></ul> <p>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.</p>	<p>We will:</p> <ul style="list-style-type: none"><li>▶ 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</li><li>▶ Review additional disclosure requirements.</li></ul>



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.

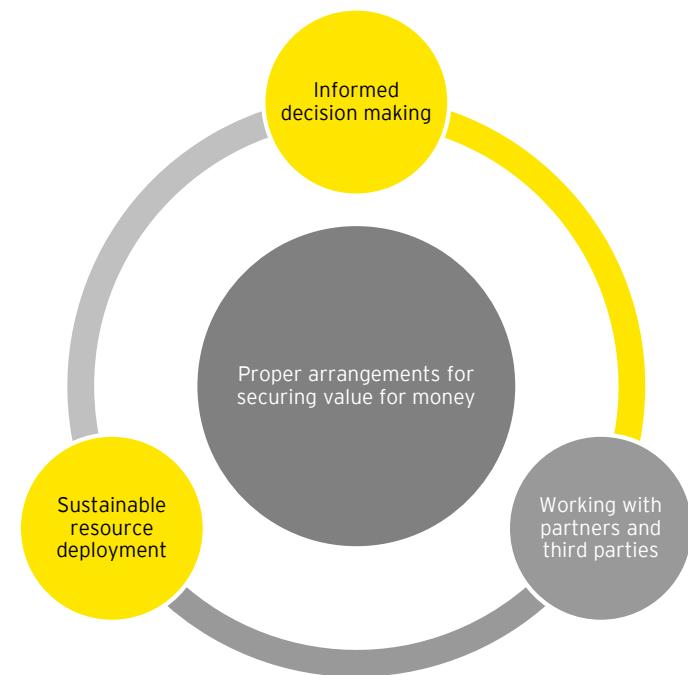
In considering your proper arrangements, we will draw on the requirements of the CIPFA/SOLACE framework for local government to ensure that our assessment is made against a framework that you are already required to have in place and to report on through documents such as your annual governance statement.

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 consider 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



# Audit materiality

## Materiality

### Materiality

For planning purposes, materiality for 2019/20 has been set at £1.54m. 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.



### 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 £1.16m which represents 75% of planning materiality. The rationale for using 75% is based on the anticipation of identifying few or no errors during the audit. This expectation has been built on our experience of the Council in the prior year.

**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.

**Specific materiality** - We have set a materiality of £1,000 for sensitive disclosures such as the remuneration disclosures, related party transactions, members' allowances and exit packages. This reflects our understanding that an amount less than our materiality would influence the economic decisions of users of the financial statements in relation to this.

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



05

## Scope of our audit





## 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.



## Scope of our audit

# 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.

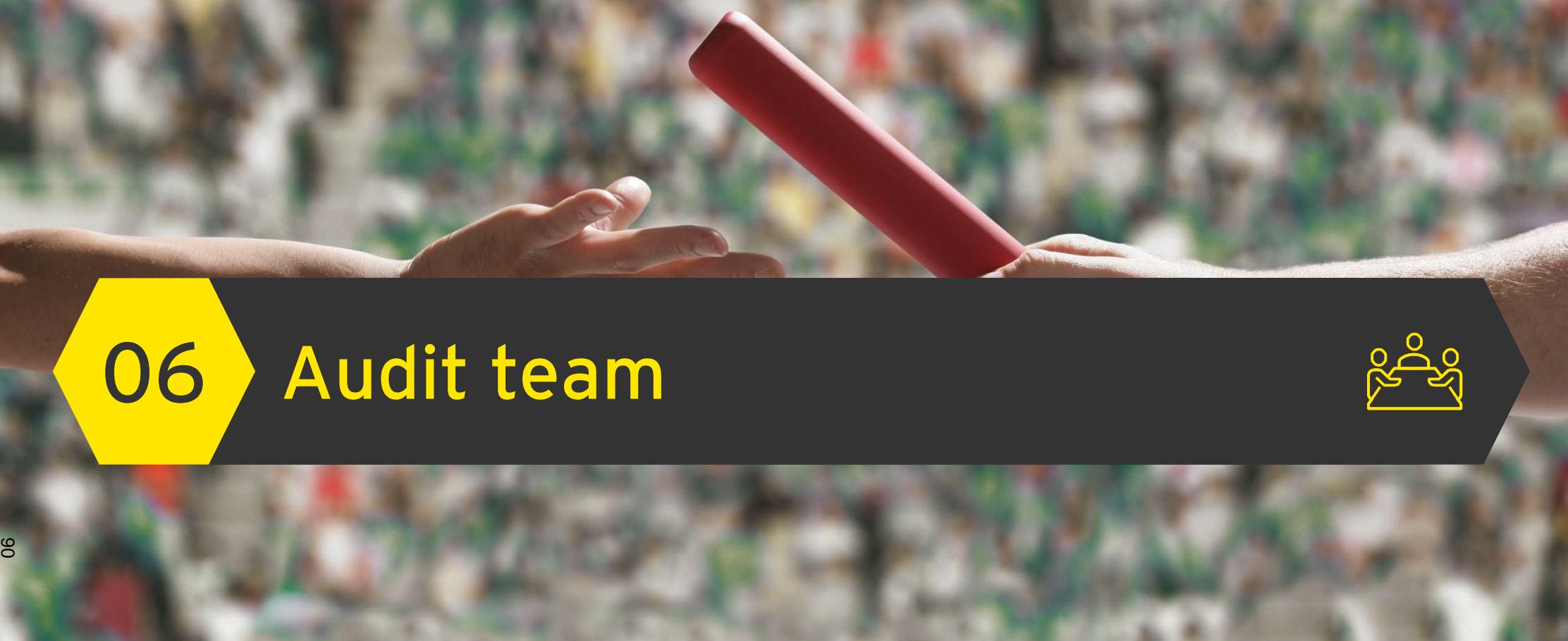
Internal audit:

We will meet with the Head of Internal Audit, 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

### 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 areas where either EY or third party specialists provide input for the current year audit are:

Area	Specialists
Valuation of Land and Buildings	<ul style="list-style-type: none"><li>Wilkes, Head and Eve - Management's RICS Registered Valuers</li><li>EY property valuers</li></ul>
Pensions disclosure	<ul style="list-style-type: none"><li>EY Actuaries</li><li>PWC consulting actuary commissioned by NAO</li><li>Hymans Robertson- Management's Actuary</li></ul>

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



## 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. The final timetable will depend on our ability to obtain sufficient, appropriate audit evidence to support our audit opinion.

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.	October - January		
Walkthrough of key systems and processes Interim audit testing	February/March	Audit Committee	Audit Planning Report
	April		
	May		
	June		
Year end audit Audit Completion procedures	July	Audit Committee	Audit Results Report Audit opinions and completion certificates
	August - October		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
<ul style="list-style-type: none"><li>▶ The principal threats, if any, to objectivity and independence identified by Ernst &amp; Young (EY) including consideration of all relationships between the you, your affiliates and directors and us;</li><li>▶ The safeguards adopted and the reasons why they are considered to be effective, including any Engagement Quality review;</li><li>▶ The overall assessment of threats and safeguards;</li><li>▶ Information about the general policies and process within EY to maintain objectivity and independence.</li><li>▶ Where EY has determined it is appropriate to apply more restrictive independence rules than permitted under the Ethical Standard.</li></ul>	<ul style="list-style-type: none"><li>▶ 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;</li><li>▶ Details of non-audit services provided and the fees charged in relation thereto;</li><li>▶ 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;</li><li>▶ Written confirmation that all covered persons are independent;</li><li>▶ 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;</li><li>▶ Details of any contingent fee arrangements for non-audit services provided by us or our network firms; and</li><li>▶ An opportunity to discuss auditor independence issues.</li></ul>

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 Kevin Suter, 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 proposed to undertake the role of reporting accountant for the DWP's Housing Benefit Assurance Process (HBAP). We have determined appropriate safeguards.

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.

### EY Transparency Report 2019

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 1 July 2019 and can be found here:

<https://www.ey.com/uk/en/about-us/ey-uk-transparency-report-2019>



## 09 Appendices



## Appendix A

### Fees

Public Sector Audit Appointments Ltd (PSAA) has published the fee scale for the audit of the 2018/19 accounts of opted-in principal local government and police bodies. 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	48,617	38,917	38,917
Total audit	48,617	38,917	38,917
Other non-audit services not covered above (Housing Benefits)	TBC	N/A	40,922
Total other non-audit services	TBC	N/A	40,922
Total fees	TBC	38,917	79,839

The agreed fee presented is based on the following assumptions:

- ▶ Officers meeting the agreed timetable of deliverables;
- ▶ The production of materially accurate draft accounts;
- ▶ 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.

*All fees exclude VAT*

#### Notes:

(1)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 Planned Fee for 2019/20 includes our initial estimate of the required work in relation to the new ledger system. We have scoped the additional work and fee in detail based on our current knowledge of the change process, however, the final additional fee may vary depending on the final scope of work required, and its findings and impact on the audit strategy. Any impact on our planned strategy for the use of data analytics may also result in further additional 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	<ul style="list-style-type: none"> <li>▶ Our view about the significant qualitative aspects of accounting practices including accounting policies, accounting estimates and financial statement disclosures;</li> <li>▶ Significant difficulties, if any, encountered during the audit;</li> <li>▶ Significant matters, if any, arising from the audit that were discussed with management;</li> <li>▶ Written representations that we are seeking;</li> <li>▶ Expected modifications to the audit report; and,</li> <li>▶ Other matters if any, significant to the oversight of the financial reporting process.</li> </ul>	Audit results report



## Appendix B

# Required communications with the Audit Committee (continued)

Required communications	What is reported?	Our Reporting to you
	When and where	
Going concern	<p>Events or conditions identified that may cast significant doubt on the entity's ability to continue as a going concern, including:</p> <ul style="list-style-type: none"> <li>▶ Whether the events or conditions constitute a material uncertainty</li> <li>▶ Whether the use of the going concern assumption is appropriate in the preparation and presentation of the financial statements</li> <li>▶ The adequacy of related disclosures in the financial statements</li> </ul>	Audit results report
Misstatements	<ul style="list-style-type: none"> <li>▶ Uncorrected misstatements and their effect on our audit opinion, unless prohibited by law or regulation</li> <li>▶ The effect of uncorrected misstatements related to prior periods</li> <li>▶ A request that any uncorrected misstatement be corrected</li> <li>▶ Corrected misstatements that are significant</li> <li>▶ Material misstatements corrected by management</li> </ul>	Audit results report
Fraud	<ul style="list-style-type: none"> <li>▶ Enquiries of the Audit Committee to determine whether they have knowledge of any actual, suspected or alleged fraud affecting the entity</li> <li>▶ Any fraud that we have identified or information we have obtained that indicates that a fraud may exist</li> <li>▶ A discussion of any other matters related to fraud</li> </ul>	Audit results report
Related parties	<ul style="list-style-type: none"> <li>▶ Significant matters arising during the audit in connection with the entity's related parties including, when applicable:</li> <li>▶ Non-disclosure by management</li> <li>▶ Inappropriate authorisation and approval of transactions</li> <li>▶ Disagreement over disclosures</li> <li>▶ Non-compliance with laws and regulations</li> <li>▶ Difficulty in identifying the party that ultimately controls the entity</li> </ul>	Audit results report



## Appendix B

# Required communications with the Audit Committee (continued)

Required communications	What is reported?	Our Reporting to you
	When and where	
Independence	<p>Communication of all significant facts and matters that bear on EY's, and all individuals involved in the audit, objectivity and independence</p> <p>Communication of key elements of the audit engagement partner's consideration of independence and objectivity such as:</p> <ul style="list-style-type: none"> <li>▶ The principal threats</li> <li>▶ Safeguards adopted and their effectiveness</li> <li>▶ An overall assessment of threats and safeguards</li> <li>▶ Information about the general policies and process within the firm to maintain objectivity and independence</li> </ul>	Audit Planning Report and Audit Results Report
External confirmations	<ul style="list-style-type: none"> <li>▶ Management's refusal for us to request confirmations</li> <li>▶ Inability to obtain relevant and reliable audit evidence from other procedures</li> </ul>	Audit results report
Consideration of laws and regulations	<ul style="list-style-type: none"> <li>▶ 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</li> <li>▶ 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</li> </ul>	Audit results report
Internal controls	<ul style="list-style-type: none"> <li>▶ Significant deficiencies in internal controls identified during the audit</li> </ul>	Audit results report



## Appendix B

# Required communications with the Audit Committee (continued)

Required communications	 What is reported?	 Our Reporting to you
		 When and where
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	<ul style="list-style-type: none"> <li>▶ Breakdown of fee information when the audit plan is agreed</li> <li>▶ Breakdown of fee information at the completion of the audit</li> <li>▶ Any non-audit work</li> </ul>	Audit planning report Audit results report



## Appendix C

# 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 consolidated 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.



## Appendix C

# 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.

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## EXTERNAL AUDIT: HOUSING BENEFIT ASSURANCE REPORT

REPORT OF:	Head of Corporate Resources
Contact Officer:	Peter Stuart, Head of Corporate Resources
	Email: <a href="mailto:Peter.Stuart@midsussex.gov.uk">Peter.Stuart@midsussex.gov.uk</a> Tel: 01444 477315
Wards Affected:	All
Key Decision	No

---

### 1. Purpose of Report

To inform the Committee of the External Auditor's Housing Benefit Assurance Report for 2018/19.

### 2. Recommendations

***The Audit Committee is recommended to note the report.***

---

### 4 Background

- 4.1 Annex 1 contains the report that sets out the findings from work to certify the Housing Benefit Subsidy claim. In essence, while the audit identified some minor quality issues with the underlying claims, which resulted in an amended claim, this was a relatively minor issue when compared to some previous years.
- 4.2 The report is fairly detailed so the Business Unit Leader for Revenues and Benefits will be attending the meeting to offer some explanation from the 'client' side.
- 4.3 The Audit Director will be able to expand upon the audit regime followed, which is largely, if not wholly, set out by the Department of Work and Pensions.

### 5 Financial implications

- 5.1 There are no financial implications arising from this report. .

### 6 Equalities implications

- 6.1 The report raises no implications of this nature.

### 7 Risk analysis

- 7.1 No material risks arise from this report

### Background Papers

None

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# Housing Benefit Assurance Process Report 2018/19

Mid Sussex District Council  
February 2020



February 2020

Members of the Audit Committee  
Mid Sussex District Council  
Oaklands  
Oaklands Road  
Haywards Heath  
RH16 1SS

Dear Audit Committee Members

Local authorities claim large sums of public money in grants and subsidies from central government and other grant-paying bodies, and must complete returns providing financial information to government departments. In some cases, these grant-paying bodies and government departments require appropriately qualified reporting accountants to certify the claims and returns submitted to them.

This report summarises the results of our work performed on Mid Sussex District Council's housing benefits subsidy claim for 2018/19. We carried out our work in accordance with the Housing Benefit Assurance Process ("HBAP") 2018/19, issued by the Department for Work and Pensions ("DWP").

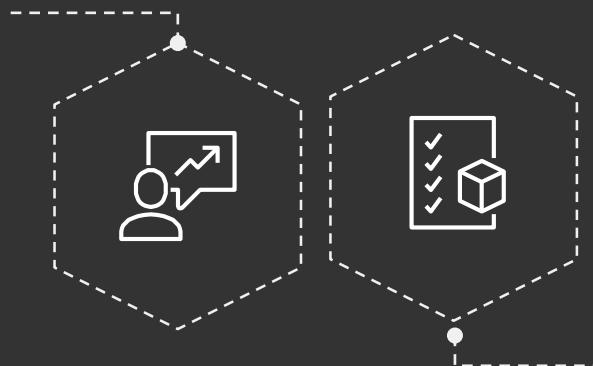
This report is intended solely for the information and use of the Audit Committee and management, and is not intended to be, and should not be, used by anyone other than these specified parties.

We welcome the opportunity to discuss this report with you at the Audit Committee meeting on 03 March 2020.  
Yours faithfully

Kevin Suter  
For and on behalf of Ernst & Young LLP

# Contents

## 01 Housing benefit assurance process



## 02 2018/19 fees

The contents of this report are subject to the terms and conditions of our appointment as set out in our engagement letter dated 17 June 2019.

This report is made solely to the Audit Committee and management of Mid Sussex District Council in accordance with the engagement letter. Our work has been undertaken so that we might state to the Audit Committee, and management of Mid Sussex 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 Mid Sussex 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.

Our Complaints Procedure - If at any time you would like to discuss with us how our service to you could be improved, or if you are dissatisfied with the service you are receiving, you may take the issue up with your usual partner or associate partner contact. If you prefer an alternative route, please contact Steve Varley, our Managing Partner, 1 More London Place, London SE1 2AF. We undertake to look into any complaint carefully and promptly and to do all we can to explain the position to you. Should you remain dissatisfied with any aspect of our service, you may of course take matters up with our professional institute. We can provide further information on how you may contact our professional institute.



01

## Housing benefit assurance process





# Housing benefit assurance process - summary

Scope of work	Results
Value of claim presented	£30,171,263
Amended/Not amended	Amended - final claim value £30,170,493.
Date final claim and HBAP Report submitted to DWP	28 November 2019
Fee - 2018/19	£40,922 (includes £27,750 for extended testing)
Fee - 2017/18	£17,858

## Overview of work undertaken in 2018/19

Local government administers the government's housing benefits scheme for tenants and can claim subsidies from the Department for Work and Pensions ("DWP") towards the cost of benefits paid. The HBAP guidance requires reporting accountants to follow a programme of work specified by DWP.

Detailed case testing is carried out on an initial sample of 20 cases per benefit type. We are also required to undertake a number of other tests and procedures, including review of system parameters and subsidy claim compilation, and testing of modified schemes.

Extended testing is carried out if the initial testing identifies errors in the calculation of benefit or compilation of the claim. Extended testing is also required where errors were identified in the certification of the previous year's claim, other than where the issue was fully resolved in the previous year. This can take the form of:

- Drill-down testing - where a sub-population of claims which are potentially impacted by the specific error can be identified
- 40+ testing - where a sub-population cannot be identified, and a random sample of claims is therefore selected from the headline cell

In summary, the results of our work in 2018/19 were as follows. Greater detail is provided on the next page of our report.

- 11 sets of extended testing were required, either as a result of prior year issues, or errors identified in the initial samples of 20 cases in 2018/19.
- 7 of these resulted in extrapolations reported in the HBAP Report.
- 3 resulted in amendments to the claim form.
- For 1 of the prior year issues, no errors were identified from the extended testing, and this matter was therefore considered closed.
- A further 5 errors were reported as Observations in the HBAP Report, but did not lead to extended testing due to the nature of the errors identified not impacting the level of subsidy claimed or had underpaid claimants.
- The total value of extrapolations in the HBAP Report was £18,115
- The total claim amendments resulted in a reduction of £770.

In 2017/18, there were a total of 7 areas where errors were identified, leading to extended testing or observations. As such, the volume of reportable issues in 2018/19 had more than doubled from the previous year.

Under HBAP, this will lead to a high volume of extended testing in 2019/20, because other than where an issue is fully resolved or has no impact on subsidy, all errors need to be followed up with extended testing in the subsequent year.



# Housing benefit assurance process - work performed

## Work undertaken in 2018/19 - detail

### Initial testing

The Council has two types of housing benefit in payment - Non-HRA Rent Rebates (paid to tenants of temporary accommodation) and Rent Allowances (paid to tenants of private rented properties). We undertook testing of a random sample of 20 claims for each benefit type, as required by the DWP. The results of this testing were as follows:

Non-HRA Rent Rebates: Errors were identified in 7 of the 20 claims tested, an error rate of 35%.

Rent Allowances: Errors were identified in 6 of the 20 claims tested, an error rate of 30%.

Some of the cases contained multiple errors.

For all errors which lead to overpayment of benefit or over-claiming of subsidy, or where the nature of the error has the potential to lead to overpayment of benefit or over-claim of subsidy, and in most instances where benefit is misclassified, extended testing must be carried out.

### Other required work

We also completed the other tests which are required under HBAP - namely review of system parameters, claim compilation processes and related software updates and reports, claim reconciliations, and modified schemes. No issues arose from these areas of work.

### Extended testing

Where possible, extended testing should be undertaken by identifying a sub-population of claims which could be impacted by the error - for example, by selecting a sample of claims with earned income where an error was identified in the prior year or initial testing in relation to the calculation of earned income. Where a sub-population cannot be identified, a random sample of further cases should be selected from the headline cell. The DWP's HBAP instructions require the full population of claims to be tested where the related population is fewer than 100. Where the population is greater than 100, a sample of 40 claims must be tested

We undertook extended testing in 11 areas, which arose either through the errors in the initial testing, or from issues reported in the prior year.

Further details of these errors by benefit type are set out on the next page.



# Housing benefit assurance process - work performed

## Work undertaken in 2018/19 - detail

### Extended testing (continued)

Extended testing - area covered and nature of errors identified	Arising from prior year or current year errors?	100% test or sample of 40?	Total cases tested	Number of errors identified
<b>Non-HRA Rent Rebates</b>				
Cell 011 earned income				
<ul style="list-style-type: none"> <li>Claimants' weekly earnings had been incorrectly calculated</li> </ul>	Current year	100% test	16	0
Cell 011 Rent				
<ul style="list-style-type: none"> <li>Claimants' rent eligible for housing benefit had been incorrectly calculated</li> </ul>	Current year	Sample	40	4
<b>Cell 012/13 correct split</b>				
<ul style="list-style-type: none"> <li>The Authority had not correctly recorded benefit over the allowable maximum amount for bed and breakfast cases in cell 13 as required, leading to overclaiming of subsidy</li> </ul>	Current year	100% test	57	2
<b>Cell 014 LHA rate</b>				
<ul style="list-style-type: none"> <li>The incorrect number of bedrooms had been used in establishing the Local Housing Allowance rate which underpins the calculation of rent for short term lease claims</li> </ul>	Prior year	100% test	56	0



# Housing benefit assurance process - work performed

## Work undertaken in 2018/19 - detail

### Extended testing (continued)

Extended testing - area covered and nature of errors identified	Arising from prior year or current year errors?	100% test or sample of 40?	Total cases tested	Number of errors identified
<b>Rent Allowances</b>				
Cell 094 earned income				
<ul style="list-style-type: none"> <li>Claimants' weekly earnings had been incorrectly calculated</li> </ul>	Prior and Current year	Sample	40	4
Cell 094 industrial injury benefit				
<ul style="list-style-type: none"> <li>Incorrect industrial injury benefit income figures had been used in the calculation of housing benefit</li> </ul>	Prior year	100% test	19	3
Cell 094 severe disability premium				
<ul style="list-style-type: none"> <li>The severe disability premium applicable amount had been applied in error, leading to understatement of the claimant's income available to pay rent</li> </ul>	Current year	Sample	40	0
Cell 094 self employed income				
<ul style="list-style-type: none"> <li>Claimants' weekly earnings had been incorrectly calculated</li> </ul>	Current year	Sample	40	4



# Housing benefit assurance process - work performed

## Work undertaken in 2018/19 - detail

### Extended testing (continued)

Extended testing - area covered and nature of errors identified	Arising from prior year or current year errors?	100% test or sample of 40?	Total cases tested	Number of errors identified
<b>Rent Allowances (continued)</b>				
Cell 094 working tax credits	Prior year	Sample	40	2
<ul style="list-style-type: none"> <li>Incorrect working tax credit income figures had been used in the calculation of housing benefit</li> </ul>				
Cell 102 rent	Prior year	Sample	40	4
<ul style="list-style-type: none"> <li>Claimants' rent eligible for housing benefit had been incorrectly calculated in housing association claims</li> </ul>				
Cell 114 overpayment classification	Prior year	Sample	40	3
<ul style="list-style-type: none"> <li>Overpayments had been incorrectly classified as claimant error, which should have been classified as local authority error/admin delay</li> </ul>				



# Housing benefit assurance process - recommendations

## Recommendations

Housing benefit administration is a complex area, both as a result of the rules of the scheme, and the nature of some of the individual claims in the Council's caseload. As such, it is highly unlikely that errors can be avoided altogether. However, the volume of issues identified this year is high compared with prior years and with similar authorities, especially in the context of the Council only having two of the three benefit types which are covered by the scheme (Housing Revenue Account Rent Rebates are not applicable at the Council).

We would recommend the Authority consider a targeted programme of claim reviews, focussing on the most commonly occurring error types from 2017/18 and 2018/19 as reflected in the above table, prior to submitting the draft subsidy claim in April 2020. This should help to reduce the incidence of error arising in these areas.



02

## 2018/19 fees





## 2018/19 fees

Claim or return	2018/19	2017/18
	Fee £	Fee £
<b>Housing benefit subsidy claim</b>		
Initial fee	13,172	17,858
Additional fee	27,750	-
<b>Total</b>	<b>40,922</b>	<b>17,858</b>

### 2018/19

The fee is as reflected in our engagement agreement with the Council.

The agreed initial fee was £13,172.

The fee for extended testing is based on the volume of work required and complexity of the testing undertaken. The agreed fee structure anticipated an average fee for each set of extended testing of approximately £2,500.

The additional fee reflects the volume of areas of extended testing in 2018/19.

The additional fee remains subject to agreement with management.

### 2017/18

The scale fee was determined by PSAA.

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